SouthGobi
Energy Resources

(formerly Asia Gold Corp.)

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2007 and 2006
(Stated in U.S. Dollars)

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Auditors' report

To the Shareholders of
SouthGobi Energy Resources Ltd.

We have audited the consolidated balance sheets of SouthGobi Energy Resources Ltd. as at December 31, 2007 and 2006 and the consolidated statements of operations and comprehensive loss, shareholders' deficiency and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte + Touche LLP

Chartered Accountants
March 18, 2008

SOUTHGOBI ENERGY RESOURCES LTD.

(formerly Asia Gold Corp.)

Consolidated Balance Sheets

December 31, 2007 and 2006

(Stated in U.S. dollars)

		2007		2006
ASSETS				
CURRENT				
Cash	**$**	**1,393,632**	$	965,494
Accounts receivable		**759,528**		215,783
Prepaid expenses		**1,890,177**		235,013
		4,043,337		1,416,290
MINERAL PROPERTIES (Note 5)		**443,360**		403,360
PLANT AND EQUIPMENT (Note 6)		**1,123,379**		232,585
	$	**5,610,076**	$	2,052,235
LIABILITIES				
CURRENT				
Accounts payable and accrued liabilities	**$**	**1,767,784**	$	451,540
AMOUNT DUE UNDER LINE OF CREDIT FACILITIES (Note 8)		**35,107,804**		5,835,501
		36,875,588		6,287,041
SHAREHOLDERS' DEFICIENCY				
Share capital (Note 9)				
Common shares		**20,625,287**		16,518,231
Preferred shares		**75,419**		-
Equity portion of line of credit facility (Note 8)		**3,055,359**		-
Contributed surplus		**7,333,146**		1,860,131
Deficit		**(62,354,723)**		(22,613,168)
		(31,265,512)		(4,234,806)
	$	**5,610,076**	$	2,052,235

CONTINUANCE OF OPERATIONS (Note 1)

COMMITMENTS (Note 14)

SUBSEQUENT EVENTS (Note 15)

The accompanying notes are an integral part of these consolidated financial statements.

APPROVED BY THE BOARD:

Pierre Lebel
Pierre Lebel, Director

Andre Deepwell
Andre Deepwell, Director

SOUTHGOBI ENERGY RESOURCES LTD.
(formerly Asia Gold Corp.)
Consolidated Statements of Operations and Comprehensive Loss
Years Ended December 31, 2007 and 2006
(Stated in U.S. dollars)

	2007	2006
EXPENSES		
Depreciation	**$ 63,610**	$ 20,323
Exploration (Note 9 (b)) (Schedule)	**16,814,245**	6,436,789
Legal	**265,515**	45,840
Office and administration	**955,956**	682,545
Professional fees	**195,291**	87,898
Salaries and benefits (Note 9 (b))	**4,622,489**	1,359,064
Travel	**246,908**	229,777
	23,164,014	8,862,236
OTHER EXPENSES/(INCOME)		
Coal transaction costs (Note 4)	**26,547**	217,781
Interest income	**(44,082)**	(49,700)
Interest expense (Note 8)	**1,358,742**	178,739
Interest accretion on line of credit facility (Note 8)	**2,237,248**	-
Foreign exchange (gain) loss	**(47,545)**	20,393
Write off of interest in joint venture (Note 5(b))	**35,009**	-
Write-down of mineral property	**-**	132,366
	3,565,918	499,579
NET LOSS AND COMPREHENSIVE LOSS	**$ 26,729,932**	9,361,815
BASIC AND DILUTED LOSS PER SHARE	**$ (0.98)**	$ (0.56)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC AND DILUTED	**27,222,351**	16,647,940

The accompanying notes are an integral part of these consolidated financial statements.

SOUTHGOBI ENERGY RESOURCES LTD.
(formerly Asia Gold Corp.)
Consolidated Statements of Shareholders' Deficiency
Years Ended December 31, 2007 and 2006
(Stated in U.S. dollars)

	Share Capital							
	Common Shares		Preferred Shares					
	Number of Shares	Amount	Number of Shares	Amount	Equity Portion of Convertible Line of Credit	Contributed Surplus	Deficit	Total
Balances, December 31, 2005	15,895,580	$ 15,287,221	-	$ -	$ -	$ 1,046,386	$ (13,251,353)	$ 3,082,254
Shares issued for:			-	-				
Exercise of warrants	576,999	715,797	-	-		-	-	715,797
Exercise of stock options	215,631	315,213	-	-		(124,540)	-	190,673
Mineral property	95,821	200,000	-	-		-	-	200,000
Stock-based compensation charged to operations	-	-	-	-		938,285	-	938,285
Net loss	-	-	-	-		-	(9,361,815)	(9,361,815)
Balances, December 31, 2006	16,784,031	16,518,231	-	-	-	1,860,131	(22,613,168)	(4,234,806)
Shares issued for:								
Coal transaction (Note 4)	57,000,000	168,081	25,576,383	75,419	-	-	-	243,500
Exercise of stock options	1,145,566	3,918,976	-	-	-	(1,354,174)	-	2,564,802
Mineral property	3,060	20,000						20,000
Stock-based compensation charged to operations	-	-	-	-	-	6,827,189	-	6,827,189
Equity portion of convertible line of credit	-	-	-	-	3,055,359	-	-	3,055,359
Coal transaction expenditures (Note 4)							(13,011,623)	(13,011,623)
Net loss and comprehensive loss	-	-	-	-	-	-	(26,729,932)	(26,729,932)
Balances, December 31, 2007	74,932,657	$ 20,625,287	25,576,383	$ 75,419	$ 3,055,359	$ 7,333,146	$ (62,354,723)	$(31,265,512)

The accompanying notes are an integral part of these consolidated financial statements.

SOUTHGOBI ENERGY RESOURCES LTD.
(formerly Asia Gold Corp.)
Consolidated Statements of Cash Flows
Years Ended December 31, 2007 and 2006
(Stated in U.S. dollars)

	2007	2006
OPERATING ACTIVITIES		
Net loss	**$ (26,729,932)**	$ (9,361,815)
Items not requiring use of cash		
Depreciation	**158,030**	54,260
Stock-based compensation	**6,827,189**	938,285
Accrued interest expense	**1,358,742**	178,739
Interest accretion on line of credit facility	**2,237,248**	-
Unrealized foreign exchange (gain) loss	**(33,644)**	3,829
Write off of interest in joint venture	**31,141**	-
Loss on disposal of capital assets	**-**	10,076
Write-down of mineral property	**-**	132,366
Changes in non-cash working capital items (Note 13(a))	**(831,905)**	(273,397)
	(16,983,131)	(8,317,657)
INVESTING ACTIVITIES		
Expenditures on plant and equipment	**(641,416)**	(173,276)
Mineral properties	**(20,000)**	(75,000)
Proceeds from disposal of plant and equipment	**25,000**	4,783
	(636,416)	(243,493)
FINANCING ACTIVITIES		
Share capital issued	**2,564,802**	906,470
Increase in line of credit facilities	**15,500,000**	5,500,000
	18,064,802	6,406,470
EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	**(17,116)**	(4,826)
INCREASE (DECREASE) IN CASH	**428,139**	(2,159,506)
CASH AT BEGINNING OF YEAR	**965,494**	3,125,000
CASH AT END OF YEAR	**$ 1,393,632**	$ 965,494

SUPPLEMENTAL CASH FLOW INFORMATION (Note 13)

The accompanying notes are an integral part of these consolidated financial statements.

1. NATURE AND CONTINUANCE OF OPERATIONS

SouthGobi Energy Resources Ltd., formerly known as Asia Gold Corp. (the "Company" or "SouthGobi") is a development stage entity that has not achieved production on any of its mineral properties and, accordingly, does not have any revenues. The Company's ability to continue as a going concern, with a capital deficiency, is dependant upon the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing and permitting to develop properties and to establish future profitable production. At December 31, 2007 the Company did not have sufficient cash to fund the exploration and development of its mineral properties to commercial production and, therefore, required additional funding, which if not raised, could have resulted in the curtailment of operations.

In January 2008, the Company announced it had closed two separate private equity placements for total proceeds of C$111,500,000 ($108,372,995). In February 2008, the Company announced another equity placement for further proceeds of C$6,400,000 ($6,484,296). The proceeds from the placements are to be used to finance initial development of the Company's Ovoot Tolgoi coal project in southern Mongolia and for exploration and development of the company's other coal and mineral projects (See Note 15 – Subsequent Events).

Management is of the opinion that additional financing is available to continue its planned activities in the normal course. There can, however, be no assurance the Company will be able to raise sufficient funds in the future.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The significant accounting policies used in these consolidated financial statements are as follows:

(a) Principles of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All inter-company balances and transactions have been eliminated.

Variable Interest Entities ("VIEs"), which include, but are not limited to, special purpose entities, trusts, partnerships, and other legal structures, as defined by the Accounting Standards Board in Accounting Guideline ("AcG") 15, "Consolidation of Variable Interest Entities" ("AcG 15"), are entities in which equity investors do not have the characteristics of a "controlling financial interest" or there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIEs are subject to consolidation by the primary beneficiary who will absorb the majority

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Principles of consolidation (continued)

of the entities' expected losses and/or expected residual returns. The Company has not identified any VIEs at December 31, 2007.

(b) Measurement uncertainties

Generally accepted accounting principles require management to make assumptions and estimates that affect the reported amounts and other disclosures in these consolidated financial statements. Actual results may differ from those estimates.

The consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Significant estimates used in the preparation of these consolidated financial statements include, among other things, the recoverability of accounts receivable, the expected economic lives of plant and equipment, the allocation of debt and equity, the valuation of future income tax amounts, and the calculation of stock based compensation.

(c) Foreign currencies

The Company and its subsidiaries' functional currency is the U.S. dollar since it is the currency in which expenditures are incurred. Accordingly, monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities at the exchange rates in effect at the time of acquisition or issue. Expenses are translated at rates approximating exchange rates in effect at the time of the transactions. All exchange gains and losses are included in operations.

(d) Mineral properties

All direct costs related to the acquisition of mineral property interests are capitalized on a property by property basis. Exploration costs, net of incidental revenues, are charged to operations in the period incurred until such time as it has been determined that a property has economically recoverable reserves, in which case subsequent exploration costs and the costs incurred to develop a property are capitalized. Exploration costs include value-added taxes incurred in foreign jurisdictions when recoverability of these taxes is uncertain.

The Company reviews the carrying values of its mineral property interests whenever events or changes in circumstances indicate that their carrying values may exceed their estimated net recoverable amounts. An impairment loss is recognized when the carrying value of a property is not recoverable and exceeds their fair value.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Mineral properties (continued)

On the commencement of commercial production, depletion of each mining property will be provided on a unit-of-production basis using estimated proven and probable recoverable reserves as the depletion base. In cases where there are no proven or probable reserves, depletion will be provided on a straight-line basis over the expected economic life of the mine.

Certain of the Company's exploration and development activities are conducted jointly with others. These consolidated financial statements reflect only the Company's interests in such activities.

(e) Plant and equipment

Plant and equipment are stated at cost less accumulated depreciation. Plant and equipment are depreciated over their expected economic lives using either the unit-of-production method or the straight-line method, as appropriate. Office equipment is depreciated on a straight-line basis over three to ten years. The Company reviews the carrying values of its plant and equipment whenever events or changes in circumstances indicate that the carrying values may exceed the estimated net recoverable amounts determined by reference to estimated future operating results and undiscounted net cash flows. An impairment loss is recognized when the carrying value is not recoverable and exceeds fair value.

(f) Asset retirement obligations

The Company recognizes liabilities for statutory, contractual or legal obligations associated with the reclamation of mining property, plant and equipment, when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, a liability for an asset retirement obligation is recognized at its fair value in the period in which it is incurred. Upon initial recognition of the liability, the corresponding asset retirement cost is added to the carrying amount of the related asset and the cost is amortized as an expense over the economic life of the asset using either the unit-of-production method or the straight-line method, as appropriate. Following the initial recognition of the asset retirement obligation, the carrying amount of the liability is increased for the passage of time and adjusted for changes to the amount or timing of the underlying cash flows needed to settle the obligation. As at December 31, 2007, the Company has no asset retirement obligations and accordingly, has not recorded an asset retirement obligation in the consolidated financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Stock-based compensation

The Company accounts for stock options granted using the fair value based method. Accordingly, the fair value of the options at the date of grant is accrued with a corresponding credit to contributed surplus, and charged to operations on a straight-line basis over the vesting period. If and when the stock options are exercised, the applicable amounts of contributed surplus are transferred to share capital.

(h) Income taxes

Future income tax assets and liabilities are computed based on differences between the carrying amounts of assets and liabilities on the balance sheet and their corresponding tax values, using the enacted or substantively enacted, as applicable, income tax rates when the differences are expected to reverse. Future income tax assets also result from unused loss carry-forwards and other deductions. The valuation of future income tax assets is reviewed on a regular basis and adjusted, if necessary, by use of a valuation allowance to reflect the estimated realizable amount.

(i) Loss per share

The basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the year. The diluted per share amounts reflect the potential dilution of common share equivalents, such as outstanding stock options and share purchase warrants, in the weighted average number of common shares outstanding during the year, if dilutive. The "treasury stock method" is used for the assumed proceeds upon the exercise of the options and warrants that are used to purchase common shares at the average market price during the year. During the years ended December 31, 2007 and 2006, all of the outstanding stock options and warrants were antidilutive.

(j) Recent accounting pronouncements

In March 2007, the CICA issued Section 3862 – Financial Instruments – Disclosures, which replaces Section 3861 and provides expanded disclosure requirements that provide additional detail by financial asset and liability categories. The CICA also issued Section 3863 – Financial Instruments – Presentation, to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. Sections 3862 and 3863 applies to interim and annual financial statements to fiscal years beginning on or after October 1, 2007, and are not expected to have a material impact on the Company's financial condition or operating results.

In June 2007, the CICA issued Section 3031 – Inventories, to replace the former Section 3030 – Inventories. Section 3031 applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. Section 3031 establishes standards for the

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Recent accounting pronouncements (continued)

measurement and disclosure of inventories. The main features of the new Section 3031 are:

- Measurement of inventories at the lower of cost and net realizable value, with guidance on the determination of cost, including allocation of overheads and other costs to inventory.
- Cost of inventories of items that are not ordinarily interchangeable, and goods or services produced and segregated for specific projects, assigned by using a specific identification of their individual costs.
- Consistent use (by type of inventory with similar nature and use) of either first-in, first-out (FIFO) or weighted average cost formula to measure the cost of other inventories.
- Reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories.

The Company does not expect the adoption of Section 3031 on January 1, 2008, to have a material impact on its financial condition or operating results.

In December 2006, the CICA issued Section 1535 – Capital Disclosures, which is effective for interim and annual financial statements beginning on or after October 1, 2007. This Section establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard, the Company will be required to disclose the following, based on the information provided internally to the Company's key management personnel:

- Qualitative information about its objectives, policies and processes for managing capital.
- Summary quantitative data about what it manages as capital.
- Whether during the period it complied with any externally imposed capital requirement to which it is subject.
- When the Company has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

The Company does not expect the adoption of Section 1535 on January 1, 2008, to have a material impact on its financial condition or operating results.

The CICA amended section 1400 – General Standards of Financial Statement Presentation to include requirements for management to assess and disclose an entity's ability to continue as a going concern. The amendment applies to interim and annual financial statements on or after January 1, 2008, and is not expected to have a material impact on the Company's financial condition or operating results.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Comparative figures

Certain figures, previously reported for 2006, have been reclassified to conform with the basis of presentation adopted in the current year. The majority of the reclassifications relates to stock based compensation which was reclassified in 2006 to conform with presentation adopted in the current year whereby stock based compensation has been allocated to exploration expense, and salaries and benefits, as appropriate (Note 9(b)).

3. CHANGE IN ACCOUNTING POLICIES

The Company adopted the provisions in the Canadian Institute of Chartered Accountants Handbook Sections 3251 – Equity, 3855 – Financial Instruments – Recognition and Measurement, 3861 – Financial Instruments – Disclosure and Presentation, 3865 – Hedges, and 1530 – Comprehensive Income, on January 1, 2007, which addresses the classification, recognition and measurement of financial instruments in the financial statements and the inclusion of other comprehensive income.

Financial Instruments

The Company classifies its financial instruments into one of the following categories: held-for-trading (assets and liabilities), assets available-for-sale, loans and receivables, assets held-to-maturity and other financial liabilities. All financial instruments are measured at fair value on initial recognition. Measurement in subsequent periods depends on the classification of the financial instrument. Financial assets and liabilities “held-for-trading” are subsequently measured at fair value with changes in fair value recognized in net income. Financial assets “available-for-sale” are subsequently measured at fair value with changes in fair value recognized in other comprehensive income, net of tax.

Financial assets “held-to-maturity”, “loans and receivables”, and financial liabilities “other financial liabilities” are subsequently amortized using the effective interest rate method.

Cash equivalents are classified as “held-for-trading” and are carried at cost which approximates fair value due to the short-term nature of these instruments. Accounts receivable and certain other assets that are financial instruments are classified as “loans and receivables”. Accounts payable and accrued liabilities, other long-term obligations and amounts due under the line of credit facility and current and long-term debt are classified as “other financial liabilities”.

Financial instruments that are derivative contracts are considered “held-for-trading”.

Under Section 3855, the Company adopted a policy to add transaction costs that are directly attributable to the acquisition or issue of financial assets or liabilities to their fair values. The Company had no other

3. CHANGE IN ACCOUNTING POLICIES (Continued)

comprehensive income or loss transactions during the year ended December 31, 2007 and no opening or closing balances for accumulated comprehensive income or loss. The adoption of Section 1530 – Comprehensive Income, had minimal effect on the presentation of the Company's financial statements for the year ended December 31, 2007.

4. COAL TRANSACTION

In July 2006, the Company and Ivanhoe signed a definitive agreement whereby the Company agreed to acquire Ivanhoe's coal division (the "coal transaction") in exchange for 82,576,383 common and preferred shares of the Company.

On August 8, 2006 the coal transaction and the equity conversion rights under the First Funding Agreement (Note 8) were approved by the Company's minority shareholders at a special meeting convened for that purpose.

The coal transaction, which was a related party transaction, received final approval from the TSX Venture Exchange on May 28, 2007. The Company continued its incorporation from the Canada Business Corporations Act to the British Columbia Business Corporations Act. As well, the Company adopted an amended and restated equity incentive plan (the "Amended Equity Incentive Plan").

On May 29, 2007 the Company completed the purchase of the Ivanhoe coal division in consideration for the issuance to Ivanhoe of 57,000,000 common shares and 25,576,383 preferred shares. The common shares issued to Ivanhoe, when aggregated with Ivanhoe's existing holding of common shares, represent approximately 86% of the total number of common shares currently issued and outstanding at December 31, 2007. The issuance of these shares has been recorded at the carrying amount in Ivanhoe's financial statements of the net assets of the coal division acquired by the Company ($244,000). The coal rights and licenses acquired by the Company have been recorded at nil as the underlying assets had no carrying amount within the Coal Division.

With the completion of the coal transaction, certain interim coal division expenditures made by Ivanhoe, from April 25, 2006 to May 28, 2007, were added to the indebtedness outstanding under the First Funding Agreement and will be repayable by the Company as if they were advances. The total coal expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007, and accepted by SouthGobi, are approximately $13.2 million of which $13.0 million are related to exploration expenses and $200,000 are for plant and equipment. In accordance with accounting for related party transactions, the coal expenditures of $13.0 million are considered to be a capital transaction directly within deficit. Together with the advances on the First Funding Agreement and interest charges, the total amount payable to Ivanhoe on the First Funding Agreement as at December 31, 2007 is $29.9 million.

(Stated in U.S. Dollars)

5. MINERAL PROPERTIES

(a) Mineral properties at December 31, 2007:

	2007	2006
Mongolia	**$ 443,360**	$ 403,360

In September 2005, the Company entered into an earn-in agreement with Solomon Resources Ltd. ("Solomon") to acquire a 70% interest in 9 exploration licenses, including the Tsakhir license, representing 4 project areas located in the West Gobi region. Upon closing of the agreement, the Company paid Solomon $50,000 and issued to Solomon 100,000 common shares valued at $78,360. As part of its initial earn-in obligations, the Company paid $75,000 to Solomon and issued 95,821 common shares valued at $200,000. During 2006, the number of projects was reduced to two and six licenses were returned.

In March 2007, following Solomon's withdrawal from these arrangements the Company entered into a new Option Agreement directly with Gallant Minerals Ltd. ("Gallant") pursuant to which the Company can earn an 80% interest in the Tsakhir license. In order to exercise the option to acquire an 80% interest in the Tsakhir license, SouthGobi is required over the next two years to make cash payments of $70,000, issue common shares of the Company valued at $50,000 and spend an aggregate of $600,000 on related work programs.

During the year ended December 31, 2007, mineral property holdings increased by $40,000. The company issued 3,060 shares to Gallant Minerals Ltd. with a deemed market value of $20,000 and a cash payment of $20,000.

(b) Interest in joint venture

The Company terminated its mineral exploration activities in Bulgaria and formally notified Hereward Ventures Bulgaria AD that the Company was withdrawing from its Bulgarian Joint Venture with Hereward effective March 2, 2007. The Company recorded a loss of $35,009 in the first quarter of 2007 related to the withdrawal from Bulgaria of which $31,141 related to the write-down of plant and equipment.

(Stated in U.S. Dollars)

6. PLANT AND EQUIPMENT

	2007		
	Cost	Accumulated Depreciation	Net Book Value
Plant and equipment	**$ 505,576**	**$ 46,980**	**$ 458,596**
Office equipment	**502,311**	**222,163**	**280,148**
Construction in progress	**384,635**	**-**	**384,635**
	$ 1,392,522	**269,143**	**$ 1,123,379**

	2006		
	Cost	Accumulated Depreciation	Net Book Value
Plant and equipment	**$ 94,217**	**$ 11,679**	**$ 82,538**
Office equipment	**251,087**	**101,040**	**150,047**
	$ 345,304	**112,719**	**$ 232,585**

7. INCOME TAXES

A reconciliation of the provision (recovery) of income taxes is as follows:

	Year ended December 31, 2007	Year ended December 31, 2006
Loss before income taxes for the year	**$ 26,729,933**	**$ 9,361,815**
Statutory tax rate	**34.12%**	**34.12%**
Recovery of income taxes based on combined Canadian and provincial statutory rates	**$ 9,120,253**	**$ 3,194,251**
Deduct:		
Lower effective tax rate in foreign jurisdictions	**(1,420,439)**	**(318,582)**
Tax effect of losses not recognized	**(6,442,559)**	**(1,870,651)**
Change in future tax rate	**(80,520)**	**(683,570)**
Non-deductible expenses	**(1,176,734)**	**(321,448)**
	$ -	**$ -**

(Stated in U.S. Dollars)

7. INCOME TAXES (Continued)

The Company's future income tax assets and liabilities are as follows:

		December 31, 2007		December 31, 2006
Future income tax assets				
Tax loss carryforwards	$	10,485,544	$	4,322,017
Capital assets		75,528		31,931
Foreign exploration expenses		-		1,520,392
Share issue costs		16,194		76,127
Total future income tax assets		10,577,265		5,950,467
Valuation allowance		(10,577,265)		(5,950,467)
Net future income tax assets	$	-	$	-

At December 31, 2007, the Company and its subsidiaries have unrecognized capital and non-capital losses for income tax purposes of approximately $37 million that may be used to offset future taxable income as follows:

		Local Currency	U.S. Dollar Equivalent	Expiry Dates
Non-capital losses				
Canadian	$	$ 7,278,686	$ 7,256,192	2009 - 2027
Mongolian Tugrik	MNT	31,029,971,734	26,544,031	(a)
Indonesian Rupiah	IDR	26,958,622,095	3,237,274	2011 - 2012
			$ 37,037,496	
Capital losses				
Canadian	$	5,423,519	$ 5,406,758	(b)

(a) These losses are carried forward until such time as production from a mine commences; thereafter, they can be amortized on a straight-line basis over a period of five years. A portion of the losses are deductible over a period of 2 years.

(b) These losses are carried forward indefinitely for utilization against any future net realized capital gains.

8. AMOUNTS DUE UNDER LINE OF CREDIT FACILITIES

On April 25, 2006, in conjunction with the coal transaction (Note 4), the Company entered into a line of credit facility (the "First Funding Agreement") with Ivanhoe whereby Ivanhoe agreed to make available to the Company an unsecured line of credit facility of up to $10 million which was extended to a maximum of $15 million on June 6, 2007. The $15 million maximum excluded the interim coal expenditures. All amounts outstanding under the line of credit bear interest at three month London Interbank Offered Rate ("LIBOR") plus two percent (a total of 6.7% at December 31, 2007). All advances pursuant to the line of credit facility would have matured and been repayable in full on April 25, 2008, but on August 1, 2007, Ivanhoe and the Company mutually agreed to extend the maturity date for the repayment of the principal balance and all accrued and unpaid interest outstanding under the line of credit facility until June 30, 2009. All other terms and conditions of the First Funding Agreement shall remain in full force and effect. Ivanhoe has the ability to accelerate the Company's obligation to repay all advances pursuant to the line of credit facility and all accrued and unpaid interest thereon in the event of a default by the Company. The Company has the right to prepay the outstanding advances and accrued and unpaid interest, in whole or in part, at any time without penalty. At December 31, 2007, the amount outstanding under the line of credit facility was $29.9 million.

The accrued interest included in the liability component of the First Funding Agreement from May 29, 2007 to December 31, 2007 is $1,089,389, the total interest for the year ended December 31, 2007 was $1,358,742.

Effective May 29, 2007, the date the coal transaction was completed, the First Funding Agreement became convertible into common shares at the election of either the Company or Ivanhoe. Until May 29, 2008, the Company has the right to require Ivanhoe to convert the outstanding amounts under the First Funding Agreement into common shares at a conversion price of C$2.09 per share. Until August 29, 2008, Ivanhoe has the right to convert the outstanding amounts under the First Funding Agreement into common shares at a conversion price of C$2.35 per share.

The outstanding amount under the First Funding Agreement is being accounted for in accordance with its substance and is presented in these consolidated financial statements in its component parts, measured at their respective fair values at the time the coal transaction (Note 4) was completed. The liability component has been calculated as the present value of the stream of interest and principal payments discounted at a rate approximating the interest rate for a similar liability without a conversion feature. The difference between the debt component of $28,785,066 and the principal amount of the loan, in the amount of $3,055,359 is classified as equity. The debt component is accreted over the term to maturity (August 29, 2008), by charges to earnings for the period. Interest accretion on the debt component for the year ended December 31, 2007 is $2,237,248.

Prior to the completion of the coal transaction on May 29, 2007, interest was added to amounts due under the First Funding Agreement. At December 31, 2006, the balance of the amounts due under the First Funding Agreement was $5,835,501.

(Stated in U.S. Dollars)

8. AMOUNTS DUE UNDER LINE OF CREDIT FACILITIES (Continued)

On October 25, 2007, Ivanhoe and the Company entered into a second interim funding agreement (the "Second Funding Agreement"). The Second Funding Agreement provides for an additional unsecured non-convertible line of credit facility of up to $32.5 million. One tranche of funding for $15 million can be used for general corporate purposes. The second tranche of $17.5 million is contingent upon Ivanhoe having drawn down funds under a credit agreement between Ivanhoe and Rio Tinto International Holdings Limited ("Rio Tinto"). Use of the proceeds from the second tranche is restricted to expenditures in respect of the Company's activities in Mongolia.

All amounts advanced under the Second Funding Agreement bear interest at an annual rate equal to LIBOR plus three and three-tenths per cent (3.3%) (a total of 8.0% at December 31, 2007) and mature on June 30, 2009.

At December 31, 2007 the company had received advances of $6.0 million against the Second Funding Agreement and accrued interest expenses of $51,460.

	First Funding Agreement	Second Funding Agreement	Total
Balance at December 31, 2005	$ -	$ -	$ -
Principal advanced	5,656,762	-	5,656,762
Interest	178,739	-	178,739
Balance at December 31, 2006	5,835,501	-	5,835,501
Amounts advanced	22,731,672	6,000,000	28,731,672
Amount assigned to equity portion of line of credit	(3,055,359)	-	(3,055,359)
Interest	1,307,282	51,460	1,358,742
Accretion	2,237,248	-	2,237,248
Balance at December 31, 2007	**$ 29,056,344**	**$ 6,051,460**	**$ 35,107,804**

(Stated in U.S. Dollars)

9. SHARE CAPITAL

(a) Common and Preferred Shares

Authorized	Unlimited common shares with no par value
	Unlimited preferred shares with no par value
Issued and outstanding	74,932,657 (2006 – 16,784,031) common shares
	25,576,383 (2006 – nil) preferred shares

Each preferred share is convertible into one (1) common share but only if, upon any such conversion, the total number of common shares held by Ivanhoe and all other insiders of the Company or any of their respective associates or affiliates does not exceed 90% of the total number of common shares then issued and outstanding. The preferred shares are non-voting and have a preference over the common shares with respect to the payment of dividends and distribution of assets in the event of a liquidation, dissolution or winding up of the Company.

(b) Stock-based Compensation – Officers and Employees

The Amended Equity Incentive Plan, approved on May 29, 2007 provides for a rolling rather than a fixed maximum number of common shares which may be issued pursuant to incentive stock options and other equity incentives, awards and issuances. Following the completion of the coal transaction, the number of issued and outstanding common shares increased from approximately 17 million to approximately 74 million and all of the employees and service providers of the Ivanhoe Coal Division became direct or indirect employees and service providers of the Company.

During the year ended December 31, 2007 the Company granted 3,252,500 stock options to certain officers and employees at prices ranging from C$2.10 to C$7.16 with expiry dates ranging from February 20, 2012 to October 18, 2012. The weighted average fair value of the options issued was estimated at $3.07 (C$3.34) per option at the grant date using the Black-Scholes option pricing model and the following weighted average assumptions:

	2007	2006
Risk free interest rate	**4.23%**	4.28%
Expected life	**3 years**	5 years
Expected volatility	**78%**	102%
Expected dividend per share	**$Nil**	$Nil

9. SHARE CAPITAL (Continued)

(b) Stock-based Compensation – Officers and Employees (continued)

Compensation cost of $9,979,374 for the options granted in the year ended December 31, 2007 will be amortized over the vesting period, of which $6,316,335 was recognized in the year ended December 31, 2007.

The Company accounts for stock options granted using the fair value based method. The total stock-based compensation calculated for the year ended December 31, 2007 was $6,827,189 (2006 - $938,285). Stock-based compensation of $3,378,761 (2006 - $322,008) has been allocated to exploration expense-salaries and $3,448,428 (2006 – $616,277) has been allocated to salaries and benefits.

(c) Outstanding stock options

The following is a summary of option transactions under the Company's stock option plan:

	2007		**2006**	
	Number of Options	Weighted-average Exercise Price (Expressed in CDN $)	Number of Options	Weighted-average Exercise Price (Expressed in CDN $)
Balance, beginning of year	**2,953,702**	**$ 1.94**	**2,199,000**	**$ 1.82**
Options granted	**3,252,500**	**4.55**	**985,000**	**2.01**
Options exercised	**(1,145,566)**	**2.31**	**(215,631)**	**1.00**
Options cancelled	**(66,004)**	**2.15**	**(14,667)**	**2.09**
Balance, end of year	**4,994,631**	**$ 3.55**	**2,953,702**	**$ 1.94**

9. SHARE CAPITAL (Continued)

(c) Outstanding stock options (continued)

The following table summarizes information about stock options outstanding and exercisable at December 31, 2007.

Options Outstanding			Options Exercisable	
Number Outstanding at December 31, 2007	Weighted-average Remaining Contractual Life (years)	Exercise Price (Expressed in CDN $)	Number Exercisable at December 31, 2007	Exercise Price (Expressed in CDN $)
477,500	0.91	$ 3.00	477,500	$ 3.00
70,000	1.06	3.00	70,000	3.00
5,000	1.20	2.14	5,000	2.14
30,000	1.23	2.00	30,000	2.00
30,000	1.32	2.07	30,000	2.07
465,000	2.22	0.86	465,000	0.86
5,000	2.40	0.70	5,000	0.70
10,000	2.66	0.95	10,000	0.95
130,214	2.70	1.00	130,214	1.00
60,000	2.87	1.24	26,660	1.24
9,000	3.01	1.26	666	1.26
16,700	3.10	1.16	30	1.16
656,737	3.46	2.10	375,027	2.10
1,000,000	3.49	2.30	583,290	2.30
70,000	3.65	3.00	36,660	3.00
22,500	3.68	2.85	14,166	2.85
15,000	4.13	2.10	5,000	2.10
3,400	4.23	3.70	1,666	3.70
216,667	4.29	4.81	66,660	4.81
1,634,414	4.47	6.00	501,047	6.00
67,500	4.79	7.16	-	7.16
4,994,631	3.35	$ 3.55	2,833,585	$ 2.81

(Stated in U.S. Dollars)

10. RELATED PARTY TRANSACTIONS

(a) The Company incurred the following expenses, on a cost recovery basis with Ivanhoe, and with a company related by way of directors or shareholders in common. Ivanhoe owns approximately 86% of the outstanding common shares of the Company, and 100% of the outstanding preferred shares at December 31, 2007.

		2007		2006
Office and administrative	**$**	**725,716**	$	360,560
Salaries and benefits		**1,415,785**		704,617
Interest		**1,358,741**		178,739

During 2007, there were interim coal expenditures of $13.2 million that were added to the indebtedness outstanding under the First Funding Agreement (Note 4).

(b) Accounts receivable include the following amounts:

		2007		2006
Accounts receivable from Ivanhoe Mines	**$**	**-**	$	49,148

(Stated in U.S. Dollars)

10. RELATED PARTY TRANSACTIONS (continued)

(c) Accounts payable and accrued liabilities include the following amounts:

	2007	2006
Amounts due for administration to Global Mining Management, a company related by way of directors and officers in common	**$ 211,045**	$ 107,122
Accounts payable to Ivanhoe	**52,045**	42,009

11. SEGMENT DISCLOSURES

(a) Operating Segments

The Company had two primary operating segments at the end of 2007, the Coal division and the Metals division. The company's reportable segments are distinct strategic business units that explore and develop different products. They are managed separately due to the different operational and marketing strategies required for each segment.

	Coal Division	**Metals Division**	**Corporate Division**	**Total**
2007				
Mineral properties, plant and equipment	**$ 898,027**	**$ 562,495**	**$ 106,217**	**$ 1,566,739**
Total assets	**2,509,471**	**1,132,269**	**1,968,336**	**5,610,076**
Capital expenditures	**467,182**	**36,564**	**137,670**	**641,416**
2006				
Mineral properties, plant and equipment	**$ -**	**$ 603,788**	**$ 32,156**	**$ 635,945**
Total assets	**-**	**1,049,397**	**1,002,838**	**2,052,235**
Capital expenditures	**-**	**139,988**	**33,288**	**173,276**

(Stated in U.S. Dollars)

11. SEGMENT DISCLOSURES (Continued)

	METALS		COAL		CORPORATE		TOTAL	
	2007	2006	**2007**	2006	**2007**	2006	**2007**	2006
EXPENSES								
Depreciation	**$ -**	$ -	**$ -**	$ -	**$ 63,610**	$ 20,323	**$ 63,610**	$ 20,323
Exploration	**4,647,726**	6,436,789	**12,166,519**	-	**-**	-	**16,814,245**	6,436,789
Legal	**-**	-	**-**	-	**265,515**	45,840	**265,515**	45,840
Office and administration	**-**	-	**-**	-	**955,956**	682,545	**955,956**	682,545
Professional fees	**-**	-	**-**	-	**195,291**	87,898	**195,291**	87,898
Salaries and benefits	**-**	-	**-**	-	**4,622,489**	1,359,064	**4,622,489**	1,359,064
Travel	**-**	-	**-**	-	**246,908**	229,777	**246,908**	229,777
	4,647,726	6,436,789	**12,166,519**	-	**6,349,769**	2,425,447	**23,164,014**	8,862,236
OTHER EXPENSES/(INCOME)								
Coal transaction costs	**-**	-	**-**	-	**26,547**	217,781	**26,547**	217,781
Interest income	**-**	-	**-**	-	**(44,082)**	(49,700)	**(44,082)**	(49,700)
Interest expense	**-**	-	**-**	-	**1,358,742**	178,739	**1,358,742**	178,739
Interest accretion on line of credit facility	**-**	-	**-**	-	**2,237,248**	-	**2,237,248**	-
Foreign exchange (gain) loss	**-**	-	**-**	-	**(47,545)**	20,393	**(47,545)**	20,393
Write off of interest in joint venture	**-**	-	**-**	-	**35,009**	-	**35,009**	-
Write-down of mineral property	**-**	-	**-**	-	**-**	132,366	**-**	132,366
	-	-	**-**	-	**3,565,918**	499,579	**3,565,918**	499,579
NET LOSS AND COMPREHENSIVE LOSS	**$ 4,647,726**	$ 6,436,789	**$ 12,166,519**	$ -	**$ 9,915,687**	$ 2,925,026	**$ 26,729,932**	$ 9,361,815

(Stated in U.S. Dollars)

11. SEGMENT DISCLOSURES (Continued)

(b) Geographic Segments

During 2007, the Company operated in Mongolia, Canada, Bulgaria, and Indonesia. In March 2007 the Company terminated its mineral exploration activities in Bulgaria (Note 5(b)).

	Mongolia	Canada	Bulgaria	Indonesia	Total
2007					
Mineral properties, plant and equipment	$ 1,398,347	$ 106,217	$ -	$ 62,175	$ 1,566,739
Total assets	3,391,666	1,968,336	-	250,074	5,610,076
2006					
Mineral properties, plant and equipment	$ 487,757	$ 32,157	$ 56,141	$ 59,890	$ 635,945
Total assets	795,876	1,002,837	66,444	187,078	2,052,235

12. FINANCIAL INSTRUMENTS

(a) Fair Values

The carrying value of the Company's cash, accounts receivable and accounts payable approximates their fair values as at December 31, 2007 because of the demand or short-term maturity of these instruments. The fair value of the amount due under the line of credit facility is not readily determinable due to the unique, related party nature of these accounts.

(b) Foreign Exchange Risk

The Company undertakes transactions denominated in foreign currencies and as such is exposed to foreign exchange risk due to fluctuations in foreign exchange rates.

(c) Interest Rate Risk

The Company is exposed to interest rate risk with respect to the variable rate of interest incurred on the line of credit facility.

(Stated in U.S. Dollars)

13. SUPPLEMENTAL CASH FLOW INFORMATION

(a) Changes in non-cash working capital items:

		2007		2006
Net (increase) in:				
Accounts receivable	**$**	**(524,730)**	$	(81,405)
Prepaid expenses		**(1,622,001)**		(285,056)
Net increase in:				
Accounts payable and accrued liabilities		**1,314,826**		93,064
	$	**(831,905)**	$	(273,397)

(b) Non-cash transactions:

		2007		2006
Purchase of plant and equipment through the issuance of common shares	**$**	**243,500**	$	-
Equity component of line of credit facility		**3,055,359**		-
Acquisition of mineral properties through the issue of common shares		**20,000**		-
Increase in line of credit facility for coal transaction expenditures		**13,231,672**		-
Transfer of contributed surplus upon exercise of options		**1,354,174**		124,540

14. COMMITMENTS

In 2007, the Company committed approximately $16 million for the purchase of a fleet of coal mining equipment for the initial development of its Ovoot Tolgoi Project in Mongolia. Payments will be made throughout 2008.

15. SUBSEQUENT EVENTS

On January 7, 2008 the Company announced it had entered into an agreement with a private institutional investor for a placement of 10,000,000 common shares at C$8.00 per share, representing an aggregate offering amount of C$80,000,000 ($77,775,618). On January 18, 2008 the Company announced it had entered into an agreement with another institutional investor for a placement of 3,500,000 common shares at C$9.00 per share, representing an aggregate offering amount for C$31,500,000 ($30,597,377). The Company also announced on February 18, 2008 that it had entered into an agreement with institutional investors for a placement of 711,111 common shares at C$9.00 per share, representing an aggregate offering amount of C$6,400,000 ($6,484,296). The gross proceeds from these three offerings of C$117,900,000 ($114,857,291) will be used to finance the Company's operations. The Company paid finders fees totaling C$3,024,000 ($3,030,080) to arm's length third parties in connection with these financings.

On January 18, 2008, funds in the amount of $8,077,470 were paid to Ivanhoe representing repayment in full of principal and accrued interest owing on the Second Funding Agreement.

On January 23, 2008 Ivanhoe converted 25,576,383 preferred shares, the total sum of preferred shares held by Ivanhoe, into common shares of the Company on a one-for-one basis. At the Company's request, Ivanhoe also converted $29,982,631 of debt into 14,709,071 common shares of the Company. As a result of this conversion, the amounts due under the line of credit facility owed to Ivanhoe on the First Funding Agreement were eliminated. The conversion ratio for preferred shares and debt held by Ivanhoe was authorized in the coal transaction, voted on and approved by minority shareholders on August 8, 2006.

SOUTHGOBI ENERGY RESOURCES LTD.
(formerly Asia Gold Corp.)
Consolidated Schedule of Exploration Expenses By Division
(Stated in U.S. dollars)

	Year ended Dec 31, 2007		
	Metals Division	Coal Division Mongolia	Total
Assaying	$ 23,255	$ 68,278	$ 91,533
Camp costs	266,259	217,848	484,107
Consulting - geophysics	-	259,946	259,946
Consulting - geological	703,785	1,647,664	2,351,449
Depreciation	61,717	32,703	94,420
Drilling	219,157	4,888,659	5,107,816
License fees	685,964	688,880	1,374,844
Fuel	40,303	86,399	126,702
Legal	143,498	36,952	180,450
Maps, photos and reproductions	17,305	24,931	42,236
Office	338,848	144,865	483,713
Rental, lease and charter costs	181,678	219,799	401,477
Salaries	1,630,793	3,604,592	5,235,385
Supplies	22,787	66	22,853
Travel	312,377	244,937	557,314
	$ 4,647,726	$ 12,166,519	$ 16,814,245

	Year ended Dec 31, 2006		
	Metals Division	Coal Division Mongolia	Total
Assaying	$ 328,202	$ -	$ 328,202
Camp costs	466,419	-	466,419
Consulting - geophysics	147,039	-	147,039
Consulting - geological	1,095,342	-	1,095,342
Depreciation	33,937	-	33,937
Drilling	808,989	-	808,989
License fees	1,108,709	-	1,108,709
Fuel	24,912	-	24,912
Legal	84,340	-	84,340
Maps, photos and reproductions	8,670	-	8,670
Office	634,226	-	634,226
Rental, lease and charter costs	188,316	-	188,316
Salaries	1,140,315	-	1,140,315
Supplies	11,690	-	11,690
Travel	378,210	-	378,210
Loss on disposal of capital assets	10,076		10,076
Option income and expense recovery	(32,603)	-	(32,603)
	$ 6,436,789	$ -	$ 6,436,789

SOUTHGOBI ENERGY RESOURCES LTD.
(formerly Asia Gold Corp.)
Schedule of Metals Division Exploration Expenses By Country
(Stated in U.S. dollars)

	Year ended December 31, 2007				
	Mongolia	**Bulgaria**	**Indonesia**	**Other**	**Total**
Assaying	$ 22,195	$ -	$ 1,060	$ -	$ 23,255
Camp costs	52,595	1,404	212,260	-	266,259
Consulting - geological	127,915	36,393	539,477	-	703,785
Depreciation	27,437	-	34,280	-	61,717
Drilling	4,696	-	214,461	-	219,157
License fees	595,174	2,508	88,282	-	685,964
Fuel	15,606	300	24,397	-	40,303
Legal	25,297	7,840	104,734	5,627	143,498
Maps, photos and reproductions	1,709	-	15,596	-	17,305
Office	116,731	7,916	209,797	4,404	338,848
Rental, lease and charter costs	64,388	5,826	111,464	-	181,678
Salaries	864,863	32,464	733,259	207	1,630,793
Supplies	932	-	21,855	-	22,787
Travel	92,636	1,247	218,494	-	312,377
	$ 2,012,174	$ 95,898	$ 2,529,416	$ 10,238	$ 4,647,726

	Year ended December 31, 2006				
	Mongolia	**Bulgaria**	**Indonesia**	**Other**	**Total**
Assaying	$ 267,786	$ 58,079	$ 2,337	$ -	328,202
Camp costs	346,561	30,000	89,858	-	466,419
Consulting - geophysics	75,098	-	71,941	-	147,039
Consulting - geological	546,643	323,165	202,780	22,754	1,095,342
Depreciation	21,382	-	12,555	-	33,937
Drilling	625,728	173,490	9,771	-	808,989
License fees	1,066,509	20,890	21,284	26	1,108,709
Fuel	15,412	-	9,500	-	24,912
Legal	10,370	15,795	50,206	7,969	84,340
Maps, photos and reproductions	964	1,035	6,643	28	8,670
Office	450,612	95,001	86,988	1,625	634,226
Rental, lease and charter costs	119,623	45,267	23,426	-	188,316
Salaries	594,200	250,986	294,719	410	1,140,315
Supplies	6,704	121	4,865	-	11,690
Travel	115,436	112,611	142,181	7,982	378,210
Loss on disposal of capital assets	10,076	-	-	-	10,076
Option income and expense recovery	(26,477)	(6,126)	-	-	(32,603)
	$ 4,246,627	$ 1,120,314	$ 1,029,054	$ 40,794	$ 6,436,789

SouthGobi Energy Resources

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
December 31, 2007

(Stated in U.S. Dollars)

SOUTHGOBI ENERGY RESOURCES LTD
(formerly ASIA GOLD CORP.)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
December 31, 2007
(Unaudited)
(Stated in U.S. Dollars)

OVERVIEW

SouthGobi Energy Resources Ltd., formerly known as Asia Gold Corp. (which, together with its subsidiaries, is collectively referred to as the "Company" or "SouthGobi") changed its name following approval by the Company's shareholders at the Annual General Meeting held on May 25, 2007. The new name reflects the Company's strategic focus on integrated coal and energy development in southern Mongolia.

Effective May 29, 2007 the Company's common shares, which traded under the symbol ASG on the TSX Venture Exchange, began trading under the new symbol SGQ.

The Company was previously a mineral exploration company with a focus on precious and base metal exploration and development in Mongolia, and elsewhere. Having completed the coal transaction (as defined below), the Company's principal focus is now on coal exploration and development in southern Mongolia.

Recent Developments

The Company and Ivanhoe Mines Ltd. ("Ivanhoe") reached a definitive agreement on July 7, 2006 for the Company to acquire Ivanhoe's coal division (the "coal transaction") in exchange for 82,576,383 common shares and preferred shares of the Company. The minority shareholders of the Company approved the coal transaction, which was a related party transaction, at a special meeting of the shareholders of the Company held on August 8, 2006. Despite shareholder approval, the closing of the coal transaction was subject to a number of conditions precedent that remained unsatisfied.

On May 1, 2007, Ivanhoe and SouthGobi announced that the Government of Mongolia completed the transfer of all of the coal exploration licenses held by Ivanhoe in the South Gobi area of Mongolia. As a result, the key condition precedent to the closing of the Company's acquisition of Ivanhoe's coal division was satisfied. The coal transaction received final approval from the TSX Venture Exchange on May 28, 2007, and closed the following day.

As consideration for the Ivanhoe coal division, the Company issued 57,000,000 common shares and 25,576,383 preferred shares. The common shares issued to Ivanhoe, when aggregated with Ivanhoe's existing holding of common shares, then represented approximately 86% of the total number of common shares then issued and outstanding. Each preferred share issued to Ivanhoe was convertible into one (1) common share but only if, upon any such conversion, the total number of common shares held by Ivanhoe and all other insiders of the Company or any of their respective associates or affiliates did not exceed 90% of the total number of common shares then issued and outstanding.

The preferred shares, which were non-voting and had a preference over the common shares with respect to the payment of dividends and distribution of assets in the event of a liquidation, dissolution or winding up of the Company were fully converted by Ivanhoe into common shares in January 2008.

When Ivanhoe and the Company reached their agreement in principle in April 2006 to effect the coal transaction, Ivanhoe also agreed to extend a line of credit (“First Funding Agreement”) to the Company of $10 million, which was subsequently increased to $15 million.

Pursuant to the agreements between the Company and Ivanhoe governing the coal transaction, certain interim coal division expenditures made by Ivanhoe after the agreement in principle was reached but prior to closing were added to the indebtedness outstanding under the line of credit and made repayable by the Company as if they were advances. These were in addition to the cash actually advanced under the credit facility described above. The total interim coal division expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007, were approximately $13.2 million. Together with the line of credit advances and interest the total amount payable by the Company to Ivanhoe under the First Funding Agreement as at December 31, 2007 was approximately $29.9 million.

The line of credit facility as described above was created pursuant to the terms of an interim funding agreement dated April 25, 2006. Amounts outstanding under the First Funding Agreement were convertible into common shares at the election of the Company until May 29, 2008, at a conversion price of C$2.09 per share, or at the election of Ivanhoe until August 29, 2008 at a conversion price of C$2.35 per share.

On August 1, 2007, Ivanhoe and SouthGobi agreed to amend the First Funding Agreement to extend the maturity date of the line of credit from April 25, 2008 to June 30, 2009. All other terms and conditions of the Funding Agreement remained unchanged.

All amounts advanced or deemed to be advanced under the First Funding Agreement bore interest at an annual rate equal to the three month London Interbank Offered Rate (“LIBOR”) plus two (2%) per cent per annum, which was approximately 6.70% at December 31, 2007.

On October 25, 2007, Ivanhoe and SouthGobi entered into a second interim funding agreement (the “Second Funding Agreement”). The Second Funding Agreement provides for an additional, unsecured non-convertible line of credit to $32.5 million. One tranche of funding for $15 million can be used for general corporate purposes and the second tranche of $17.5 million is contingent upon Ivanhoe having drawn down funds under a credit agreement between Ivanhoe and Rio Tinto International Holdings Limited (“Rio Tinto”). Use of the proceeds from the second tranche is restricted to expenditures in respect of the Company’s activities in Mongolia. The advances and interest amount payable to Ivanhoe as at December 31, 2007 was approximately $6.1 million.

All amounts advanced under the Second Funding Agreement bear interest at an annual rate equal to the three month London Interbank Offered Rate ("LIBOR") plus 3.3% per cent per annum, which is approximately 8.0% at December 31, 2007. The Second Funding Agreement matures on June 30, 2009.

Upon the closing of the coal transaction, the Company continued its domicile of incorporation from Canada to British Columbia. As well, the Company adopted an amended and restated employees' and directors equity incentive plan (the "Amended Equity Incentive Plan").

The Amended Equity Incentive Plan provides for a rolling rather than a fixed maximum number of common shares which may be issued pursuant to incentive stock options and other equity incentives, awards and issuances. Following the completion of the coal transaction, the number of issued and outstanding common shares increased from approximately 17 million to approximately 74 million and all of the employees and service providers of the former Ivanhoe coal division became direct or indirect employees and service providers of the Company.

On May 29, 2007, the Company announced the appointment of two new directors, Stuart "Tookie" Angus and Robert Hanson. On June 25, 2007 Peter Meredith, Ivanhoe's Deputy Chairman, was appointed SouthGobi's new Chief Executive Officer (CEO) and John Macken, Ivanhoe's President and CEO, was appointed as the Company's new Chairman. Pierre Lebel, the Company's former Chairman, was appointed as the independent Lead Director.

In September 2007 David Owens resigned his position as Executive Vice President, Metals Group to pursue corporate opportunities in the Asian metal mining industry. David led the SouthGobi mineral exploration and development team throughout his tenure with the Company. Richard Gosse, Vice President Exploration, who joined SouthGobi in 2004, has taken over daily operational initiatives for the Company's Metals Division.

On September 11, 2007, the Company received official notification from the Government of Mongolia that it had been granted a mining license for its open-pit coal mine at its Ovoot Tolgoi Project. A 30-year Mining License Certificate, dated September 20, 2007 was received on October 1, 2007. SouthGobi is expecting to receive the Permit to Mine early in 2008.

SouthGobi announced, on November 5, 2007 that it had committed to purchase a fleet of coal-mining equipment for the Ovoot Tolgoi Project. Delivery of the equipment, valued at approximately $16 million, is now underway.

In early January 2008, the Mongolian Government's Mineral Resources and Petroleum Authority selected Southgobi as Mongolia's "Best Exploration Company of 2007".

On January 24, 2008 the Company announced the closing of an equity private placement of 10 million common shares at C$8.00 per share and a second equity private placement of 3.5 million common shares at C$9.00 per share to institutional investors, for total gross proceeds of C$111,500,000 ($108,372,995).

Concurrent with the closing of these equity private placements, Ivanhoe converted its preferred shares and convertible debt under the First Funding Agreement into common shares of the Company. Subsequently, the Company repaid the amounts due under the second line of credit facility

On February 18, 2008 Southgobi announced an additional equity private placement to institutional investors in Hong Kong for 711,111 common shares at C$9.00 per share for proceeds of C$6.4 million. It is expected that the bulk of the proceeds of the three equity private placements completed in January and February 2008 will be used to further develop the Ovoot Tolgoi open-pit and underground projects, along with other development projects.

Ivanhoe currently owns 104,796,155 common shares representing approximately 81% of the issued and outstanding common shares of Southgobi.

FORWARD LOOKING STATEMENTS

Except for statements of fact relating to the Company, certain information contained herein constitutes forward-looking statements. Forward-looking statements are frequently characterized by words such as “plan”, “expect”,“project”,”intend”,”believe”,”anticipate” and other similar words, or statements that certain events or conditions “may” or “will” occur. Forward-looking statements are based on the opinions and estimates of management at the dates the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These factors include the inherent risks involved in the exploration and development of mineral properties, the uncertainties involved in interpreting drilling results and other geological data, fluctuating metal prices, the possibility of project cost overruns or unanticipated costs and expenses, uncertainties related to completion results of planned exploration and development programs on the Company’s material properties, issuance of licenses and permits and the availability of and costs of financing needed in the future and other factors described in this discussion under the heading “Outlook”. Except as required by law, the Company undertakes no obligation to update forward-looking statements if circumstances or management’s estimates or opinions should change. The reader is cautioned not to place undue reliance on forward-looking statements.

CRITICAL ACCOUNTING ESTIMATES

A detailed summary of all of the Company's significant accounting policies is included in Note 2 to the annual Consolidated Financial Statements for the year ended December 31, 2007.

All direct costs related to the acquisition of mineral property interests are capitalized by property. Exploration costs are charged to operations until such time as it has been determined that a property has economically recoverable reserves, in which case subsequent exploration costs and the costs incurred to develop a property are capitalized. Exploration costs include value-added taxes incurred in foreign jurisdictions when recoverability of those taxes is uncertain.

The Company reviews the carrying values of its mineral property interests whenever events or changes in circumstances indicate that their carrying values may exceed their estimated net recoverable amounts. An impairment loss is recognized when the carrying value of those assets is not recoverable and exceeds their fair value.

Future income tax assets and liabilities are computed based on differences between the carrying amounts of assets and liabilities on the balance sheet and their corresponding tax values, using the enacted or substantively enacted, as applicable, income tax rates at each balance sheet date. Future income tax assets also result from unused loss carry-forwards and other deductions. The valuation of future income tax assets is reviewed quarterly and adjusted, if necessary, by use of a valuation allowance to reflect the estimated realizable amount.

The Company accounts for stock options granted to directors, officers, employees and service providers using the fair value method of accounting. Accordingly, the fair value of the options at the date of the grant is determined using the Black-Scholes option pricing model, as required by generally accepted accounting principles, and stock-based compensation is accrued and charged to operations, with an offsetting credit to contributed surplus, on a straight-line basis over the vesting periods. Option pricing models require the input of highly subjective assumptions regarding the expected volatility. Changes in assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a realistic measure of the fair value of the Company's stock options at the date of the grant or thereafter.

CHANGE IN ACCOUNTING POLICIES

The Company adopted the provisions in the Canadian Institute of Chartered Accountants Handbook Sections 3251 – Equity, 3855 – Financial Instruments – Recognition and Measurement, 3861 – Financial Instruments – Disclosure and Presentation, 3865 - Hedges and 1530 – Comprehensive Income, on January 1, 2007, which addresses the classification, recognition and measurement of financial instruments in the financial statements and the inclusion of other comprehensive income. The Company's financial instruments' carrying value approximate fair values due primarily to their immediate or short term maturity. Section 1530 – Comprehensive Income, has no impact to the Company at this time.

MINERAL PROPERTIES

Qualified Persons

Disclosure of a scientific or technical nature in this Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") with respect to the Company's Metals Division was prepared by, or under the supervision of, Richard R. Gosse, P.Geo, the Vice President Exploration, of the Company's Metals Division. Disclosure of a scientific or technical nature in this MD&A with respect to the Company's Coal Division was prepared by, or under the supervision of Gene Wusaty, P.Eng, Chief Operating Officer of the Coal Division. Each of Messrs. Gosse and Wusaty is a "qualified person" for the purposes of National Instrument 43-101 of the Canadian Administrators ("NI 43-101")

Mongolia Exploration Licenses-Overview

Prior to June 30, 2006, exploration licenses in Mongolia were granted for a period of three years with rights to two 2-year extensions (for a total of seven years) and required escalating annual rent payments. In early July 2006, the Government of Mongolia approved new mining legislation. The term for an exploration license has increased from a maximum of seven to nine years, with escalating rate structures varying from $0.10 per hectare ("ha") to $1.50 per ha for licenses that are outstanding seven to nine years. Accordingly, the longer an exploration license is held the higher the annual cost becomes. As exploration licenses are identified as having limited mineral potential, they will be surrendered in order to minimize license fees. The number of licenses held will therefore fluctuate on a period to period basis as new properties are acquired and older ones surrendered. Under the new law, a mining license is now granted for a term of 30 years with rights to two 20 year extensions.

The new 2006 Minerals Law also created requirements for making minimum exploration license expenditures. Beginning in 2007, an exploration license holder is required to undertake reconnaissance, exploration and related work at a per ha minimum of $0.50 for each of the second and third years of the term of the exploration license; $1.00 for each of the fourth to sixth years and $1.50 for each of the seventh to ninth years. The Company targeted its 2007 exploration program to meet the minimum expenditures.

Coal Group Profile

Mongolia Exploration Licenses

The purchase of the former Ivanhoe coal division included Ivanhoe's entire interest in the Ovoot Tolgoi (formerly Nariin Sukhait) coal development project, the Tsagaan Tolgoi coal exploration project and various coal exploration projects in Mongolia. To complete the transaction, 35 coal exploration licenses held by Ivanhoe, along with other assets and personnel, were transferred to the Company. The Company already owned a further 19 exploration licenses with coal potential, and with the additional 35 licenses, an aggregate of 54 licenses covering an area of approximately 2.1 million ha were available for coal exploration.

The Company regularly targets and prioritizes a number of licenses on the basis of potential, age, and cost. As a result of this review, a group of licenses were relinquished during the fourth quarter in 2007.

As at March 18, 2008 the Company held 51 licenses, with an area of approximately 1.9 million ha.

Properties in Mongolia

Ovoot Tolgoi Project (formerly Nariin Sukhait)

The Nariin Sukhait property was renamed "Ovoot Tolgoi" to differentiate Ivanhoe's coal exploration and development project in Mongolia's South Gobi Province from the adjoining Nariin Sukhait coal mine owned by the Mongolian-Chinese joint venture company, MAK/Qinhua.

The Ovoot Tolgoi coal deposit is located in the southwest corner of the Omnogovi Aimag (South Gobi Province) of Mongolia. The deposit is within the administrative unit of Gurvantes Soum, 320 kilometers ("km") southwest of the provincial capital of Dalanzadgad and 950 km south of the nation's capital of Ulaanbaatar.

Ivanhoe initiated coal exploration in the Ovoot Tolgoi area in October 2004 and carried out extensive exploration programs in 2005, 2006 and 2007. The Company's 2007 exploration program was designed to bring the level of knowledge for the identified resource area to a pre-feasibility level for mine planning. In addition, the exploration program continued to expand the extent of the known mineralization in both the underground and surface coal deposits as well as increase the knowledge level of the quality and structure of both deposits.

Resources at the Ovoot Tolgoi property are found in two different resource areas, referred to as the South-East and the West Fields. Estimated resources for these areas, categorized in accordance with NI 43-101, are approximately 105 million tonnes of measured resources, 45 million tonnes of indicated resources and an additional 29 million tonnes of inferred resources. The coal rank is volatile B to A bituminous based on the ASTM D388 standards. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are available in the Technical Report entitled "Ovoot Tolgoi Property – Omnogovi Aimag, Mongolia" dated March 27, 2008 and available at www.sedar.com.

In April 2007, Ivanhoe initiated the formal process for obtaining a Mining License for development of a surface open-pit coal mine at Ovoot Tolgoi. As required by the Minerals Law of Mongolia, the Company filed a Detailed Environmental Impact Assessment (DEIA) and a Geological Resource Report for the Ovoot Tolgoi property. In May 2007, the DEIA for the Ovoot Tolgoi coal project was approved by the Mongolian Government's Ministry of Environment. On August 6, 2007 the government approved the Geological Resource Report. The 30 year Mining License dated September 20, 2007, was received on October 1, 2007.

In order to commence mining operations at Ovoot Tolgoi, SouthGobi needs to obtain a Permit to Mine. In order to obtain a Permit to Mine, the Company submitted for review by governmental authorities in Mongolia a Technical and Economical Report (comparable to a scoping level study) and a first year mine plan.

Mining equipment has been ordered and the Company expects to receive its Permit to Mine in the first half of 2008. In the interim, the necessary information is being compiled to apply for land use permits for the mining area and its associated infrastructure, such as roads, personnel facilities and shop complex. Permanent site facilities have been designed and construction is scheduled to start in the second quarter of 2008 once weather permits. The exploration camp has been winterized and commissioned and will service the project until the permanent facilities are ready. A temporary maintenance shop has also been purchased and will be erected in early 2008. Semi-weekly flights to the Ovoot Tolgoi airport began at the end of 2007.

Recruiting activities were initiated during the fourth quarter of 2007 in preparation for hiring the workforce in coordination with the commissioning of the mining equipment. All senior mine operation staff have now been hired. Regular manpower rotation at the site is in effect.

An updated mining study on Ovoot Tolgoi was completed in the fourth quarter 2007. This study refines and enhances previous mining plans and studies carried out to date.

A purchase order was signed to purchase approximately $16 million of mining equipment from a local mining equipment supplier in Ulaanbaatar. Delivery is underway for 2008.

Ovoot Tolgoi Underground Project

The Ovoot Tolgoi Underground Project is contiguous to and located directly below the proposed surface mine development. The entire extension of the coal at depth designated for the underground development is located inside the existing Ovoot Tolgoi mining license.

In June 2007, Norwest Corporation ("Norwest") identified two potential underground mining areas in conjunction with potential surface mining activities, the West Field and the South Field. In March 2008, The Americas Group prepared a 43-101 compliant resource estimate for underground resources in the West Field. Estimated resources for the West Field, categorized in accordance with NI 43-101, are approximately 3.9 million tons of measured resources, 12.6 million tons of indicated resources and 36.7 million tons of inferred resources. The coal rank is volatile B to A bituminous based on ASTM D388 standards. Holes drilled in the 2007 exploration program were not included in the resource estimation. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are available in the Technical Report entitled "Underground Resources at Ovoot Tolgoi – West Field" dated March 28, 2008 and available at www.sedar.com.

In 2007, seven deep holes were drilled into the coal below 250 m designated for underground mining. The drilling was conducted to obtain additional information respecting the structure and quality of the deep underground coal mineralization. The drilling conducted in 2006 and 2007 has identified coking and semi-soft coal at depths of between 250 m and 650 m below surface beneath the lower boundaries of the planned open pits at the South-East and West Fields. The No. 5 coal seam is open to depth and along strike.

The assessment of underground mining alternatives continued during the fourth quarter of 2007. The Company has engaged an underground coal mining consultant and is preparing a new scoping level study for future underground mining. The information from the drilling carried out during the 2007 exploration program will be used in preparation of this study. The Company plans to undertake a significant exploration program during 2008, the results of which will be used as the basis for a resource estimate and to advance the mine planning for development.

Tsagaan Tolgoi Project

Tsagaan Tolgoi contains a coal resource which has the potential to supply coal for Ivanhoe's proposed Oyu Tolgoi copper and gold mining project. The Tsagaan Tolgoi coal field is located in south-central Mongolia. The property is located in the Omnogovi Aimag approximately 570 km south of Ulaanbaatar and 113 km southeast of the provincial capital of Dalanzadgad, and approximately 115 km west of Oyu Tolgoi.

A coal delineation program was first carried out in 2004, but no further work was conducted in 2005. Exploration programs were carried out during 2006 and 2007 to provide for the basis of a resource estimate. The NI 43-101 compliant resource estimate issued on February 25, 2008 were 36.4 million tonnes of measured and indicated and 9.0 million tonnes of inferred resources. Coal is of volatile bituminous B to C in rank based on ASTM D 388 standards and is suitable for use as a thermal coal. The resources are suitable for surface extraction down to a maximum depth of 150 m. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are available in the Technical Report entitled "Coal Geology and Resources – Tsagaan Tolgoi Property" dated March 25, 2008 and available at www.sedar.com.

A baseline DEIA study was commissioned during the previous quarter for the Tsagaan Tolgoi area. The DEIA baseline study is a necessary step in advancing the project to the production stage as part of a power project.

Tavan Tolgoi Extension Project

The Tavan Tolgoi Extension Project is composed of 8 exploration licenses located east of Dalanzadgad, the provincial capital in the Omnogovi Aimag. These exploration licenses surround the third party owned Tavan Tolgoi coal project on three sides. The Tavan Tolgoi coalfield was discovered in the 1950s by a joint Mongolian/Soviet team and is believed to be one of the largest undeveloped metallurgical coal deposits in the world.

A field reconnaissance program was carried out on the Tavan Tolgoi Extension licenses in 2006. The exploration area has been surveyed for copper and gold exploration using BHP Falcon aerial geophysics. The Company has obtained the aeromagnetic and aero gravity survey data and is using the results of the upcoming analysis of the Falcon data to help delineate potential coal targets. A significant exploration program was started in the third and fourth quarters of 2007. Further exploration work on the extension will continue into 2008.

Ovoot Tolgoi Extension

In 2005 coal occurrences were identified in the N and O fields (now called Ovoot Tolgoi Extension) approximately 16 and 23 km east-southeast of Ovoot Tolgoi, respectively. Further exploration drilling in 2006 has indicated that these coal occurrences may in fact be one coal field. The 2007 exploration drilling provided additional structure and quality information, where significant intersections were encountered and potential exists for expanding known mineralization along strike and down dip. Further drilling is expected to take place on the Ovoot Tolgoi Extension during 2008.

Other Coal Projects

In November 2007 the Company signed a Memorandum of Agreement with an Indonesian company to advance exploration on coal deposits in East Kalimantan. The direct interest of the Company in the project will be 56% and to date the Company has advanced funds to carry out an initial drilling and documentation program, while joint venture and cooperation agreements are finalized.

Coal Exploration Programs

In 2007 SouthGobi completed a major exploration program on six separate coal projects in the Gobi area of southern Mongolia. The program was designed to meet existing project and Mongolian Minerals Law requirements. Mobilization of drills, crews and camps was started in May 2007.
The 2007 exploration program carried out work in the following areas:

1) Ovoot Tolgoi surface mine
   Infill drilling and drilling to assess the extent of the coal bearing formation along strike so that mine shop facilities and waste dump locations can be located in areas where there is no coal potential

2) Ovoot Tolgoi underground
   Rotary / core holes to better determine the No.5 seam structure, dip and quality for additional information for planning purposes

3) Ovoot Tolgoi extension
   Further drilling in the Ovoot Tolgoi extension focused on gaining a better geological, structural and quality understanding of the coal mineralization and extension of N and O fields

4) Tavan Tolgoi extension
   The Tavan Tolgoi extension licenses held by the Company are in close proximity to the known, third party-owned Tavan Tolgoi coal fields. This program was carried out to identify new metallurgical coal mineralization due to its proximity to the known, third party-owned Tavan Tolgoi coal fields. The Company is using the results to delineate potential coal targets.

5) Tsagaan Tolgoi extension
   The Tsagaan Tolgoi exploration program included localized drilling and trenching on licenses in the immediate area of the existing coal resource

6) Greenfields Exploration
   The program was designed to target high potential coal bearing formations and in order to meet minimum expenditure requirements.

For 2008, SouthGobi has scheduled an extensive drill program in all areas. A substantial portion of the drilling planned for 2008 will be aimed at delineating additional surface resources and providing the basis for an initial estimate of the underground coal resource and the potential for the development of an underground mining operation at Ovoot Tolgoi.

Metals Group Profile

Mongolia Exploration Licenses

As of March 5, 2008, the Company's Metals Group held 31 exploration licenses for copper and gold exploration in Mongolia covering an aggregate area of approximately 539,000 ha. Seventeen of these licenses, comprising an area of approximately 457,000 ha, the West Gobi Properties, are located in the west-central portion of the Omnogovi Aimag (province) approximately 510 km southwest of Ulaanbaatar, Mongolia. Three of the remaining licenses are known as the Oyut Ovoo property and are located approximately 270 km southwest of Ulaanbaatar. In addition, one license is held in Dornod Aimag which is located approximately 300 km northeast of Ulaanbaatar, five licenses are held in Khuvsgul Aimag in northern Mongolia and one license is held as part of a joint venture agreement with Gallant and four are located in the Tsagaan Tolgoi region.

The Company regularly targets and prioritizes a number of copper and gold licenses on the basis of potential, age, and cost. As a result of this review, a group of metals related licenses were relinquished during the quarter, and further licenses are pending sale subsequent to the year end.

Properties in Mongolia

West Gobi Properties

Exploration on these licences is directed towards discovering porphyry copper–gold deposits and epithermal and mesothermal gold vein systems. Grassroots exploration began in 2003 using Landsat satellite data. A new round of target generation using Aster satellite data was initiated in late 2004 along with regional stream sediment sampling. More than 1,000 stream sediment samples were collected and numerous anomalies were followed up. This work led to the discovery of both the Khongor copper-gold and the Naran Bulag gold projects in 2005.

Khongor Project

The Khongor porphyry copper-gold prospect in southern Mongolia has a mineralized strike length of about 2 km. About half of this strike length (Khongor North) is located within the West Falcon Gobi Property. The balance referred to as Khongor South is located on the Tsakhir license, which has been optioned by the Company from Gallant Minerals Ltd. ("Gallant").

In order to exercise the option from Gallant to acquire an 80% interest in the Tsakhir license, SouthGobi is required over the next two years to make cash payments of $70,000, issue common shares of the Company valued at $50,000 and spend an aggregate of $600,000 on related work programs. Subject to SouthGobi exercising its option to acquire an 80% interest in the Tsakhir license, Gallant has a one time option, exercisable within 30 days of SouthGobi completing the option, to retain its 20% interest as a fully participating joint venture partner, or to convert its 20% interest into a net smelter royalty of up to 3%. The Company retains the right to buy down the royalty pursuant to a payment scale based on the amount of the annual net smelter revenue.

The Khongor porphyry copper-gold deposit was discovered by the Company in 2005. A first stage drilling program comprising 935 m in five holes was completed in December 2005. All five holes intersected copper mineralization. Hole KPDH-3 intersected stockwork style mineralization from surface to a down-hole depth of 70.3 m grading 0.67% Cu and 0.16 g/t Au. A second stage drilling program comprising 3,167 m in 18 holes was completed in July 2006. Six holes intersected strong sheeted quartz stockwork with associated high grade copper mineralization. Hole KPDH-9 reported 1.0% Cu and 0.3 g/t Au over a 50 m interval from 64.0 m to 114.0 m. The Khongor mineralization is open to the west, east and south.

Mapping on the Tsakhir license has identified a number of other porphyry bodies and significant areas of quartz stock work and breccia bodies. The property scale geology suggests that Tsakhir and Khongor may be part of a very large (>10 km diameter) multi-phase intrusive complex with significant prospectivity. Tsakhir and Khongor lie within the South Gobi arc terrain that hosts the Oyu Tolgoi copper-gold deposit, located 300 km to the east.

A 3,000 m diamond drill program began in March 2008.

BHP West Falcon Gobi Joint Venture

Pursuant to an Option Agreement with BHP Minerals Asia Inc. ("BHP") dated June 30, 2005, as amended February 27 2006, BHP was able to earn a 50% interest in the 7,648 square kilometres ('km^2') West Falcon Gobi Property by spending $3.5 million on exploration prior to December 31, 2007, and an additional 20% interest by funding a feasibility study up to a maximum value of $45 million.

BHP notified the company in December 2007 that it did not intend to exercise its option to acquire the 50% interest in the West Falcon Gobi Property. The Option Agreement that the Company had entered into with BHP was terminated and BHP relinquished all rights to Khongor North. The Company now retains a 100% interest in the West Falcon Gobi Property including Khongor North.

Naran Bulag Project

In 2005, the Company discovered 13 quartz veins containing visible gold at Naran Bulag on a 100% owned exploration license about 50 km south of the Khongor prospect. The veins occurred over a distance of 2.5 km. A 7,000 m trenching program commenced that year confirmed high grade gold in five main veins and revealed two new veins which were found within 2 km of the main vein system.

A 3,500 m combined diamond and reverse circulation (RC) drill program was carried out in April 2006. Three blocks were defined for RC grid drilling on the down-dip extensions of three veins that host high grade gold mineralization 84 RC drill holes (diameter 13.1 cm), including 20 holes on the B vein, 35 on the D vein and 29 on the AC vein system were collared on 10 m centers on drill hole fence-lines with a 25 m line separation for the B and D veins and a 50 m line separation for the AC veins.

The holes identified four possible shallow dipping, south plunging mineralized shoots within the quartz veins that are defined by an envelope of anomalous gold and base metals which encloses the better gold intersections. Grades of up to 12 g/t gold over 2 m in the AC vein, 10 g/t gold over 2 metres in the B vein and 13 g/t gold over 1 m in the B vein were intersected. The estimated dimensions of the shoots are 30 to 60 m in width, 1 to 4 m in thickness and 90 to 130 m down plunge. All four shoots are open at depth. The Company is currently reviewing the project and considering various options including joint venture proposals.

Other West Gobi Properties

At Tsagaan Temmee a dipole-dipole IP survey identified a 500 m diameter chargeability anomaly between 300-500 m in depth that corresponds in plan to an area of intense leaching and alteration. Further interpretation is required to define the drill target.

Exploration on other licenses was minimal but sufficient to meet the minimum expenditures required to keep the licenses in good standing.

An agreement to sell and transfer a single license was signed on January 21, 2008. The purchaser paid $100,000 for the license and agreed to pay a 5% net production royalty and an additional $50,000 payment on the first anniversary.

Other Properties in Mongolia

In Khuvsgul Aimag the Company holds 5 exploration licenses totaling approximately 33,000 ha. These areas are considered to be prospective for Proterozoic shale-hosted gold mineralization similar to deposits in Irkutsk Oblast. Reconnaissance level exploration consisting of regional stream sediment sampling and prospecting was conducted in 2005 and the results were used to prioritize target areas. In June 2007 a follow up program of detailed stream sediment led to outcropping pyritic carbonate-altered shale with anomalous gold in one area. In September additional stream sediment sampling in three other target areas resulted in numerous geochemical anomalies including a cluster of nine contiguous catchments (about 70 square km) that is anomalous in gold and pathfinder elements. A follow up reconnaissance prospecting and mapping program is planned to start in June 2008.

As of January 2008, the Company held a single license in Dornod Aimag covering a total area of approximately 17,500 ha. In June 2007, a Letter of Intent was signed with Batu Mining Mongolia LLC to explore the license. Under the proposed agreement Batu can earn up to 80% of the joint venture by spending a minimum of $500,000 within three years. No further work is planned at this time and costs incurred in 2007 and 2006 relate to regulatory and filing fees. In 2007 Batu carried out a wide spaced soil survey over the entire licence and identified several weak lead and zinc anomalies.

For the Oyut Ovoo property, as of January 2008, the Company held 3 licenses covering a total area of about 10,000 ha. No further work is planned at this time and costs incurred in 2007 and 2006 relate to regulatory and filing fees and site visits to several copper occurrences.

Properties in Indonesia

Kaputusan Project

The Company signed a Venture Agreement and Cooperation Agreement with PT Harita Multi Karya Mineral ("HMKM") on September 7, 2006 to explore the Kaputusan copper gold porphyry prospect located on Bacan Island, Maluku in Indonesia. The joint venture consists of two Exploration KP's of 13,641 ha and 13,770 ha and a General Survey KP of 10,250 ha for a total exploration area to 37,661 ha. The Company earned an 85% interest in the project by spending $300,000 on exploration during the first year of the joint venture. A joint venture company, PT ASG Harita Mining Services was incorporated in 2006. The 15% interest held by HMKM in the joint venture company is free carried to commercial mine production while the Company is responsible for funding 100% of any project costs through to commercial mine production.

The Kaputusan porphyry was discovered, trenched and drilled during a joint Indonesian-German (BGR) regional program between 1977 and 1979. The Company's first-stage exploration program comprising geological mapping, 110 line km of high resolution ground magnetics, 42 line km of dipole-dipole IP and trenching began in March 2006. Geological mapping confirmed the presence of porphyry copper-gold mineralization hosted by potassic-altered and magnetite-bearing tonalite porphyry stocks over an area measuring approximately 1,300 m by 500 m.

Results of SouthGobi's resampling of seventeen of the original BGR trenches compare well with BGR results and provide confidence in all BGR analytical results. An additional 15 trenches totaling 2,958 m resulted in the discovery of porphyry copper-gold mineralization, the new West Zone, and new areas of mineralization in the north and south. In the North Zone, a 152 m section of mineralization that is open to the east and west, grades 0.20% copper and 0.18 g/t gold and includes a 60 m interval grading 0.31% copper and 0.36 g/t gold. The north–south extent of copper-gold mineralization at Kaputusan was increased to 1,800 m and is still open to the north and south.

A 3,000 m diamond drilling program to test the North, South and West Zones began in February 2007. Six diamond drill holes totaling 1,000 m were completed by the end of May 2007. All six holes encountered porphyry copper-gold mineralization; however the drill was not sufficiently powerful and was demobilized in June 2007. Drilling is expected to resume in 2008 using a new contractor and a more powerful Longyear 44 drill once the Company obtains an Exploration Permit from the Department of Forestry.

Other Indonesia Projects

The Company has signed Letters of Intent with two Indonesian companies for a 90% fully participating interest in a number of copper and gold projects through its 100% owned Indonesian subsidiary, PT AGC Indonesia. These projects are located in Sumatra, Java, Kalimantan, and Sulawesi.

At the joint venture project located in Java, the Company has discovered an encouraging low sulphidation epithermal gold and silver system. The discovery is located within an 8 km by 2-3 km structural corridor where other occurrences of sinter, silica caps, high level epithermal veins and anomalous levels of gold and silver have been identified. An initial program of more than 70 trenches has identified numerous high-level epithermal veins in an area of 520 m wide and 200 m long. Further trenching is in progress and a 3,000 m drill program is planned for early 2008.

Elsewhere in Indonesia the Company has also recently identified a new porphyry copper gold system. Mineralization consists of chalcopyrite, bornite and pyrite disseminated in a potassic altered hornblende diorite porphyry with quartz veinlet stockwork. It is exposed in outcrop for 380 m while boulders of similarly mineralized rock found 500 m northwest suggest the presence of a second zone.

SELECTED ANNUAL INFORMATION

($ in thousands, except per share information)	**Year ended December 31,**		
	2007	2006	2005
Exploration expenses	$ 16,814	$ 6,437	$ 4,655
Net loss	26,730	9,362	6,214
Net loss per share	(0.98)	(0.56)	(0.41)
Cash and cash equivalents	1,394	965	3,125
Total assets	5,610	2,052	3,775
Amounts due under line of credit facilities	35,108	5,836	-

For each of the years ended December 31, 2007, 2006 and 2005, the Company had no sales or other operating revenues.

Prior to the completion of the coal transaction in May 2007, the Company was a mineral exploration company with a focus on precious and base metals exploration and development. Exploration expenditures increased throughout 2005 and 2006, as the scope of the Company's exploration projects increased during the year.

Exploration for precious and base metals continues into 2007; however the principal focus is on coal exploration and development in Mongolia. Expenditures for the coal division began in June 2007.

The Company has relied on Ivanhoe for its additional financing throughout 2007 so it could continue its planned activities in the normal course. Subsequent to the year end, the Company has successfully completed a series of equity financings that enabled it to further develop its projects for both the coal and metals divisions, and repay the amounts due to Ivanhoe under the Second Funding Agreement.

SELECTED QUARTERLY DATA

($ in thousands, except per share information)

	2007				2006			
QUARTER ENDED	31-Dec	30-Sep	(1) 30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar
Exploration expenses	$ 5,958	$ 5,205	$ 4,784	$ 867	$ 1,237	$ 1,920	$ 2,734	$ 546
Net loss	9,000	7,840	8,240	1,650	2,042	2,689	3,634	997
Net loss per share	(0.12)	(0.11)	(0.22)	(0.10)	(0.11)	(0.16)	(0.23)	(0.06)

(1) June 30, 2007

As noted above, upon the completion of the coal transaction, certain interim coal division expenditures made by Ivanhoe were added to the indebtedness outstanding under the line of credit facility established pursuant to the First Funding Agreement, which became repayable by the Company as if they were advances. The total of such coal expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007 was approximately $13.2 million of which $13 million was related to exploration expenses and $200,000 are for plant and equipment.

The $13 million of interim coal division expenditures were expensed during the quarter ended June 30, 2007 and were also included in the income statement for the six months ended June 30, 2007 and nine months ended September 30, 2007.

After a further review of the nature of the interim coal division expenditures, and the accounting for related party transactions with respect to these expenditures, these $13.0 million of expenditures have been reclassified effective May 28, 2007. These expenditures have now been treated as an additional contribution and recorded as a capital transaction and charged directly to deficit. This reclassification provides for a more descriptive presentation of the coal transaction and related interim coal expenditures, and does not impact the overall financial condition of the Company. The previously reported and restated information is disclosed as follows:

	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007	Nine Months Ended September 30, 2007
Exploration expenses as reported	$ 17,795,842	$ 18,662,858	$ 23,867,452
Exploration expenses revised	4,784,219	5,651,235	10,855,829
Net loss as reported	$ 21,252,070	$ 22,901,791	$ 30,741,705
Net loss revised	8,240,447	9,890,168	17,730,082
Earnings per share as reported	$ (0.57)	$ (0.85)	$ (1.13)
Earnings per share revised	$ (0.22)	$ (0.37)	$ (0.65)
Deficit as reported	$ (45,514,959)	$ (45,514,959)	$ (53,354,873)
Deficit revised	(45,514,959)	(45,514,959)	(53,354,873)

The quarterly financial statements for the three months ended March 31, 2007 and the three months ended September 30, 2007 are unchanged.

Selected Quarterly Information

Certain figures, the majority of which are related to stock based compensation expense, presented for comparative purposes for the period ended December 31, 2006 have been reclassified to conform to the presentation adopted for the current year.

The changes in comparative results of operations on a quarter over quarter basis are due primarily to significant fluctuations in the following areas: exploration expenses, stock-based compensation charges, foreign exchange gains and losses and interest expense.

Exploration expenses will vary from quarter to quarter depending on the number of projects and the related seasonality of the exploration programs. Most of the exploration expenditures recorded for five quarters ended March 31, 2007 were incurred on the metals exploration projects in Mongolia, Bulgaria and Indonesia. The majority of the expenses for the remainder of 2007 relate to the coal expenditures that were incurred after the completion of the coal transaction, which were direct incurred costs related to the operations of the Mongolia coal division.

Stock-based compensation is allocated between exploration expense and salaries and benefits and reflects both the number of options granted during a given period and the vesting pattern of the underlying stock options that gave rise to the compensation expense resulting in fluctuations on a quarterly basis.

Foreign exchange gains and losses arise primarily from significant cash balances which are maintained in Canadian funds whereas the reporting currency of the Company is U.S. dollars. Accordingly, fluctuations in the Canada-U.S. exchange rate results in the recording of gains or losses on a quarterly basis. The Company also has transactions in the Mongolian Tugrik, the Indonesian Rupiah, and in past quarters prior to 2007, the Bulgarian Lev and the Euro, which will affect the foreign exchange gains or losses recorded in the financial statements.

Interest expense relates to the two funding agreements with Ivanhoe. The interest accretion of the liability component of the debt component of the First Funding Agreement is charged to earnings for the period.

RESULTS OF OPERATIONS

	Three Months Ended December 31, 2007	2006
EXPENSES		
Depreciation	**$ 36,886**	$ 5,085
Exploration	**5,958,416**	1,236,685
Legal	**110,409**	10,963
Office and administration	**278,507**	198,349
Professional fees	**46,267**	10,260
Salaries and benefits	**849,594**	310,240
Travel	**45,508**	56,630
	7,325,588	1,828,212
OTHER EXPENSES/(INCOME)		
Coal transaction costs	**-**	113,781
Interest income	**(11,201)**	(8,374)
Interest expense	**546,804**	63,645
Interest accretion on line of credit facility	**1,118,783**	-
Foreign exchange loss	**19,877**	7,996
Write-down of mineral property	**-**	132,366
	1,674,262	309,414
NET LOSS AND COMPREHENSIVE LOSS	**$ 8,999,851**	$2,137,626

Three Months Ended December 31, 2007 and 2006

The Company incurred a net loss for the three months ended December 31, 2007 of $9.0 million as compared to a net loss of $2.1 million for the same period in 2006. This change is due primarily to higher exploration, stock based compensation, interest and line of credit interest accretion expense for the three months ended December 31, 2007.

Exploration expenses for the three months ended December 31, 2007 are significantly higher due to the completion of the coal transaction and the related direct costs incurred by the coal division in Mongolia. In 2006, the Company had operations in Mongolia, Bulgaria and Indonesia, which were related to the metals division only.

Legal fees have increased for the three months ended December 2007 as compared to the same period in 2006. The majority of these charges were for costs associated with the Company's compliance with regulatory requirements including expenses associated with corporate governance, statutory filings, registration, disclosure, financing, and business acquisition documentation.

Professional fees for both the December 2007 and 2006 quarters include the cost of quarterly reviews and accruals for the year end audit of the Company's financial statements. The current quarter fees also relate to year end audit accruals, and costs incurred for internal corporate tax planning and documentation.

For the three months ended December 31, 2007 the Company has allocated stock-based compensation expense of $498,000 (2006 - $55,000) to exploration expense and $509,000 (2006 – $111,000) to salaries and benefits. The total stock based compensation expense calculated for the three months ended December 31, 2007 was $1.0 million as compared to $166,000 in the same period in 2006. The increase reflected additional option grants in the June 2007 quarter and the related vesting and volatility of the underlying stock options that gave rise to the compensation expense.

Salaries and benefits, excluding stock based compensation costs, increased slightly in the three months ended December 31, 2007 to $341,000 as compared to $339,000 for the three months ended September 30, 2007. . Salary and benefits compared to the same period in 2006 have increased due to the increased corporate activities related to the coal division.

Office and administration fees increased in the three months ended December 31, 2007 as compared to the same period in 2006. The increases relate to the development of the exploration projects, added personnel and office and administration support costs. Certain of the Company's administrative staff and office facilities are provided by Global Mining Management ("GMM")(see 'Related Party Transactions' below) whose costs are allocated on an as-used basis. Accordingly, quarterly fluctuations in the costs of administrative and personnel costs can be expected commensurate with increases or decreases in quarterly corporate activity and the level of personnel employed.

Interest income will increase or decrease in a quarter depending on the cash position, draws on the line of credit from Ivanhoe and related spending in the metals and coal divisions. Interest income has increased, which relates directly to the Company's draws on the line of credit from Ivanhoe and increased cash position throughout the quarter. Interest expense of $547,000 for the three months ended December 31, 2007 relates to the lines of credit from Ivanhoe and $1.1 million on accretion of the liability component of the First Funding Agreement credit facility. The First Funding Agreement line of credit facility bears interest at an annual rate equal to the three month London Interbank Offered Rate (LIBOR) plus two percent per annum, which was approximately 6.70% at December 31, 2007. On October 25, 2007, Ivanhoe and SouthGobi entered into a Second Funding Agreement. All amounts advanced under the Second Funding Agreement bear interest at an annual rate equal to the three month London Interbank Offered Rate ("LIBOR") plus 3.30% per cent per annum, which was approximately 8.0% at December 31, 2007.

The foreign exchange gains are primarily the result of changes of the U.S. to Canadian dollar exchange rates during these periods.

In 2006, the Company wrote down mineral properties by $132,000.

RESULTS OF OPERATIONS

	Twelve Months Ended December 31, 2007	2006
EXPENSES		
Depreciation	**$ 63,610**	$ 20,323
Exploration	**16,814,245**	6,436,789
Legal	**265,515**	45,840
Office and administration	**955,956**	682,545
Professional fees	**195,291**	87,898
Salaries and benefits	**4,622,489**	1,359,064
Travel	**246,908**	229,777
	23,164,014	8,862,236
OTHER EXPENSES/(INCOME)		
Coal transaction costs	**26,547**	217,781
Interest income	**(44,082)**	(49,700)
Interest expense	**1,358,742**	178,739
Interest accretion on line of credit facility	**2,237,248**	-
Foreign exchange (gain) loss	**(47,545)**	20,393
Write off of interest in joint venture	**35,009**	-
Write-down of mineral property	**-**	132,366
	3,565,918	499,579
NET LOSS AND COMPREHENSIVE LOSS	**$ 26,729,932**	9,361,815

Year Ended December 31, 2007 and 2006

The Company incurred a net loss for the year ended December 31, 2007 of $26.7 million as compared to a net loss of $9.4 million in 2006. This change is due primarily to higher exploration, stock compensation, salary and benefits, interest and line of credit interest accretion expense in the 2007.

Exploration expenditures during 2007 were $16.8 million as compared to $6.4 million in the 2006. With the completion of the coal transaction, the coal division in Mongolia incurred exploration costs on six separate coal projects in the Gobi area of southern Mongolia. The metals division continued exploration programs in Mongolia and Indonesia.

Salary and benefits expense was $4.6 million for 2007 as compared to $1.4 million in 2006. Stock based compensation expense allocated to salary and benefits expense was $3.4 million for 2007 compared to $616,000 in 2006. Salary and benefits expense, excluding stock option compensation costs, were $1.2 million in 2007 and $743,000 in 2006. The majority of the increase in salary and benefits expense relates to added personnel. The stock compensation expense reflects additional options grants, particularly in the second quarter of 2007, and the related vesting and volatility pattern of the underlying stock options that gave rise to the compensation expense and the fair value.

Office and administration costs increased to $956,000 for 2007 compared to $683,000 in 2006. The increases relate to added personnel and related office and administration support costs for the development of the exploration projects

Legal fees increased for the year ended December 31, 2007 compared 2006. The majority of these increases were for costs associated with the Company's compliance with regulatory requirements including expenses associated with corporate governance, annual statutory information filings, registration, disclosure and preparation of financing documentation. Included in professional fees are costs related to the quarterly reviews of the Company's financial statements, accrued year end audit, recruitment expenses and corporate tax planning.

Costs to effect the coal transaction in 2007 are for legal and professional fees. The fees relate to the preparation of the documentation for closing the acquisition by the Company of Ivanhoe's coal division. The coal transaction, which was a related party transaction, received final approval from the TSX Venture Exchange on May 28, 2007. The coal transaction costs for 2006 relate to the preparation and approval of the documentation for the special shareholders meeting regarding the acquisition by the Company of Ivanhoe's coal division.

Lower interest income during 2007 reflects slightly lower average cash balances compared to 2006. Interest expense has increased for the year ended December 31, 2007 compared to 2006 due to further advances on the line of credit to fund continuing operations, including the accretion on the liability component of the loan. With the completion of the coal transaction, certain interim coal division expenditures made by Ivanhoe were added to the indebtedness outstanding under the line of credit established under the First Funding Agreement in the quarter ended June 30, 2007.

A foreign exchange gain of $47,000 was recorded for 2007 as compared to a loss of $20,000 for 2006. These amounts are primarily reflective of the changes in the value of the Canadian dollar versus its U.S. counterpart during these periods and to a lesser extent the effect of the Mongolian Tugrik, and the Indonesian Rupiah.

In 2006, the Company wrote down mineral properties by $132,000.

EXPLORATION COSTS BY DIVISION

	2007	2006
Metals Division	**$ 4,647,726**	$ 6,436,789
Coal Division	**12,166,519**	-
Total Exploration	**$ 16,814,245**	$ 6,436,789

Metals Division

For 2007 exploration expenses were $4.7 million as compared to exploration expenses of $6.4 million in 2006.

Exploration expenditures in Mongolia were reduced from $4.2 million for 2006 to $2.0 million in 2007 while the Company continued its evaluation of the potential projects and further drilling activity throughout 2007. During 2007 the majority of the expenses incurred in Mongolia were related to ongoing license fees and salaries. The two main projects in Mongolia during 2006 were Khongor and Naran Bulag.

In 2007 Bulgarian expenditures decreased substantially as compared to 2006 due to the withdrawal from the Bulgarian joint venture effective March 2, 2007.

In Indonesia exploration expenditures increased to $2.5 million in 2007 from $1.1 million in 2006 due to continued work on the Kaputusan prospect and some new smaller projects.

Included in the salary expense of $1.6 million for 2007 is $826,000 of stock based compensation expense compared to $322,000 in 2006.

Coal Division

The total coal exploration expenditures in 2007 were $12.2 million and included consulting-geological, drilling, license fees, office and salary and benefits. The Company incurred direct coal expenditures costs of $4.7 million for the three months ended December 31 2007; $4.3 million for the three months ended September 30, 2007 and $3.2 million for the three months ended June 30, 2007. This latter quarter was the first quarter that the coal division was operating subsequent to the completion of the coal transaction at the end of May 2007. Expenditures in 2008 will increase as the coal division assembles equipment, hires additional personnel and begins development activity at the Ovoot Tolgoi mine site.

With the completion of the coal transaction in the second quarter of 2007, certain interim coal division expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007, were added to the outstanding balance under the line of credit facility from Ivanhoe. The total interim coal expenditures of $13.2 million that were added to the indebtedness outstanding under the line of credit include approximately $13.0 million of expenses and $200,000 of plant and equipment.
Of the $13.0 million of interim coal expenditures for the period from April 25, 2006 to May 28, 2007, $3.0 million relates to geological consulting; $4.2 to drilling, assaying and camp costs, $2.5 million to license fees; $1.4 million to salaries and benefits; and $1.9 million to office, legal, and travel.

Included in the salary expense of $3.6 million for 2007 is $2.6 million of allocated stock based compensation expense. Total coal division exploration costs excluding the allocated stock based compensation expense is $9.6 million for the year ended December 31, 2007.

Ivanhoe began exploration on the Ovoot Tolgoi properties in late 2004. The program continued into 2005 and expanded throughout 2006 with emphasis on the South-East and West Fields. The exploration program and related activities used at Ovoot Tolgoi include field reconnaissance mapping, satellite imagery, surface-resistivity geophysical surveying, trenching, and drilling.

A new drilling program began on the Ovoot Tolgoi Project in June 2007. Mobilization of drills, crews and camps was started in May 2007. For the remainder of the year from June 2007 to December 2007 the Company has completed a combination of programs on Ovoot Tolgoi, Tavan

Tolgoi Extension and the Company's other coal exploration properties. Further exploration activities are scheduled for 2008.

LIQUIDITY AND CAPITAL RESOURCES

		December 31, 2007		December 31, 2006
ASSETS				
CURRENT				
Cash	**$**	**1,393,632**	$	965,494
Accounts receivable		**759,528**		215,783
Prepaid expenses		**1,890,177**		235,013
		4,043,337		1,416,290
MINERAL PROPERTIES		**443,360**		403,360
PLANT AND EQUIPMENT		**1,123,379**		232,585
	$	**5,610,076**	$	2,052,235
LIABILITIES				
CURRENT				
Accounts payable and accrued liabilities	**$**	**1,767,784**	$	451,540
AMOUNT DUE UNDER LINE OF CREDIT FACILITIES		**35,107,804**		5,835,501
		36,875,588		6,287,041
SHAREHOLDERS' DEFICIENCY				
Share capital				
Common shares		**20,625,287**		16,518,231
Preferred shares		**75,419**		-
Equity portion of line of credit facility		**3,055,359**		-
Contributed surplus		**7,333,146**		1,860,131
Deficit		**(62,354,723)**		(22,613,168)
		(31,265,512)		(4,234,806)
	$	**5,610,076**	$	2,052,235

CONTRACTUAL OBLIGATIONS (Expressed in thousands of U.S. dolars)	**Payments Due by**		
	Total	**Less than 1 year**	**> 1 year**
Line of Credit Facilities	$ 35,108	$ 35,108	$ -
Purchase Obligations	16,000	16,000	-
TOTAL CONTRACTUAL OBLIGATIONS	**$ 51,108**	**$ 51,108**	**$ -**

At December 31, 2007, the Company had cash resources of $1.4 million compared to $965,000 as at December 31, 2006. During the year, $15.5 million was drawn on the Ivanhoe line of credit facilities. These amounts plus $2.6 million received from the exercise of stock options provided financing for the Company's operations during the year ended December 31, 2007.

Subsequent to December 31, 2007 the Company completed a series of equity financing transactions.

On January 24, 2008 the Company announced the closing of an equity private placement of 10 million common shares at C$8.00 per share and a second equity private placement of 3.5 million common shares at C$9.00 per share to institutional investors, for total gross proceeds of C$111,500,000.

On February 18, 2008 Southgobi announced an additional equity private placement to institutional investors in Hong Kong of 711,111 of common shares at C$9.00 per share for proceeds of C$6.4 million.

The proceeds from these financings will be used for the initial development of the open-pit coal mine at the Company's Ovoot Tolgoi project, and for additional drilling and engineering focused on developing of the underground coal mine at the Ovoot Tolgoi site. Proceeds will also be used for investigating new projects and for general corporate and administrative purposes.

Accounts receivable includes funds due from government taxation authorities (GST or VAT). Prepaid balances have increased from $235,000 at December 31, 2006 to $1.9 million at December 31, 2007. The increase relates to the timing of prepayments for Mongolian exploration licenses, additional lease deposits and deposits for equipment and supplies for the Ovoot Tolgoi open-pit project. The coal division also has prepaid expenditures on insurance, design and building costs.

Accounts payable have also increased with the additional coal exploration activity.

The Company's investment in plant and equipment increased during 2007; with increases relating to mining software and equipment for project development, vehicles, camp equipment and office furniture.

In April 2006, in conjunction with the coal transaction, the Company obtained from Ivanhoe an unsecured line of credit of up to $10 million, which was subsequently increased to $15 million.

The outstanding loan was, under the terms of the First Funding Agreement, convertible into common shares at the election of either the Company or Ivanhoe. Until May 29, 2008, the Company had the right to require Ivanhoe to convert the outstanding loans into common shares at a conversion price of C$2.09 per share. Until August 29, 2008, Ivanhoe had the right to convert the outstanding loans into common shares at a conversion price of C$2.35 per share.

Coal expenditures incurred by Ivanhoe during the period from April 25, 2006 to May 28, 2007 were deemed to be advances under the line of credit facility. All amounts outstanding under the line of credit bore interest at the three month LIBOR plus two percent per annum.

The credit facility, with its conversion feature, is required to be presented as a compound instrument, with value ascribed to the holders' conversion option. The value of the conversion option is presented as equity and the residual carrying value of the line of credit facility is included in liabilities and is accreted to its face value over the term of the facility.

On October 25, 2007, Ivanhoe and SouthGobi entered into a second interim funding agreement (the “Second Funding Agreement”). The Second Funding Agreement provides for an additional, unsecured non-convertible line of credit to $32.5 million. One tranche of funding for $15 million can be used for general corporate purposes and the second tranche of $17.5 million is contingent upon Ivanhoe having drawn down funds under a credit agreement between Ivanhoe and Rio Tinto International Holdings Limited (“Rio Tinto”). Use of the proceeds from the second tranche is restricted to expenditures in respect of the Company’s activities in Mongolia.

All amounts advanced under the Second Funding Agreement bear interest at an annual rate equal to the three month LIBOR plus 3.30% per cent per annum and matures on June 30, 2009. The balance due under the Second Funding Agreement included accrued interest and was repaid on January, 18 2008 from proceeds of the equity financing.

Concurrent with the closing of the equity placements on January 24, 2008, Ivanhoe converted its preferred shares and convertible debt under the First Funding Agreement into common shares of the Company, and therefore the Company no longer has any debt outstanding

Ivanhoe currently owns 104,796,155 common shares representing approximately 81% of the issued and outstanding common shares of SouthGobi.

The Company is a development stage entity that has not achieved production on any of its mineral properties and, accordingly, does not have any revenues. The Company’s ability to continue as a going concern, with a capital deficiency, is dependant upon the discovery of economically recoverable resources, the ability of the Company to obtain the necessary financing and permitting to develop properties and to establish future profitable production. Management is of the opinion that additional financing is available to continue its planned activities in the normal course.

RELATED PARTY TRANSACTIONS

The coal transaction between Ivanhoe and the Company was a related party transaction. (See ‘Recent Developments’).

The Company is a party to a shareholders’ cost-sharing agreement with certain other public and private companies, including Ivanhoe (the “Other Companies”) pursuant to which the Company and the Other Companies are equal shareholders in GMM and, through GMM, share office space, furnishings and equipment and communications facilities (on a cost recovery basis) and the employment, on a part-time basis, of various administrative, office and management personnel in Vancouver, British Columbia. Costs of the shared office facilities and the shared part-time employees are recovered from the Company proportionate to the time spent by the shared part-time employees on matters pertaining to the Company. Certain of the directors and officers of the Company are also officers and directors of GMM. The Company has utilized the services of the GMM staff and office since September 1, 2003 and has incurred costs of $2.1 million and $1.1 million for the years ended December 31, 2007 and 2006, respectively.

All amounts outstanding under the line of credit facility, created pursuant to the First Funding Agreement with Ivanhoe bore interest at three month LIBOR plus two percent. All amounts advanced under the Second Funding Agreement bore interest at an annual rate equal to the three month LIBOR plus 3.30% per cent per annum and matures on June 30, 2009.

During the year ended December 31, 2007, $1.4 million of interest has been accrued on the line of credit facilities with Ivanhoe.

In July 2003, the Company and Ivanhoe entered into a coal rights retention agreement ("CRRA") whereby Ivanhoe retained the rights to any coal and coal-related products situated in, on or under the geographical boundaries of any of the 40 exploration licenses acquired prior to 2004. The CRRA does not apply to the licenses acquired by the Company after July 2003. The CRRA was terminated by operation of law upon the completion of the coal transaction.

OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value. As at March 18, 2008: 130,246,549 common shares were issued and outstanding and 4,377,304 share purchase options were outstanding. On a fully diluted basis, 134,623,853 common shares were outstanding.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that material information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to permit timely decisions regarding public disclosure.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on this evaluation as of December 31, 2007, the Chief Executive Officer and Chief Financial Officer has concluded that the Company's disclosure controls and procedures, as defined in Multilateral Instrument 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings ("52-109"), are effective to ensure that the information required to be disclosed in reports that are filed or submitted under Canadian Securities legislation are recorded, processed, summarized and reported within the time period specified in those rules.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Management is also responsible for the design of the Company's internal control over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the design of the Company's internal control over financial reporting. Based on this evaluation as of December 31, 2007, the Chief Executive Officer and Chief Financial Officer has concluded that the Company's internal control over financial reporting, as defined in 52-109, is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of the financial statements for the year ended December 31, 2007, in accordance with Canadian generally accepted accounting principles.

There has been no change in the Company's internal control over financial reporting that occurred during the most recently completed quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

RISK FACTORS

The business of mineral exploration and extraction involves a high degree of risk. Few properties that are explored are ultimately developed into production.

In addition to the other information included in this Management Discussion and Analysis, including the matters addressed under the heading "Forward-Looking Statements", an investor in the Company's Common Shares should carefully consider the following risks before making an investment decision.

The feasibility of mining at the Ovoot Tolgoi Project and the Tsagaan Tolgoi Project has not been established, which means work has not been completed to determine if it is commercially feasible to develop these properties.

The feasibility of mining at the Ovoot Tolgoi Project (at surface or underground) and the Tsagaan Tolgoi Project has not been, and may never be, established. Whether a mineral deposit will be commercially viable depends on a number of factors, some of which are: the particular attributes of the deposit, such as size, grade and proximity to infrastructure; commodity prices, which are highly cyclical; and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, importing and exporting of mineral resources and environmental protection. If the Company is unable to develop the Ovoot Tolgoi Project and the Tsagaan Tolgoi Project, it may never be able to generate revenues from operations.

The Company's prospects of obtaining an Investment Agreement with the Government of Mongolia are uncertain.

The Company may be unsuccessful in negotiating an Investment Agreement with the Government of Mongolia for the Ovoot Tolgoi Project or may only be able to obtain an agreement on terms that are adverse to the economic viability of the project. Although there is no legal requirement that the Company enter into an Investment Agreement with the Government of Mongolia before commencing development and mining operations at the Ovoot Tolgoi Project, the Company believes that entering into a mutually satisfactory Investment Agreement with the Government of Mongolia is key to the prospects for the project's long term success. The Minerals Law provides broad parameters and substantial negotiating latitude for an Investment Agreement, which makes the outcome of negotiations difficult to predict. A key issue will be whether or not the Government considers the Ovoot Tolgoi Project to be a "strategic deposit" and, if so, how much of an ownership interest in the project the Government will demand. The Company believes that the deposits that are the subject of the Ovoot Tolgoi Project were all discovered using private funds and that, if the project is considered to be a strategic deposit, the maximum ownership interest that the Government is entitled to acquire under the Minerals Law is 34%. However, the matter is not free from doubt and the Government could conceivably demand an ownership interest in the project of 50% or more.

Currently, the Mongolian Government has initiated a process to amend the existing Mineral Law. Until that process is complete and any proposed amendments are finalized, the impact, if any, of these provisions of the new Minerals Law on the Company's projects cannot be measured. Delays in obtaining, or a failure to obtain, a reasonable Investment Agreement from the Government of Mongolia could have a significant adverse impact on the development of the Ovoot Tolgoi Project and on the Company itself.

The Company's financial condition is subject to coal price and volume volatility.

The market price of the Company 's Common Shares, the Company's ability to raise financing and, if and when the Company commences commercial production, its financial condition will be directly related to the demand for, and price of, coal and coal-related products. Coal demand and price are determined by numerous factors beyond the control of the Company, including the international demand for steel and steel products, the availability of competitive coal supplies, international exchange rates, political and economic conditions, and production costs in major coal producing regions. In the past, there have been periods of oversupply of coal in the market, which has resulted in price decreases. An oversupply of coal in world markets or a general downturn in the economies of any significant markets for coal and coal-related products would have a material adverse effect on the Company's financial condition. the Company 's dependence on foreign markets may result in instability due to political and economic factors in those foreign jurisdictions which are beyond the control of the Company. The combined effects of any or all of these factors on coal price or volume are impossible for the Company to predict. If realized coal prices fall below the full cost of production of any of the Company 's future mining operations and remain at such a level for any sustained period, the Company could experience losses and may decide to discontinue operations. This could require the Company to incur closure and/or care and maintenance costs.

There are a number of risks associated with coal transportation.

If and when the Company commences commercial production of coal, it is anticipated that the majority of such coal production will be exported from Mongolia. Therefore, the Company's future mining operations are anticipated to be highly dependent on road and rail services. As a result, a significant portion of total transportation and other costs is expected to be attributable to road transportation and rail costs. Contractual disputes, road closures due to environmental degradation, rail capacity issues, prolonged labour stoppages, weather problems or other factors could seriously impact the Company 's ability to export its production which would likely have a material adverse effect on the Company's financial condition. Significant cost escalation for these transportation services could also reduce profitability, possibly increasing the full cost of production above realized coal prices. To the extent such increases are sustained, the Company could experience losses and may decide to discontinue operations. This could require the Company to incur closure and/or care and maintenance costs.

Increased industry demand has created a shortage of mining equipment.

The recent growth in global mining and mineral exploration activities has created a demand for mining equipment and related services that has outpaced supply. As a result, future operations could be adversely affected if the Company encounters difficulties obtaining access to equipment and services on a timely basis. In the event that the Company is unable to secure required mining equipment and services on a timely basis, exploration and development activities, production, productivity and costs could be negatively affected.

There are a number of risks associated with dependence on a limited number of customers.

The coal industry is characterized by a relatively small number of customers worldwide. The incremental cost of transporting coal products from the Ovoot Tolgoi Project over long distances effectively limits its potential customer base to a relatively proximate geographical area. Accordingly, if and when the Company commences commercial production of coal from the Ovoot Tolgoi Project, the loss of, or a significant reduction in, purchases by any of the limited number of potential customers could adversely affect the Company 's future revenue and the economic viability of the Ovoot Tolgoi Project.

Coal demand could be adversely affected by future changes to environmental laws aimed at reducing greenhouse gas emissions.

Mongolia and China have not introduced comprehensive regulations addressing greenhouse gas emissions, including emission targets for specific industrial sectors. Both Mongolia and China have ratified the Kyoto Protocol and have committed to limit their net greenhouse gas emissions. The primary source of greenhouse gas emissions in both Mongolia and China is the use of hydrocarbon energy. The operations of the Company will depend significantly on hydrocarbon energy sources to conduct daily operations, and there are currently no economic substitutes for these forms of energy. A significant proportion of China's industrial sector faces a similar situation. The Mongolian and Chinese governments have not finalized any formal regulatory programs to control greenhouse gases, and it is not yet possible to reasonably estimate the nature, extent, timing and cost of any programs contemplated or their potential effects on the operations of the Company. While sales are not expected to be significantly affected by Mongolia and China’s Kyoto ratification decisions, the broad adoption of emission limitations or other regulatory efforts to control greenhouse gas emissions might negatively affect in a materially adverse way the demand for coal as well as increase production and transportation costs.

The Ovoot Tolgoi Project and the Tsagaan Tolgoi Project lack basic infrastructure.

The Ovoot Tolgoi Project and the Tsagaan Tolgoi Project are both located in extremely remote areas which lack basic infrastructure, including sources of power, water, housing, food and transport. The Company will need to hire personnel, construct facilities and otherwise establish its own infrastructure before it can commence operations on its own. The Company will need to engage expatriate workers to come to Mongolia as there is a shortage of locally trained personnel. The Company will also need to establish the facilities and procure the materials necessary to support operations. Construction of a permanent man camp, administration and maintenance facilities are scheduled to start in the 2nd Qt. 2008. A temporary camp and shop have been constructed at the site and will service the project until construction of the permanent facilities is complete. An airport was built to facilitate crew rotations and supply requirements. Initially all coal will be transported by truck to China. Other coal transportation systems are being reviewed. The inability to make suitable arrangements may delay the conduct of the Company’s exploration and development programs and prevent the Company from meeting its stated business objectives. The remoteness of these properties will also affect the potential viability of mining operations, as the Company will also need to establish substantially greater sources of power, water, physical plant and transport infrastructure in the area before it can conduct mining. The availability of such sources may adversely affect mining feasibility and will, in any event, require the Company to arrange significant financing, locate adequate supplies and obtain necessary approvals from national, provincial and regional governments, none of which can be assured.

Information in this document regarding future plans reflects current intentions and is subject to change.

The Company describes its exploration and development plans and objectives in this Management Discussion and Analysis and in other public continuous disclosure filings it makes pursuant to applicable securities laws. Whether the Company ultimately implements these plans and achieves these objectives will depend on: the availability and cost of capital; current and projected coal prices; costs and availability of drilling rigs and other equipment, supplies and personnel; success or failure of activities in similar areas; and changes in estimates of project completion costs. The Company will continue to gather information about its projects, and it is possible that additional information will cause the Company to alter its schedule or determine that a project should not be pursued at all. Accordingly, the Company's plans and objectives might change from those described in this Management Discussion and Analysis and in its other public continuous disclosure filings.

There are a number of risks associated with resource estimates.

Resource estimates are forward-looking statements inherently subject to error. Although resource estimates require a high degree of assurance in the underlying data when the estimates are made, unforeseen events and uncontrollable factors can have significant adverse or positive impacts on the estimates. Actual results may differ from estimates based on unforeseen events and uncontrollable factors including, but are not limited to: geologic uncertainties such as inherent sample variability; commodity price fluctuations; variations in mining and processing parameters; and adverse changes in environmental or mining laws and regulations. The timing and effects of variances from estimated values cannot be accurately predicted.

The planned exploration, and, if warranted, development and mining activities on the Ovoot Tolgoi Project and the Tsagaan Tolgoi Project involve high degrees of risk typically associated with mining operations.

The Company's planned operations will be subject to all the hazards and risks normally encountered in the exploration, development and production of coal, including, without limitation, unusual and unexpected geologic formations, seismic activity, pit-wall failures, cave-ins, flooding and other conditions involved in the drilling and removal of material, any of which could result in damage to, or destruction of, mines and other producing facilities, personal injury or loss of life, damage to property, environmental damage and legal liability. Mining operations are subject to various hazards, including, without limitation, equipment failure, which may result in environmental pollution and legal liability. There are also physical risks to the exploration personnel working in the rugged terrain of Mongolia, often in poor climatic conditions.

The parameters used in estimating mining and processing efficiency are based on testing and experience with previous operations. While the parameters used have a reasonable basis, various unforeseen conditions can occur that may materially affect the estimates.

Previous mining operations may have caused environmental damage at certain of the Company's properties. It may be difficult or impossible to assess the extent to which such damage was caused by the Company or by the activities of previous operators, in which case liability for such damage may be disputed or uncertain.

The Company does not have experience in placing properties into production.

The Company has no experience in placing mineral properties into production, and its ability to do so will be dependent upon using the services of appropriately experienced personnel or entering into agreements with other major resource companies that can provide such expertise. There can be no assurance that the Company will have available to it the necessary expertise to take a mineral deposit into production. A group of senior experienced mining personnel have been hired and are working on the project. To date project development is proceeding and expected to meet the development schedule.

The Company's prospects depend on its ability to attract and retain key personnel.

Recruiting and retaining qualified personnel is critical to the Company's success. The number of persons skilled in the acquisition, exploration and development of mining properties is limited and competition within the mining industry for such persons is intense. The Company believes that it has been successful in recruiting the key personnel necessary to meet its corporate objectives but, as the Company's business activity grows, it will require additional key financial, administrative, mining, marketing and public relations personnel as well as additional operations staff. Although the Company believes that it will be successful in attracting and retaining qualified personnel, there can be no assurance of such success.

Foreign currency fluctuations could affect expenses and any future earnings.

The Company carries out exploration activities in Mongolia that render it subject to foreign currency fluctuations. While the Company minimizes the risks associated with foreign currency fluctuations by holding essentially all of its cash and short-term investments in U.S. and Canadian dollars rather than the local currency, to the extent that its operations in Mongolia are carried out using the local currency, any appreciation of such local currency relative to the U.S. and Canadian dollar could have an adverse impact on the Company's financial position. Since the Company's financial results are reported in U.S. dollars, its financial position and results are also impacted by exchange rate fluctuations between the Canadian and U.S. dollars. Furthermore, if and when the Company begins production, it will likely sell its coal into China using Chinese currency. This will give rise to foreign exchange currency exposure, both favourable and unfavourable, which may materially impact the financial condition of the Company.

Legislation in developing countries such as Mongolia can be difficult to interpret and contrary interpretations by government bureaucrats and civil servants may have adverse consequences for business structures or arrangements regarded as novel.

The Mongolian legal system shares several of the qualitative characteristics typically found in a developing country and a burgeoning democracy insofar as many of its laws, particularly with respect to matters of taxation, tend to be basic and have not evolved to a point where they contemplate or recognize more sophisticated transactions and business structures involving relatively well-established Western legal concepts such as joint ventures and beneficial, as opposed to legal, ownership of assets. Likewise, the Mongolian government bureaucrats and civil servants who administer these laws often lack any significant degree of experience in assessing these types of transactions such that a transaction or business structure that would likely be regarded under a

Western legal system as appropriate and relatively straightforward is just as likely to be regarded by Mongolian government bureaucrats and civil servants as novel and without precedent and therefore outside the scope of Mongolian law. As a result, structuring business arrangements with third parties and engaging in tax planning within the limited ambit of settled Mongolian law carries significant risks, particularly when business objectives and practicalities dictate the use of arrangements and structures that, while not necessarily contrary to settled Mongolian law, are sufficiently novel within a Mongolian legal context, that it is impossible to determine with any degree of certainty that they will not be impugned after the fact by Mongolian government bureaucrats and civil servants who, because of their unfamiliarity with the arrangement or structure, may be inclined to "make" the law address the particular arrangement or structure in a manner that would be regarded, in a Western legal context, as arbitrary and unfair and that would be materially adverse to the parties to the arrangement or structure.

Amendments to legislation could adversely affect the Company's mining rights in its projects or make it more difficult or expensive to develop its projects and carry out mining.

In 2006, the Government of Mongolia enacted a new Minerals Law. The new Minerals Law largely preserves the substance of the former 1997 minerals legislation, which was drafted with the assistance of Western legal experts and was widely regarded as progressive, internally consistent and effective legislation. However, the new Minerals Law also contains new provisions that could increase the potential for political interference and potentially weaken the rights and security of title of holders of mineral tenures in Mongolia. Certain provisions of the new Minerals Law are ambiguous and it is unclear how they will be interpreted and applied in practice. Currently, the Mongolian Government has initiated a process to amend the existing Mineral Law. Until that process is complete and any proposed amendments are finalized, the impact, if any, of these provisions of the new Minerals Law on the Company's projects cannot be measured.

There can also be no assurance that income tax laws, royalty regulation and government incentive programs relating to the mining industry in Mongolia will not be changed in a manner which adversely affects the Company or that income tax laws, royalty regulations and government incentive programs relating to the mining industry in other producing countries will not change to favour the Company's competitors leading to reduced international coal prices and demand for coal products that the Company intends to produce.

The Company's ability to carry on business in Mongolia is subject to political risk.

The Company's ability to efficiently conduct its exploration and development activities is subject to changes in legislation or government regulations or shifts in political attitudes within Mongolia that are beyond the Company's control. Government policy may change to discourage foreign investment, nationalization of mining industries may occur or other government limitations, restrictions or requirements not currently foreseen may be implemented. There can be no assurance that the Company's assets will not be subject to nationalization, requisition or confiscation, whether legitimate or not, by any authority or body.
There is no assurance that provisions under Mongolian law for compensation and reimbursement of losses to investors under such circumstances would be effective to restore the value of the Company's original investment. Similarly, the Company's operations may be affected in varying degrees by government regulations with respect to restrictions on production, price controls, export controls, income taxes, environmental legislation, mine safety and annual fees to maintain mineral licenses in good standing. There can be no assurance that Mongolian laws protecting foreign

investments will not be amended or abolished or that existing laws will be enforced or interpreted to provide adequate protection against any or all of the risks described above.

There are title risks with respect to the Company's property interests.

The acquisition of title to resource properties or interests therein is a very detailed and time-consuming process. Title to and the area of resource concessions may be disputed. There is no guarantee of title to any of the Company's properties. The properties may be subject to prior unregistered agreements or transfers and title may be affected by undetected defects. Title may be based upon interpretations of law which may be ambiguous, inconsistently applied and subject to reinterpretation or change. The Company has not surveyed the boundaries of any of its mineral properties and consequently the boundaries of the properties may be disputed.

Licenses and permits are subject to renewal and various uncertainties.

The Company's MELs are subject to periodic renewal. While the Company anticipates that renewals will be given as and when sought, there is no assurance that such renewals will be given as a matter of course and there is no assurance that new conditions will not be imposed in connection therewith. The Company's business objectives may also be impeded by the costs of holding its MELs. License fees in Mongolia for MELs increase substantially upon renewal. The Company will need to continually assess the mineral potential of each MEL, particularly when it must be renewed, to determine if the costs of maintaining the MEL are justified by the exploration results to date, and will likely elect to let some of its MELs lapse. A moratorium on transfers of MELs was recently lifted and there is a risk that it could be re-imposed. The Company will require mining licenses in order to conduct mining operations at the Ovoot Tolgoi Project and the Tsagaan Tolgoi Project and there can be no assurance that such licenses will be obtained on terms favourable to the Company or at all. At present all required mining licenses are held by the Company, although the Company is still awaiting receipt of its Permit to Mine which it expects to receive in the first half of 2008.

The Company does not insure against all risks which it may be subject to in planned operations.

No assurance can be given that insurance to cover the risks to which the Company's activities are subject will be available at all or at commercially reasonable premiums. Exploration, development and production operations on mineral properties involve numerous risks, including unexpected or unusual geological operating conditions, rock bursts or slides, fires, floods, earthquakes or other environmental occurrences, and political and social instability. It is not always possible to obtain insurance against all such risks and the Company may decide not to insure against certain risks as a result of high premiums or for other reasons. Should such liabilities arise, they could reduce or eliminate the Company's actual or prospective profitability and result in increasing costs and a decline in the value of the securities of the Company. The Company does not maintain insurance against political or environmental risks. The impact of any uninsured liabilities would likely have a material adverse effect on the financial position of the Company.

Competition can hinder the Company's exploration and development plans.

Significant and increasing competition exists for mineral deposits in Mongolia. As a result of this competition, much of which is with large established mining companies with substantially greater financial and technical resources than the Company, the Company may be unable to acquire additional attractive mining claims or financing on terms it considers acceptable. The Company also competes with other mining companies in the recruitment and retention of qualified employees and consultants.

Complying with environmental and regulatory requirements can be costly.

the Company's operations are subject to environmental regulations in the various jurisdictions in which it operates. Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations.

Government approvals and permits are required in connection with the Company's operations. To the extent such approvals are required and not obtained, the Company may be delayed or prohibited from proceeding with planned exploration or development of its mineral properties. Failure to comply with applicable laws, regulations and permitting requirements may result in enforcement actions thereunder, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in mining operations may be required to compensate those suffering loss or damage by reason of the mining activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

Amendments to current laws, regulations and permits governing operations and activities of mining companies, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in capital expenditures or production costs or reductions in levels of production at producing properties or require abandonment or delays in development of new mining properties.

There can be no assurance that the Company will be capable of raising the additional funding that it needs to carry out its development and exploration objectives.

The further development and exploration of the Ovoot Tolgoi Project, the Tsagaan Tolgoi Project and the various other mineral properties in which the Company holds interests depends upon its ability to obtain financing through capital markets, or other means. To date, the Company has relied upon Ivanhoe to provide funding by way of a line of credit facility. Among the funding alternatives being considered is additional funding by Ivanhoe, although there is no assurance that the Company will be successful in obtaining financing as and when needed. Unfavourable market conditions may make it difficult or impossible for the Company to obtain debt financing or equity financing on acceptable terms or at all. the Company operates in a region of the world that has a tendency to be politically and economically unstable, which may make it more difficult for the Company to obtain debt financing from project lenders. the Company must arrange additional financing for development of the Ovoot Tolgoi Project and the Tsagaan Tolgoi Project. The January 2008 private placements raised sufficient funds to accommodate SouthGobi's 2008 exploration and development plans. Failure to obtain additional financing on a timely basis may cause the Company to postpone its development plans, forfeit rights in some or all of its properties or joint ventures or reduce or terminate some or all of its operations.

Certain directors of the Company are directors or officers of, or have significant shareholdings, in other mineral resource companies and there is the potential that such directors will encounter conflicts of interest with the Company.

Certain of the directors of the Company are directors or officers of, or have significant shareholdings in, other mineral resource companies and, to the extent that such other companies may participate in ventures in which the Company may participate, the directors of the Company may have a conflict of interest in negotiating and concluding terms respecting the extent of such participation. Such other companies may also compete with the Company for the acquisition of mineral property rights. In the event that any such conflict of interest arises, a director who has such a conflict will disclose the conflict to a meeting of the directors of the Company and will abstain from voting for or against the approval of such participation or such terms. In appropriate cases, the Company will establish a special committee of independent directors to review a matter in which several directors, or management, may have a conflict. From time to time, several companies may participate in the acquisition, exploration and development of natural resource properties thereby allowing their participation in larger programs, permitting involvement in a greater number of programs and reducing financial exposure in respect of any one program. It may also occur that a particular company will assign all or a portion of its interest in a particular program to another of these companies due to the financial position of the company making the assignment. In accordance with the laws of Canada, the directors of the Company are required to act honestly, in good faith and in the best interests of the Company. In determining whether or not the Company will participate in a particular program and the interest therein to be acquired by it, the directors will primarily consider the potential benefits to the Company, the degree of risk to which the Company may be exposed and its financial position at that time.

The Company's share ownership is highly concentrated.

Ivanhoe holds approximately 81% of the Company's issued and outstanding Common Shares. Other than in respect of transactions in which Ivanhoe has an interest that is different from the interests of other the Company shareholders such that applicable securities laws would require approval by the Company's minority shareholders, Ivanhoe can control the outcome of any corporate transaction or other matter submitted to the Company's shareholders for approval, including a merger or the sale of all or substantially all of the Company's assets, and also can prevent or cause a change in control. The interests of Ivanhoe may conflict with the interests of the Company's other shareholders. In addition, third parties may be discouraged from making a tender offer or bid to acquire the Company because of this concentration of ownership.

OUTLOOK

In 2007 SouthGobi completed a major exploration program on six separate coal projects in the Gobi area of southern Mongolia. Along with the infill drilling at the Ovoot Tolgoi surface site, the exploration program continued at Ovoot Tolgoi underground, Ovoot Tolgoi extension, Tavan Tolgoi extension, Tsagaan Tolgoi extension and Greenfields sites. Tsagaan Tolgoi, Ovoot Tolgoi (Open Pit) and Ovoot Tolgoi (Underground) now have NI 43-101 resource estimates.

For 2008, SouthGobi is continuing its coal exploration program in the Gobi area of southern Mongolia. The 2008 program is dedicated to further delineating the surface reserves and confirming the underground coal resource and the potential for the development of an underground mining operation at Ovoot Tolgoi.

The Company will also continue its exploration efforts on identification and drilling of prospective copper-gold targets on its exploration licenses in Mongolia and Indonesia, and identification and acquisition of new mineral property exploration opportunities.

The 30 year Ovoot Tolgoi Mining License dated September 20, 2007, was received on October 1, 2007. In order to commence mining operations at Ovoot Tolgoi, SouthGobi needs to obtain a Permit to Mine. In order to obtain a Permit to Mine, the Company submitted for review by governmental authorities in Mongolia a Technical and Economical Report (comparable to a scoping level study) and a first year mine plan.

The Company expects to receive its Permit to Mine in the first half of 2008. Mining equipment that was ordered in early November 2007 is now being commissioned on the site. Permanent site facilities have been designed and construction will start in 2008 once weather permits. The Company has established a schedule for the development of commercial operations on the Ovoot Tolgoi Project. Pre development work and training has commenced with production anticipated in the latter part of 2008.

The proceeds from the current equity financings will be used for the initial development of the open-pit coal mine at the Company's Ovoot Tolgoi project, and for additional drilling and engineering focused on developing of the underground coal mine at the Ovoot Tolgoi site. Proceeds will also be used for investigating new projects and for general corporate and administrative purposes.

Management will focus its efforts on developing metallurgical and thermal coal deposits in the South Gobi region of Mongolia. As well, the Company will continue on the fundamentals of discovering and developing economic ore bodies in Mongolia and Indonesia.

The Company has initiated an internal strategic review of the metals division to identify the most effective means of optimizing value for the shareholders. This review will encompass the evaluation of available options, including reorganizing the metals division into a separate company.

The Company will focus its efforts on expanding and developing the coal assets acquired pursuant to the coal transaction. This will provide the Company with property interests which have the potential for near term development and cash flows, particularly the more advanced project at Ovoot Tolgoi.

March 28, 2008