



SouthGobi
Energy Resources

CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

(Stated in U.S. Dollars)

(Unaudited)

SOUTHGOBI ENERGY RESOURCES LTD.

Consolidated Balance Sheets

(Unaudited)

(Stated in U.S. dollars)

| | March 31, 2008 | December 31, 2007 |
|---|-----------------------|----------------------|
| ASSETS | | |
| CURRENT | | |
| Cash and cash equivalents | \$ 85,318,299 | \$ 1,393,632 |
| Accounts receivable | 2,248,949 | 759,528 |
| Prepaid expenses | 2,942,044 | 1,890,177 |
| | 90,509,292 | 4,043,337 |
| DEFERRED CHARGES | 985,607 | - |
| MINERAL PROPERTIES (Note 3) | 699,360 | 443,360 |
| PLANT AND EQUIPMENT (Note 4) | 14,322,483 | 1,123,379 |
| | \$ 106,516,742 | \$ 5,610,076 |
| LIABILITIES | | |
| CURRENT | | |
| Accounts payable and accrued liabilities | \$ 1,876,890 | \$ 1,767,784 |
| ASSET RETIREMENT OBLIGATIONS (Note 5) | 256,000 | - |
| AMOUNT DUE UNDER LINE OF CREDIT FACILITY (Note 6) | - | 35,107,804 |
| | 2,132,890 | 36,875,588 |
| SHAREHOLDERS' EQUITY (DEFICIENCY) | | |
| Share capital (Note 7) | | |
| Common shares | 167,560,783 | 20,625,287 |
| Preferred shares | - | 75,419 |
| Equity portion of line of credit facility | - | 3,055,359 |
| Contributed surplus | 7,716,377 | 7,333,146 |
| Deficit | (70,893,308) | (62,354,723) |
| | 104,383,852 | (31,265,512) |
| | \$ 106,516,742 | \$ 5,610,076 |

SUBSEQUENT EVENTS (Note 13)

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

APPROVED BY THE BOARD:

Director

Director

SOUTHGOBI ENERGY RESOURCES LTD.

Consolidated Statements of Operations

Three Months Ended March 31, 2008 and 2007

(Unaudited)

(Stated in U.S. dollars)

| | 2008 | 2007 |
|---|---------------------|---------------------|
| EXPENSES | | |
| Depreciation | \$ 35,898 | \$ 5,908 |
| Exploration (Note 9 (b)) (Schedule) | 7,608,798 | 867,016 |
| Legal | 201,030 | 13,398 |
| Office and administration | 259,246 | 175,171 |
| Professional fees | 124,936 | 32,277 |
| Salaries and benefits (Note 9 (b)) | 814,581 | 338,657 |
| Travel | 70,631 | 61,937 |
| | 9,115,120 | 1,494,364 |
| OTHER (INCOME)/EXPENSES | | |
| Interest income | (528,257) | (6,760) |
| Interest expense (Note 6) | 148,187 | 121,765 |
| Interest accretion on line of credit facility (Note 6) | 279,048 | - |
| Foreign exchange (gain) loss | (475,513) | 5,343 |
| Write off of interest in joint venture | - | 35,009 |
| | (576,535) | 155,357 |
| NET LOSS AND COMPREHENSIVE LOSS | \$ 8,538,585 | \$ 1,649,721 |
| BASIC AND DILUTED LOSS PER SHARE | \$ (0.10) | \$ (0.10) |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC AND DILUTED | 85,169,263 | 16,807,785 |

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

SOUTHGOBI ENERGY RESOURCES LTD.
Consolidated Statements of Shareholders' Equity (Deficiency)
(Unaudited)
(Stated in U.S. dollars)

| | Share Capital | | | | Equity Portion of Convertible Line of Credit | Contributed Surplus | Deficit | Total |
|--|---------------------|----------------|---------------------|----------|--|------------------------|-----------------|----------------|
| | Common Shares | | Preferred Shares | | | | | |
| | Number of Shares | Amount | Number of Shares | Amount | | | | |
| Balances, December 31, 2006 | 16,784,031 | \$ 16,518,231 | - | \$ - | \$ - | \$ 1,860,131 | \$ (22,613,168) | \$ (4,234,806) |
| Shares issued for: | | | | | | | | |
| Coal transaction | 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 | - | - | - | - | - | - | (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) |
| Shares issued for: | | | | | | | | |
| Cash, net of issue costs | 14,211,111 | 111,613,073 | - | - | - | - | - | 111,613,073 |
| Conversion of preferred shares | 25,576,383 | 75,419 | (25,576,383) | (75,419) | - | - | - | - |
| Conversion of line of credit | 14,709,071 | 32,498,927 | - | - | (3,055,359) | - | - | 29,443,568 |
| Exercise of stock options | 817,327 | 2,748,077 | - | - | - | (716,783) | - | 2,031,294 |
| Stock-based compensation charged to operations | - | - | - | - | - | 1,100,014 | - | 1,100,014 |
| Net loss and comprehensive loss | - | - | - | - | - | - | (8,538,585) | (8,538,585) |
| Balances, March 31, 2008 | 130,246,549 | \$ 167,560,783 | - | \$ - | \$ - | \$ 7,716,377 | \$ (70,893,308) | \$ 104,383,852 |

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

SOUTHGOBI ENERGY RESOURCES LTD.

Consolidated Statements of Cash Flows

Three Months Ended March 31, 2008 and 2007

(Unaudited)

(Stated in U.S. dollars)

| | 2008 | 2007 |
|--|----------------------|---------------------|
| OPERATING ACTIVITIES | | |
| Net loss | \$ (8,538,585) | \$ (1,649,721) |
| Items not requiring use of cash | | |
| Depreciation | 96,282 | 20,378 |
| Stock-based compensation | 1,100,014 | 167,340 |
| Accrued interest expense | - | 121,765 |
| Interest accretion on line of credit facility | 279,048 | - |
| Interest expense on conversion of line of credit | 108,176 | - |
| Unrealized foreign exchange (gain) loss | (453,328) | 5,262 |
| Write off of interest in joint venture | - | 31,141 |
| Loss on disposal of capital assets | 3,004 | - |
| Changes in non-cash working capital items (Note 12(a)) | (2,445,559) | (112,636) |
| | (9,850,948) | (1,416,471) |
| INVESTING ACTIVITIES | | |
| Expenditures on plant and equipment | (13,298,390) | (9,945) |
| Increase to deferred charges | (985,607) | - |
| Proceeds from disposal of plant and equipment | - | 25,000 |
| | (14,283,997) | 15,055 |
| FINANCING ACTIVITIES | | |
| Share capital issued, net of issue costs | 113,644,367 | 124,875 |
| Increase in line of credit facility | 2,000,000 | 2,000,000 |
| Repayment of line of credit facility | (8,077,470) | - |
| | 107,566,897 | 2,124,875 |
| EFFECT OF FOREIGN EXCHANGE RATE | | |
| CHANGES ON CASH | 492,715 | (6,491) |
| INCREASE IN CASH | 83,924,667 | 716,968 |
| CASH AND CASH EQUIVALENTS, | | |
| AT BEGINNING OF PERIOD | 1,393,632 | 965,494 |
| CASH AND CASH EQUIVALENTS, | | |
| AT END OF PERIOD | \$ 85,318,299 | \$ 1,682,462 |
| SUPPLEMENTAL CASH FLOW INFORMATION (Note 12(b)) | | |

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

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

1. NATURE OF OPERATIONS

These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). However, they do not include all the information and disclosures required by Canadian GAAP for annual financial statements. They have been prepared using the same accounting policies and methods of application as the latest annual consolidated financial statements. In the opinion of management, all adjustments of a normal recurring nature necessary for a fair presentation have been included. The results for interim periods are not necessarily indicative of results for the entire year. The information contained in the interim financial statements should be read in conjunction with the Company’s latest audited consolidated financial statements for the year ended December 31, 2007.

SouthGobi Energy Resources Ltd, (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, is dependent upon the confirmation of economically recoverable reserves, the ability of the Company to obtain further 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.

2. CHANGE IN ACCOUNTING POLICIES

On January 1, 2008, the Company adopted the following provisions of the Canadian Institute of Chartered Accountants (“CICA”) Handbook. There was no material impact on the Company’s financial condition or operating results, as a result of the adoption of these new standards:

- (a) Section 3862 – Financial Instruments – Disclosures, which replaces Section 3861 and provides expanded disclosure requirements that provide additional information by financial asset and liability categories.
- (b) 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.
- (c) Section 3031 – Inventories, which establishes standards for the measurement and disclosure of inventories. It provides the Canadian equivalent to International Accounting Standard IAS 2 – Inventories. The company’s current practice for valuing inventory is substantially in accordance with the new standard and therefore the financial results of the Company are not expected to be materially affected by the new standard.

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

2. CHANGE IN ACCOUNTING POLICIES (Continued)

(d) Section 1535 – Capital Disclosures, which establishes standards for disclosing information about an entity’s capital and how it is managed. Under this standard, the Company is 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; and
- when the Company has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

(e) 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.

3. MINERAL PROPERTIES

Mineral properties at March 31, 2008:

| | March 31, 2008 | December 31, 2007 |
|--|---------------------------|------------------------------|
| | <hr/> | <hr/> |
| Mineral properties | \$ 443,360 | \$ 443,360 |
| Asset retirement obligation costs (Note 5) | 256,000 | - |
| | <hr/> | <hr/> |
| | \$ 699,360 | \$ 443,360 |

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

4. PLANT AND EQUIPMENT

| | March 31, 2008 | | |
|--------------------------|---------------------------|-------------------------------------|---------------------------|
| | <u>Cost</u> | <u>Accumulated Depreciation</u> | <u>Net Book Value</u> |
| Plant and equipment | \$ 13,003,511 | \$ 91,090 | \$ 12,912,421 |
| Office equipment | 697,066 | 272,510 | 424,556 |
| Construction in progress | 985,506 | - | 985,506 |
| | <u>\$ 14,686,083</u> | <u>\$ 363,600</u> | <u>\$ 14,322,483</u> |

| | December 31, 2007 | | |
|--------------------------|------------------------------|-------------------------------------|---------------------------|
| | <u>Cost</u> | <u>Accumulated Depreciation</u> | <u>Net Book Value</u> |
| Plant and equipment | \$ 505,576 | \$ 46,980 | \$ 458,596 |
| Office equipment | 502,311 | 222,163 | 280,148 |
| Construction in progress | 384,635 | - | 384,635 |
| | <u>\$ 1,392,522</u> | <u>\$ 269,143</u> | <u>\$ 1,123,379</u> |

5. ASSET RETIREMENT OBLIGATION

Reclamation and closure costs have been estimated based on the Company's interpretation of current regulatory requirements and have been measured at fair value. Fair value is determined based on the net present value of future cash expenditures upon reclamation and closure. Reclamation and closure costs are capitalized as mine development costs and amortized over the life of the mine.

SOUTHGOBI ENERGY RESOURCES LTD.

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(Stated in U.S. Dollars)

5. ASSET RETIREMENT OBLIGATION (Continued)

The asset retirement obligations relate to reclamation and closure costs relating to the Company's mine operations at the Ovoot Tolgoi Mine. The asset retirement obligations are calculated as the net present value of estimated future net cash flows of the reclamation and closure costs, which total \$1,023,941 and are required to satisfy the obligations, discounted using a credit adjusted risk-free rate of 8%. The settlement of the obligations will occur through to 2025.

The following is an analysis of the asset retirement obligation.

| | |
|---|--------------------|
| Additions to future costs for the quarter | \$ 256,000 |
| Accretion incurred in the current quarter | <u> -</u> |
| Balance at March 31, 2008 | \$ 256,000 |

6. AMOUNTS DUE UNDER LINE OF CREDIT FACILITY

In April 2006 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, excluding interest and the interim coal expenditures. In May 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 First Funding Agreement became 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 amounts under the First Funding Agreement 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 amounts under the First Funding Agreement into common shares at a conversion price of C\$2.35 per share.

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.

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(Unaudited)

(Stated in U.S. Dollars)

6. AMOUNTS DUE UNDER LINE OF CREDIT FACILITY (Continued)

In October 2007, Ivanhoe and the Company entered into a second interim funding agreement (the "Second Funding Agreement"). The Second Funding Agreement provided for an additional unsecured non-convertible line of credit facility of up to \$32.5 million

On January 18, 2008, funds in the amount of \$8,077,470 were paid to Ivanhoe representing repayment in full of the principal of \$8.0 million and accrued interest of \$77,470 owing on the Second Funding Agreement. The Second Funding Agreement was then terminated.

7. 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 | 130,246,549 (2007 – 74,932,657) common shares |
| | Nil (2007 – 25,576,383) preferred shares |

Share issuances

During the three months ended March 31, 2008, the Company:

1. Issued 10,000,000 common shares at C\$8.00 per share for gross proceeds of C\$80,000,000 (\$77,775,618) by way of private placement
2. Issued 3,500,000 common shares at C\$9.00 per share for gross proceeds of C\$31,500,000 (\$30,597,377) by way of private placement
3. Issued 711,111 common shares at C\$9.00 per share for gross proceeds of C\$6,400,000 (6,484,296) by way of private placement.

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

7. SHARE CAPITAL (Continued)

The Company paid finder's fees totaling C\$3,024,000 in connection with the three financings.

All the preferred shares were converted into 25,576,383 common shares on a one-for-one basis (Note 6). Additionally, debt due under the line of credit facility in the amount of \$29,982,631 was converted into 14,709,071 common shares of the Company.

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

During the three months ended March 31, 2008 the Company granted 653,000 stock options to certain officers and employees at prices ranging from \$7.16 to \$13.32 with expiry dates ranging from January 7, 2013 to March 31, 2013.

The Company accounts for stock options granted using the fair value based method of accounting for stock-based compensation. The weighted average fair value of the options issued was estimated at \$5.67(CDN \$5.80) per option at the grant date using the Black-Scholes option pricing model. The weighted average assumptions used for the calculation were:

| | <u>2008</u> | <u>2007</u> |
|-----------------------------|----------------|-------------|
| Risk free interest rate | 3.01% | 4.03% |
| Expected life | 3 years | 5 years |
| Expected volatility | 73% | 95% |
| Expected dividend per share | \$Nil | \$Nil |

A compensation cost of \$3,703,902 for the options granted in the three months ended March 31, 2008 will be amortized over the vesting period, of which \$169,806 was recognized in the three month period ended March 31, 2008.

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

7. SHARE CAPITAL (Continued)

The Company changed from the straight line method of calculating vested options to the graded vesting method. The graded vesting method results in front-end loaded vesting compared to the straight line method which allocates vesting equally over the vesting period. It is not practical to determine the impact of the change in methods on periods subsequent to the change in the methods as the calculation may be significantly impacted by changes in the Company's share price and therefore the disclosure would not be meaningful.

The total stock-based compensation calculated in the three month period ended March 31, 2008 was \$1,100,014 (2007 - \$167,340). Stock-based compensation of \$578,443 (2007 - \$57,800) has been allocated to exploration expense-salaries and \$521,571 (2007 - \$109,540) has been allocated to salaries and benefits.

(c) *Outstanding stock options*

As at March 31, 2008, there were 4,830,304 stock options outstanding with exercise prices and expiry dates ranging from (CDN \$0.70 to CDN \$13.32) and November 28, 2008 to March 31, 2013, respectively. At March 31, 2008, there were 2,129,750 exercisable options outstanding.

8. 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 80% of the outstanding common shares of the Company.

| | Three Months Ended | |
|---------------------------|---------------------------|-----------------------|
| | March 31, 2008 | March 31, 2007 |
| Office and administrative | \$ 159,655 | \$ 122,535 |
| Salaries and benefits | 356,395 | 219,317 |
| Interest | 413,235 | 121,765 |
| | \$ 929,285 | \$ 463,617 |

During 2008, the amounts due under the line of credit facility were fully settled (Note 6).

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

8. RELATED PARTY TRANSACTIONS (Continued)

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

| | <u>March 31,</u> <u>2008</u> | <u>December 31,</u> <u>2007</u> |
|---|---------------------------------|------------------------------------|
| Amounts due for administration to Global Mining Management, a company related by way of directors and officers in common | \$ 202,417 | \$ 211,045 |
| Accounts payable to Ivanhoe | 28,212 | 52,045 |

9. SEGMENT DISCLOSURES

(a) *Operating Segments*

The Company had two primary operating segments at the end of March 31, 2008, 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.

| | <u>Coal</u> <u>Division</u> | <u>Metals</u> <u>Division</u> | <u>Corporate</u> <u>Division</u> | <u>Total</u> |
|---|--------------------------------|----------------------------------|-------------------------------------|---------------|
| March 31, 2008 | | | | |
| Mineral properties, plant and equipment | \$ 14,403,348 | \$ 548,342 | \$ 70,153 | \$ 15,021,843 |
| Total assets | 20,427,160 | 837,041 | 85,252,541 | 106,516,742 |
| Capital expenditures | 13,297,203 | 1,187 | - | 13,298,390 |
| December 31, 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 |

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

Three Months Ended March 31, 2008 and 2007

(Unaudited)

(Stated in U.S. dollars)

9. SEGMENT DISCLOSURES (Continued)

| | METALS | | COAL | | CORPORATE | | TOTAL | |
|---|---------------------|-------------------|---------------------|-------------|-------------------|-------------------|---------------------|---------------------|
| | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 | 2008 | 2007 |
| EXPENSES | | | | | | | | |
| Depreciation | \$ - | \$ - | \$ - | \$ - | \$ 35,898 | \$ 5,908 | \$ 35,898 | \$ 5,908 |
| Exploration | 1,302,662 | 867,016 | 6,306,136 | - | - | - | 7,608,798 | 867,016 |
| Legal | - | - | - | - | 201,030 | 13,398 | 201,030 | 13,398 |
| Office and administration | - | - | - | - | 259,246 | 175,171 | 259,246 | 175,171 |
| Professional fees | - | - | - | - | 124,936 | 32,277 | 124,936 | 32,277 |
| Salaries and benefits | - | - | - | - | 814,581 | 338,657 | 814,581 | 338,657 |
| Travel | - | - | - | - | 70,631 | 61,937 | 70,631 | 61,937 |
| | 1,302,662 | 867,016 | 6,306,136 | - | 1,506,322 | 627,348 | 9,115,120 | 1,494,364 |
| OTHER EXPENSES/(INCOME) | | | | | | | | |
| Interest income | - | - | - | - | (528,257) | (6,760) | (528,257) | (6,760) |
| Interest expense | - | - | - | - | 148,187 | 121,765 | 148,187 | 121,765 |
| Interest accretion on line of credit facility | - | - | - | - | 279,048 | - | 279,048 | - |
| Foreign exchange (gain) loss | - | - | - | - | (475,513) | 5,343 | (475,513) | 5,343 |
| Write off of interest in joint venture | - | - | - | - | - | 35,009 | - | 35,009 |
| | - | - | - | - | (576,535) | 155,357 | (576,535) | 155,357 |
| NET LOSS AND COMPREHENSIVE LOSS | \$ 1,302,662 | \$ 867,016 | \$ 6,306,136 | \$ - | \$ 929,787 | \$ 782,705 | \$ 8,538,585 | \$ 1,649,721 |

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

9. SEGMENT DISCLOSURES (Continued)

(b) Geographic Segments

At March 31, 2008, the Company operated in Mongolia, Canada and Indonesia. In March 2007 the Company terminated its mineral exploration activities in Bulgaria.

| March 31, 2008 | <u>Mongolia</u> | <u>Canada</u> | <u>Indonesia</u> | <u>Total</u> |
|---|-----------------|---------------|------------------|----------------|
| Mineral properties, plant and equipment | \$ 14,455,084 | \$ 513,513 | \$ 53,246 | \$ 15,021,843 |
| Total assets | 20,491,076 | 85,766,054 | 259,612 | \$ 106,516,742 |
| December 31, 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 |

10. FINANCIAL INSTRUMENTS

The fair values of the Company's cash and cash equivalents, accounts receivable, and accounts payable approximate their carrying values. The fair values of the amounts due under line of credit facility, by their nature, are not readily determinable.

The Company's financial instruments are exposed to certain financial risks, including market risk with respect to currency risk, interest risk, credit risk, liquidity risk, and commodity price risk.

(a) Currency risk

The Company is exposed to the financial risk related to the fluctuation of foreign exchange rates. The Company operates in Mongolia, Indonesia and Canada and its functional currency is the U.S. dollar. A significant change in the currency exchange rates between the Canadian dollar relative to the U.S. dollar could have a material effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations. As of March 31, 2008, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars, Mongolian Tugriks and Indonesian Rupiahs.

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

10. FINANCIAL INSTRUMENTS (Continued)

| | March 31, 2008 | | |
|--|---------------------|---------------------|----------------------|
| | Canadian Dollars | Mongolian Tugrik | Indonesian Rupiah |
| Cash and cash equivalents | \$ 83,108,460 | \$ 13,800 | \$ 23,608 |
| Accounts receivable | 221,508 | 2,254,504 | 62,435 |
| Accounts payable and accrued liabilities | (29,142) | (133,384) | (90,869) |
| As stated in U.S. Dollars | \$ 83,300,826 | \$ 2,134,920 | \$ (4,826) |

Based on the above net exposures as of March 31, 2008, and assuming that all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar and Mongolian tugrik against the U.S. dollar would result in an increase/decrease of approximately \$7,800,000 (\$7,600,000 for the Canadian dollar, \$200,000 for the Mongolian tugrik) in the Company's net loss. The effect of a currency rate change of the Indonesian rupiah is considered to be immaterial.

(b) Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's cash and short-term bank deposits are held in large Canadian financial institutions. Short-term bank deposits are composed of financial instruments issued by Canadian banks and companies with high investment-grade ratings and are not subject to external restrictions. These investments mature at various dates over the current operating period. The Company's accounts receivable consists primarily of Value Added Tax receivables in Mongolia.

(c) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk through the management of its capital structure and financial leverage in Note 11.

Accounts payable and accrued liabilities are due within the current operating period.

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

10. FINANCIAL INSTRUMENTS (Continued)

(d) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The risk that the Company will realize a loss as a result of a decline in the fair value of the short-term investments included in cash and cash equivalents is limited because these investments, although held for trading, are generally held to maturity.

(e) Commodity price risk

The ability of the company to develop its mineral properties and the future profitability of the company are directly related to the market price of coal. Diesel fuel is a significant cost factor in mine operations.

11. CAPITAL RISK MANAGEMENT

The Company includes as capital its cash and cash equivalents, common shares, and contributed surplus. The Company's objectives are to safeguard the Company's ability to continue as a going concern in order to pursue the development of its mineral properties and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. As the Company has no cash flow from operations, to maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, acquire or dispose of assets or adjust the amount of cash and cash equivalents.

In order to facilitate the management of its capital requirements, the Company prepares annual expenditure budgets that are updated as necessary depending on various factors, including capital deployment, results from the exploration and development of its properties and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

11. MANAGEMENT OF CAPITAL RISK (Continued)

In order to maximize ongoing development efforts, the Company does not pay out dividends. The Company's investment policy is to invest its cash in highly liquid short-term interest-bearing investments with maturities 90 days or less from the original date of acquisition, selected with regards to the expected timing of expenditures from continuing operations.

The Company expects its current capital resources will be sufficient to carry its exploration and development plans and operations through its current fiscal year.

12. SUPPLEMENTAL CASH FLOW INFORMATION

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

| | Three Months Ended March 31 | |
|---|-----------------------------|---------------------|
| | 2007 | 2007 |
| Net (increase) in: | | |
| Accounts receivable | \$ (1,495,831) | \$ (7,648) |
| Prepaid expenses | (1,060,530) | (11,338) |
| Net increase (decrease) in: | | |
| Accounts payable and accrued liabilities | 110,801 | (93,650) |
| | <u>\$ (2,445,559)</u> | <u>\$ (112,636)</u> |

(b) *Non-cash transactions:*

| | Three Months Ended March 31 | |
|--|-----------------------------|--------|
| | 2008 | 2007 |
| Conversion of line of credit facility (First funding agreement) | \$ 32,498,927 | \$ - |
| Conversion of preferred shares to common | 75,419 | - |
| Transfer of contributed surplus upon exercise of options | 716,783 | 84,964 |

SOUTHGOBI ENERGY RESOURCES LTD.

Notes to the Consolidated Financial Statements

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

13. SUBSEQUENT EVENTS

On April 15, 2008 the Company announced that it agreed to purchase its second fleet of coal mining equipment for the development of its Ovoot Tolgoi Project in Mongolia for deliveries in 2009. The amount of the purchase is approximately \$36 million. The Company has issued further commitments to purchase truck and shovel fleets for delivery in 2010 and 2011 with prices to be negotiated at the time of the orders.

The Company has entered into a subscription agreement with the major supplier for a private placement of 2,000,000 common shares at C\$12.45 per share. On April 28, 2008 the Company issued 1,000,000 common shares for proceeds of C\$12,450,000 (\$12,253,937). On May 19, 2008 a further C\$7,000,000 was received for the subscription agreement.

SOUTHGOBI ENERGY RESOURCES LTD.

Consolidated Schedule of Exploration Expenses

(Unaudited)

(Stated in U.S. dollars)

| | Three months ended March 31, 2008 | | |
|---------------------------------|-----------------------------------|---------------------|---------------------|
| | Metals Division | Coal Division | Total |
| Assaying | \$ 534 | \$ 987 | \$ 1,521 |
| Camp costs | 35,129 | 256,266 | 291,395 |
| Consulting - geophysics | - | 85,757 | 85,757 |
| Consulting - geological | 79,758 | 659,641 | 739,399 |
| Depreciation | 17,070 | 43,314 | 60,384 |
| Drilling | 232,900 | 453,859 | 686,759 |
| License fees | 317,845 | 2,765,894 | 3,083,739 |
| Fuel | 12,007 | 217,348 | 229,355 |
| Legal | 21,799 | 60,245 | 82,044 |
| Maps, photos and reproductions | 1,653 | 3,216 | 4,869 |
| Office | 62,948 | 290,613 | 353,561 |
| Rental, lease and charter costs | 47,015 | 475,706 | 522,721 |
| Salaries | 499,683 | 879,112 | 1,378,795 |
| Supplies | 4,132 | 37,107 | 41,239 |
| Travel | 61,097 | 77,071 | 138,168 |
| Expense recovery | (90,909) | - | (90,909) |
| | \$ 1,302,662 | \$ 6,306,136 | \$ 7,608,798 |

| | Three months ended March 31, 2007 | | |
|---------------------------------|-----------------------------------|---------------|-------------------|
| | Metals Division | Coal Division | Total |
| Assaying | \$ 1,060 | \$ - | \$ 1,060 |
| Camp costs | 54,661 | - | 54,661 |
| Consulting - geological | 150,776 | - | 150,776 |
| Depreciation | 14,470 | - | 14,470 |
| Drilling | 80,528 | - | 80,528 |
| License fees | 58,875 | - | 58,875 |
| Fuel | 5,430 | - | 5,430 |
| Legal | 9,716 | - | 9,716 |
| Maps, photos and reproductions | 1,392 | - | 1,392 |
| Office | 83,458 | - | 83,458 |
| Rental, lease and charter costs | 45,983 | - | 45,983 |
| Salaries | 281,332 | - | 281,332 |
| Supplies | 7,381 | - | 7,381 |
| Travel | 71,954 | - | 71,954 |
| | \$ 867,016 | \$ - | \$ 867,016 |

SOUTHGOBI ENERGY RESOURCES LTD.
Schedule of Metals Division Exploration Expenses By Country

(Unaudited)

(Stated in U.S. dollars)

| | Three Months ended March 31, 2008 | | | |
|---------------------------------|-----------------------------------|------------|--------|--------------|
| | Mongolia | Indonesia | Other | Total |
| Assaying | \$ 534 | \$ - | \$ - | \$ 534 |
| Camp costs | 7,909 | 27,220 | - | 35,129 |
| Consulting - geological | 4,379 | 74,800 | 580 | 79,759 |
| Depreciation | 6,954 | 10,115 | - | 17,070 |
| Drilling | 156,205 | 76,694 | - | 232,900 |
| License fees | 300,513 | 17,332 | - | 317,845 |
| Fuel | 3,492 | 8,515 | - | 12,007 |
| Legal | 179 | 21,620 | - | 21,799 |
| Maps, photos and reproductions | 376 | 1,277 | - | 1,653 |
| Office | 22,053 | 40,895 | - | 62,948 |
| Rental, lease and charter costs | 13,414 | 33,601 | - | 47,015 |
| Salaries | 303,077 | 196,606 | - | 499,683 |
| Supplies | 1,147 | 2,987 | - | 4,132 |
| Travel | 27,551 | 33,546 | - | 61,097 |
| Option and expense recovery | (90,909) | - | - | (90,909) |
| | \$ 756,874 | \$ 545,208 | \$ 580 | \$ 1,302,662 |

| | Three months ended March 31, 2007 | | | |
|---------------------------------|-----------------------------------|-----------|------------|------------|
| | Mongolia | Bulgaria | Indonesia | Total |
| Assaying | \$ - | \$ - | \$ 1,060 | \$ 1,060 |
| Camp costs | 6,894 | 1,404 | 46,363 | 54,661 |
| Consulting - geological | 44,656 | 36,393 | 69,727 | 150,776 |
| Depreciation | 6,897 | - | 7,573 | 14,470 |
| Drilling | - | - | 80,528 | 80,528 |
| License fees | 46,037 | 2,508 | 10,330 | 58,875 |
| Fuel | 1,855 | 300 | 3,275 | 5,430 |
| Legal | 1,876 | 7,840 | - | 9,716 |
| Maps, photos and reproductions | - | - | 1,392 | 1,392 |
| Office | 26,827 | 7,916 | 48,715 | 83,458 |
| Rental, lease and charter costs | 14,858 | 5,826 | 25,299 | 45,983 |
| Salaries | 109,112 | 32,464 | 139,756 | 281,332 |
| Supplies | - | - | 7,381 | 7,381 |
| Travel | 12,106 | 1,247 | 58,601 | 71,954 |
| | \$ 271,118 | \$ 95,898 | \$ 500,000 | \$ 867,016 |

SOUTHGOBI ENERGY RESOURCES LTD.
Schedule of Coal Division Exploration Expenses By Country

(Unaudited)

(Stated in U.S. dollars)

| | Three Months Ended March 31, 2008 | | |
|---------------------------------|-----------------------------------|---------------------|---------------------|
| | Mongolia | Indonesia | Total |
| Assaying | \$ 987 | \$ - | \$ 987 |
| Camp costs | 256,266 | - | 256,266 |
| Consulting - geophysics | 85,757 | - | 85,757 |
| Consulting - geological | 423,319 | 236,322 | 659,641 |
| Depreciation | 43,314 | - | 43,314 |
| Drilling | 376,944 | 76,915 | 453,859 |
| License fees | 762,085 | 2,003,809 | 2,765,894 |
| Fuel | 217,348 | - | 217,348 |
| Legal | 12,985 | 47,260 | 60,245 |
| Maps, photos and reproductions | 544 | 2,672 | 3,216 |
| Office | 177,612 | 113,001 | 290,613 |
| Rental, lease and charter costs | 474,923 | 783 | 475,706 |
| Salaries | 879,112 | - | 879,112 |
| Supplies | 37,107 | - | 37,107 |
| Travel | 75,520 | 1,551 | 77,071 |
| | \$ 3,823,824 | \$ 2,482,312 | \$ 6,306,136 |



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS
March 31, 2008**

(Stated in U.S. Dollars)

SOUTHGOBI ENERGY RESOURCES LTD

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

March 31, 2008

(Unaudited)

(Stated in U.S. Dollars)

OVERVIEW

SouthGobi Energy Resources Ltd., (which, together with its subsidiaries, is collectively referred to as the "Company" or "SouthGobi"). The Company's strategic focus is on integrated coal and energy development in southern Mongolia after the acquisition from Ivanhoe Mines Ltd. ("Ivanhoe") of significant coal assets in Mongolia ("the coal transactions").

The Company's common shares trade under the symbol SGQ, on the TSX-V

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, the Company's principal focus is now on coal exploration and development in southern Mongolia.

Recent Developments

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 certain preferred shares and convertible debt into common shares of the Company. Subsequently, the Company repaid all non-convertible indebtedness owing to Ivanhoe.

The preferred shares were issued to Ivanhoe pursuant to the coal transaction. 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.

Ivanhoe currently owns 104,796,155 common shares representing approximately 80% of the issued and outstanding common shares of SouthGobi.

Under the terms of a funding agreement dated April 25, 2006 (the "First Funding Agreement"), the loans outstanding there under were 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. In connection with the equity private placements announced in January,

2008 the Company elected the conversion of the outstanding loans under the terms of the First Funding Agreement into common shares, at C\$2.09 per common share.

A second funding agreement between the Company and Ivanhoe dated October 25, 2007 (the "Second Funding Agreement") provided for an additional, unsecured non-convertible line of credit to \$32.5 million. Advances and interest under the Second Funding Agreement of approximately \$ 8.1 million were repaid to Ivanhoe from the proceeds of the January 2008 equity private placement. The Second Funding Agreement was then terminated.

On February 18, 2008 Southgobi announced an additional equity private placement to institutional investors in Hong Kong of 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, exploration activities and for general corporate and administrative purposes.

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. In March 2008 the Company received its Permit to Mine for the Ovoot Tolgoi open pit operations.

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 commenced in March 2008. Auxiliary equipment and a temporary maintenance facility were delivered to the mine site in December 2007 to begin pre-stripping activities.

Pre-development of the Ovoot Tolgoi open pit mine began during the first quarter of 2008. Road construction, site clearing, drainage control and topsoil removal, from the planned coal stockpile area, continued throughout the quarter. The mancamp and permanent shop facility plans were submitted to the government for final approval and construction is expected to commence in the second quarter of 2008.

The initial workforce for the Ovoot Tolgoi open-pit mine has been selected, along with senior mine management staff. Initial shipments of coal are scheduled to commence in the third quarter of 2008.

On April 15, 2008 the Company announced the purchase of a second fleet of coal mining equipment for the Ovoot Tolgoi open-pit mine and an additional equity private placement.

The equipment was purchased through a local equipment distributor in Mongolia, and is valued at approximately \$36 million. The second fleet is scheduled for delivery in the second quarter of 2009. The Company has also issued further commitments to purchase additional truck and shovel fleets for delivery in 2010 and 2011. The purchase of the larger capacity fleet allows the Company to expand the annual production capacity and accelerate development at the Ovoot Tolgoi open-pit mine.

The Company entered into a subscription agreement with the Mongolian equipment distributor for a private placement of 2 million shares at C\$12.45 per share representing an aggregate offering amount of C\$24,900,000. On April 29, 2008 the Company issued 1 million shares for C\$12,450,000,

and received a further C\$7,000,000 on May 19, 2008 against the balance of the subscription agreement.

Southgobi intends to use the proceeds from this offering along with previous capital raised in January and February 2008 to further develop and expand the Ovoot Tolgoi open-pit mine and to finance additional drilling and engineering focused on developing an underground mine at Ovoot Tolgoi.

In April 2008 the Company entered into a Joint Venture Agreement with an Indonesian company to explore and develop a coal project, in East Kalimantan, Indonesia. The agreement allows for SouthGobi to earn a 56% interest by spending approximately \$14.5 million on the exploration and development of the project. The Joint Venture Agreement also gives the Company the right to increase its ownership position to 100%.

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

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.

The Company is required to undertake reclamation activities based on the Company's interpretation of current applicable environmental laws and regulatory requirements. The estimated costs of these reclamation activities depend on labor costs, the environmental impacts of the Company's operations, the effectiveness of the chosen reclamation techniques, and applicable government environmental standards. The Company also estimates expected mine closure dates, interest rates, and foreign currency exchange rates when determining its asset retirement obligation. Changes in any of these factors could cause a significant change in the reclamation expense charged in a period.

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

On January 1, 2008, the Company adopted the following provisions of the Canadian Institute of Chartered Accountants (“CICA”) Handbook Sections. There was no material impact on the Company’s financial condition or operating results, as a result of the adoption of these new standards:

- a) Section 3862 – Financial Instruments – Disclosures, which replaces Section 3861 and provides expanded disclosure requirements that provide additional detail by financial asset and liability categories.
- b) 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.
- c) Section 3031 – Inventories, which establishes standards for the measurement and disclosure of inventories. It provides the Canadian equivalent to International Accounting Standard IAS 2 – Inventories. The company’s current practice for valuing inventory is substantially in accordance with the new standard and therefore the financial results of the Company are not expected to be materially affected by the new standard.
- d) Section 1535 – Capital Disclosures, which establishes standards for disclosing information about an entity’s capital and how it is managed. Under this standard, the Company is 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; and
 - when the Company has not complied with such externally imposed capital requirements, the consequences of such non-compliance.
- e) 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.

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 is targeting its 2008 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, a total of 54 licenses covering an area of approximately 2.1 million ha were then available for coal exploration.

The Company regularly targets and prioritizes a number of licenses on the basis of potential, age, and cost.

As at May 7, 2008 the Company held 51 licenses, covering 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 first initiated coal exploration in the Ovoot Tolgoi area in October 2004 and extensive exploration programs were also carried out in 2005, 2006 and 2007. To prepare the project for production 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 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.

As a final step, and in order to commence mining operations at Ovoot Tolgoi, SouthGobi obtained a Permit to Mine on March 31, 2008 with an effective date of April 2, 2008. In order to obtain the 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. Initial pre-development work was started in January with stockpiling of topsoil, ditching and roadwork. Approximately \$16 million of mining equipment was purchased from a local mining equipment supplier in Ulaanbaatar. The Company received the mining equipment in March 2008 and

training programs were initiated. Land use permits for the mining area and its associated infrastructure, such as roads, personnel facilities and shop complex were obtained in January 2008. Permanent site facilities have been designed and final approvals from the government will allow construction 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 erected. 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 and commissioning of the mining equipment. All senior mine operation staff have now been hired. Regular manpower rotation at the site is in effect. As of the end of March 2008 the project had 137 employees.

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.

On April 15, 2008, the Company purchased a second fleet of coal mining equipment for the open pit mine, which is scheduled for delivery in the second quarter of 2009. This second fleet of equipment is valued at approximately \$36 million. SouthGobi also issued commitments for future deliveries of mining fleets in 2010 and 2011. The additional equipment will expand annual production capacity for the Ovoot Tolgoi mine.

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 from 250 to 600 meters that is 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 resource estimate for underground resources in the West Field. Estimated resources for the West Field 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 No. 5 seam 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 600 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. A resource estimate prepared by Norwest and issued on February 25, 2008 quantified 36.4 million tonnes of measured (23.4 million tonnes) and indicated (13.0 million tonnes) and 9.0 million tonnes of inferred resources. The 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 planned 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.

Baseline work for a DEIA study was commissioned during the previous quarter for the Tsagaan Tolgoi area. The DEIA baseline work 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, and the results are being used to delineate further potential coal targets. 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 planned 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 exploration concessions in East Kalimantan, Indonesia. The initial direct interest of the Company in the project will be 56%, which will require approximately \$14.5 million on the development of the project. To date the Company has advanced funds to carry out geological reconnaissance and mapping, initial drilling, and a documentation program. The Joint Venture Agreement (JVA) has been completed and cooperation agreements are being finalized. The terms of the JVA allow for the Company to acquire an interest of up to 100% in the project.

The coal project in East Kalimantan, Indonesia has 4 concessions each in various stages of exploration, development and permitting. The Company has been notified that on one of the concessions, mining, carry and selling permits are expected to be issued in the second quarter of 2008. The other government permits required to commence production are the site infrastructure plan and the port permit.

The Company has contracted a local consultant to assist in the field programs, and preliminary site investigation indicates the potential for continuous coal structures over a large area. Geological mapping delineated encouraging coal outcrops with over thirty coal seams being identified to date.

The field programs will better define the potential size of the prospect along with the coal quality.

Coal Exploration Programs

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 greenfields coal resources. This program is designed to meet existing project and Mongolian Minerals Law requirements in order to keep the licenses in good standing and provides technical information required for determining license retention.

A detailed drilling program has been advanced in Indonesia to determine coal quality and geology.

Metals Group Profile

Mongolia Exploration Licenses

As of May 7, 2008, the Company's Metals Group held 31 exploration licenses for copper and gold exploration in Mongolia covering an aggregate area of approximately 488,000 ha. Seventeen of these licenses, comprising an area of approximately 406,000 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 in the West Gobi 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, metals related licenses are relinquished or sold once the reviews are finalized.

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 prospects 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.

A 3,000 m diamond drill program began on March 22, 2008. The program focuses on three key targets defined by geology and geophysics.

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.

The Company holds 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. In 2007 Batu carried out a wide spaced soil survey over the entire licence and identified several weak lead and zinc anomalies. Batu withdrew from the joint venture in January 2008.

For the Oyut Ovoo property the Company holds 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. Seven General Survey and Exploration licenses covering copper and gold projects in Sumatra, Java and Sulawesi have been granted to the two Indonesian companies.

At one, the joint venture gold projects 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. A 3,000 m diamond drill program began on March 25, 2008.

Elsewhere in Indonesia the Company 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. Geological mapping and soil sampling are in progress and ground geophysics is planned to begin shortly. On the same property an area of 150 m by 150 m of sericite altered andesite contains quartz sulphide breccia veins with 2-3 g/t gold.

Stream sediment geochemistry and regional prospecting has been carried out on a number of other licenses during the first quarter of 2008. Follow up mapping and sampling is in progress.

SELECTED QUARTERLY DATA

(\$ in thousands, except per share information)

| | 2008 | 2007 | | | 2006 | | | |
|----------------------|-------------|-------------|----------|-----------------------|-------------|----------|----------|----------|
| QUARTER ENDED | 31-Mar | 31-Dec | 30-Sep | 30-Jun ⁽¹⁾ | 31-Mar | 31-Dec | 30-Sep | 30-Jun |
| Exploration expenses | \$ 7,609 | \$ 5,958 | \$ 5,205 | \$ 4,784 | \$ 867 | \$ 1,237 | \$ 1,920 | \$ 2,734 |
| Net loss | 8,539 | 9,000 | 7,840 | 8,240 | 1,650 | 2,042 | 2,689 | 3,634 |
| Net loss per share | (0.10) | (0.12) | (0.11) | (0.22) | (0.10) | (0.11) | (0.16) | (0.23) |

Selected Quarterly Information

Certain figures, the majority of which are related to stock based compensation expense, presented for comparative purposes for the periods ended in 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 four 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 quarters prior to 2008, 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. Both funding agreements have now been terminated.

RESULTS OF OPERATIONS

| | Three Months Ended | |
|---|---------------------------|---------------------|
| | March 31, | |
| | 2008 | 2007 |
| EXPENSES | | |
| Depreciation | \$ 35,898 | \$ 5,908 |
| Exploration | 7,608,798 | 867,016 |
| Legal | 201,030 | 13,398 |
| Office and administration | 259,246 | 175,171 |
| Professional fees | 124,936 | 32,277 |
| Salaries and benefits | 814,581 | 338,657 |
| Travel | 70,631 | 61,937 |
| | 9,115,120 | 1,494,364 |
| OTHER (INCOME)/EXPENSES | | |
| Interest income | (528,257) | (6,760) |
| Interest expense | 148,187 | 121,765 |
| Interest accretion on line of credit facility | 279,048 | - |
| Foreign exchange (gain) loss | (475,513) | 5,343 |
| Write off of interest in joint venture | - | 35,009 |
| | (576,535) | 155,357 |
| NET LOSS AND COMPREHENSIVE LOSS | \$ 8,538,585 | \$ 1,649,721 |

Three Months Ended March 31, 2008 and 2007

The Company incurred a net loss for the three months ended March 31, 2008 of \$8.5 million as compared to a net loss of \$1.6 million for the same period in 2007. This change is due primarily to higher exploration, stock based compensation, salaries, legal and professional fees for the three months ended March 31, 2008.

Exploration expenses for the three months ended March 31, 2008 are significantly higher due to the related direct costs incurred by the coal division in Mongolia and Indonesia. In 2007, 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 March 31, 2008 as compared to the same period in 2007. 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 March 2008 and 2007 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 information systems project costs, administrative support, and costs incurred for internal corporate tax planning, and documentation.

For the three months ended March 31, 2008 the Company has allocated stock-based compensation expense of \$578,443 (2007 - \$58,000) to exploration expense and \$521,571 (2007 – \$109,000) to salaries and benefits. The total stock based compensation expense calculated for the three months ended March 31, 2008 was \$1.1 million as compared to \$167,000 in the same period in 2007.

Salaries and benefits, excluding stock based compensation costs, increased in the three months ended March 31, 2008 to \$293,000 as compared to \$230,000 for the three months ended March 31, 2007. Salary and benefits compared to the same period in 2007 have increased due to the increased corporate activities related to the coal division.

Office and administration fees increased in the three months ended March 31, 2008 as compared to the same period in 2007. 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, and related spending in the metals and coal divisions. Interest income has increased, which relates directly to the completion of the financings in the current quarter and the resulting increased cash position throughout the quarter. Interest expense is \$148,187 for the three months ended March 31, 2008 as compared to \$121,765 in the same period in 2007 and relates to the lines of credit from Ivanhoe. Interest accretion on line of credit expense was \$279,048 in the current period relates to the accretion of the liability component of the First Funding Agreement credit facility. The First Funding Agreement line of credit facility and the Second Funding Agreement were terminated in January 2008.

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

EXPLORATION COSTS BY DIVISION

| | <u>2008</u> | <u>2007</u> |
|--------------------------|---------------------|-------------------|
| Metals Division | \$ 1,302,662 | \$ 867,016 |
| Coal Division | 6,306,136 | - |
| Total Exploration | \$ 7,608,798 | \$ 867,016 |

Metals Division

For the three months ended March 31, 2008 exploration expenses were \$1.3 million as compared to exploration expenses of \$867,000 in 2007.

Exploration expenditures in Mongolia increased to \$757,000 for 2008 from \$271,000 in 2007 while the Company continued its evaluation of the potential projects and further drilling activity. During 2008 the majority of the expenses incurred in Mongolia were related to ongoing license fees, drilling, and salaries.

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, metals related licenses are relinquished or sold once the reviews are finalized. During the quarter a license was sold to an unrelated third party.

In Indonesia exploration expenditures increased slightly to \$545,000 in 2008 from \$500,000 in 2007 due to continued exploration on a number of new prospects.

Included in the salary expense of \$500,000 for 2008 is \$293,000 of stock based compensation expense.

The Company terminated its mineral exploration activities in Bulgaria in March 2007.

Coal Division

The total coal exploration expenditures in the three months ended March 31, 2008 were \$6.3 million. The coal division started operating subsequent to the completion of the coal transaction at the end of May 2007.

Exploration expenditures in Mongolia were \$3.8 million and included consulting-geological, drilling, license fees, office and salary and benefits. Expenditures in 2008 were incurred as the coal division assembled equipment, hired additional personnel and began pre-development activities at the Ovoot Tolgoi mine site.

In Indonesia, exploration expenditures were \$2.5 million for the three months ended March 31, 2008. To date the Company has advanced funds to carry out geological reconnaissance, licensing, mapping, initial drilling, and a documentation program on the new concessions in East Kalimantan.

Included in the salary expense of \$900,000 for 2008 is \$285,000 of allocated stock based compensation expense.

LIQUIDITY AND CAPITAL RESOURCES

| | March 31, 2008 | December 31, 2007 |
|---|-----------------------|----------------------|
| ASSETS | | |
| CURRENT | | |
| Cash and cash equivalents | \$ 85,318,299 | \$ 1,393,632 |
| Accounts receivable | 2,248,949 | 759,528 |
| Prepaid expenses | 2,942,044 | 1,890,177 |
| | 90,509,292 | 4,043,337 |
| DEFERRED CHARGES | 985,607 | - |
| MINERAL PROPERTIES | 699,360 | 443,360 |
| PLANT AND EQUIPMENT | 14,322,483 | 1,123,379 |
| | \$ 106,516,742 | \$ 5,610,076 |
| LIABILITIES | | |
| CURRENT | | |
| Accounts payable and accrued liabilities | \$ 1,876,890 | \$ 1,767,784 |
| ASSET RETIREMENT OBLIGATION | 256,000 | - |
| AMOUNT DUE UNDER LINE OF CREDIT FACILITY | - | 35,107,804 |
| | 2,132,890 | 36,875,588 |
| SHAREHOLDERS' EQUITY (DEFICIENCY) | | |
| Share capital | | |
| Common shares | 167,560,783 | 20,625,287 |
| Preferred shares | - | 75,419 |
| Equity portion of line of credit facility | - | 3,055,359 |
| Contributed surplus | 7,716,377 | 7,333,146 |
| Deficit | (70,893,308) | (62,354,723) |
| | 104,383,852 | (31,265,512) |
| | \$ 106,516,742 | \$ 5,610,076 |

At March 31, 2008, the Company had cash resources of \$85.3 million compared to \$1.4 million as at December 31, 2007.

During the quarter ended March 31, 2008 the Company completed a series of equity financing transactions.

On January 24, 2008 the Company completed 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).

On February 18, 2008 the Company announced an additional equity private placement to institutional investors for 711,111 of common shares at C\$9.00 per share for proceeds of C\$6.4 million (\$6,484,296).

These amounts plus \$2.0 million received from the exercise of stock options provided financing for the Company's operations during the quarter ended March 31, 2008.

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 (Goods and Services Tax or Value Added Tax). Prepaid balances have increased from \$1.9 million at December 31, 2007 to \$2.9 million at March 31, 2008. The increase relates to the timing of prepayments for Mongolian exploration licenses, additional lease deposits and deposits for equipment, design and building costs and supplies for the Ovoot Tolgoi open-pit project.

Mineral properties have increased with the addition of future asset retirement obligation costs for the quarter, and the deferred charges relate to initial listing application costs on an Asian stock exchange.

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

The Company's investment in plant and equipment increased substantially during the quarter ended March 31, 2008. The purchase of coal mining equipment that was announced in November 2007 was commissioned for use at Ovoot Tolgoi in March 2008.

In April 2006, in conjunction with the coal transaction, the Company entered into a funding agreement with Ivanhoe (the "First Funding Agreement") pursuant to which 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 First Funding Agreement 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 funding agreement (the “Second Funding Agreement”). The Second Funding Agreement provided for an additional, unsecured non-convertible line of credit to \$32.5 million. One tranche of funding for \$15 million was available for use for general corporate purposes and the second tranche of \$17.5 million was 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 was restricted to expenditures in respect of the Company’s activities in Mongolia.

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. The \$8,077,470 balance due under the Second Funding Agreement included accrued interest and was repaid on January, 18 2008 from proceeds of the equity financings.

Concurrent with the closing of the equity private 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 80% 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 further 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 \$900,000 and \$500,000 for the three months ended March 31, 2008 and 2007, 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.

During the three months ended March 31, 2008, \$148,187 (2007 - \$121,765) of interest has been paid on the line of credit facilities with Ivanhoe.

Both credit facilities are now terminated.

OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value. As at May 7, 2008: 131,391,949 common shares were issued and outstanding and 4,672,570 share purchase options were outstanding. On a fully diluted basis, 136,604,519 common shares were outstanding.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

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.

Material risks and uncertainties affecting SouthGobi, their potential impact and the Company's principal risk management strategies are substantially unchanged from those disclosed in the Company's MD&A for the year ended December 31, 2007, which is available on SEDAR.

OUTLOOK

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 resources and confirming the underground coal resource and the potential for the development of an underground mining operation at Ovoot Tolgoi.

The Company's new Indonesian coal project is well situated to target the Japanese, Korean, Indian and Chinese coastal markets. The Company has begun preliminary site investigation and two geological field programs will better define the potential size and coal quality of the project.

The Company has established a schedule for the development of commercial operations on the Ovoot Tolgoi Project. Pre-development work and training has commenced, road construction continued with topsoil removal from the coal stockpile area. Revenue is anticipated in the latter part of 2008.

A second fleet of equipment has been purchased. Delivery and commissioning of the equipment is scheduled for the second quarter of 2009. The additional mining equipment will be used to expand the annual production capacity of the Ovoot Tolgoi open-pit mine.

The proceeds from the 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 the underground coal mine at the Ovoot Tolgoi site. Proceeds will also be used for investigating new projects, equipment deposits and for general corporate and administrative purposes.

Over the last several months, the Company has identified potential customers in China and Western Inner Mongolia to whom it could sell its coal. These customers include end users, distributors, steel mills, power plants and industrial consumers.

The Chinese coal market has been identified as having extremely low thermal coal stocks and power shortages. China has become a net coal importer and the demand for coal is growing in the economies of Asia, which has put additional constraints on supply. This has put an upward pressure on coal prices.

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

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.

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, and those assets which have been acquired in the most recent transaction in Indonesia. 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.

May 20, 2008