CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2008 and 2007
(Stated in U.S. Dollars)

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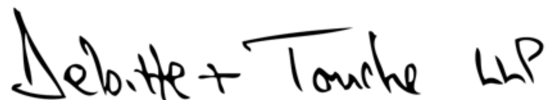
Auditors' report

To the Shareholders of
SouthGobi Energy Resources Ltd.

We have audited the consolidated balance sheets of SouthGobi Energy Resources Ltd. as at December 31, 2008 and 2007 and the consolidated statements of operations and comprehensive loss, shareholders' equity (deficiency) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants
March 11, 2009

SOUTHGOBI ENERGY RESOURCES LTD.
Consolidated Balance Sheets
December 31, 2008 and 2007
(Stated in U.S. dollars)

	2008	2007
Assets		
Current		
Cash and cash equivalents	**$ 10,117,311**	$ 1,216,954
Accounts receivable	**7,289,726**	683,312
Inventories (Note 4)	**13,676,716**	-
Prepaid expenses	**2,578,527**	1,573,297
Current assets held for sale (Note 13)	**637,600**	569,774
	34,299,880	4,043,337
Mineral properties, plant and equipment (Note 5)	**65,832,263**	1,004,244
Assets held for sale (Note 13)	**-**	562,495
	$ 100,132,143	$ 5,610,076
Liabilities		
Current		
Accounts payable and accrued liabilities	**$ 7,400,009**	$ 1,497,989
Deposit received for sale of metals division (Note 13)	**3,000,000**	-
Current liabilities held for sale (Note 13)	**255,080**	269,795
	10,655,089	1,767,784
Asset retirement obligations (Note 6)	**512,364**	-
Amount due under line of credit facilities (Note 8)	**-**	35,107,804
	11,167,453	36,875,588
Shareholders' equity (deficiency)		
Share capital (Note 9)		
Common shares	**200,570,743**	20,625,287
Preferred shares	**-**	75,419
Equity portion of line of credit facility	**-**	3,055,359
Contributed surplus	**13,134,518**	7,333,146
Deficit	**(124,740,571)**	(62,354,723)
	88,964,690	(31,265,512)
	$ 100,132,143	$ 5,610,076

Nature of Operations (Note 1)

Commitments (Note 18)

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

APPROVED BY THE BOARD:

"Andre Deepwell"

Director

"Pierre Lebel"

Director

SOUTHGOBI ENERGY RESOURCES LTD.
Consolidated Statements of Operations and Comprehensive Loss
Years Ended December 31, 2008 and 2007
(Stated in U.S. dollars)

		2008		2007
Revenues	**$**	**3,125,851**	$	-
Operating expenses [i]		**1,930,762**		-
Depreciation, depletion and accretion		**313,741**		-
Income from mine operations		**881,348**		**-**
Corporate administration [i]		**9,329,972**		6,349,768
Exploration [i]		**36,173,614**		12,166,819
Operating loss from continuing operations		**(44,622,238)**		(18,516,587)
Other income/(expense)				
Interest expense (Note 8)		**(148,187)**		(1,358,742)
Interest accretion on line of credit facilities (Note 8)		**(279,048)**		(2,237,248)
Listing Fees (Note 10)		**(6,715,220)**		-
Other income/(expense) (Note 11)		**(2,709,903)**		30,071
		(9,852,358)		(3,565,919)
Loss from continuing operations		**(54,474,596)**		(22,082,506)
Loss from discontinued operations (Note 13) [i]		**(7,911,252)**		(4,647,426)
Net loss and comprehensive loss	**$**	**(62,385,848)**	$	(26,729,932)
Basic and diluted loss per share from				
Continuing operations	**$**	**(0.43)**	$	(0.43)
Discontinued operations	**$**	**(0.06)**	$	(0.09)
Net loss	**$**	**(0.49)**	$	(0.52)
Weighted average number of common shares outstanding - basic and diluted		**128,353,692**		51,070,891
(i) Stock option expense (a non-cash item) included in Operating expenses, Corporate administration, Exploration and Loss from discontinued operations (Note 9 (b))	**$**	**7,591,336**	$	6,827,189

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

SOUTHGOBI ENERGY RESOURCES LTD.
Consolidated Statements of Shareholders' Equity (Deficiency)
Years Ended December 31, 2008 and 2007
(Stated in U.S. dollars)

	Share Capital							
	Common Shares		Preferred Shares					
	Number of Shares	Amount	Number of Shares	Amount	Equity Portion of Line of Credit Facility	Contributed Surplus	Deficit	Total
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	3,918,975	-	-	-	(1,354,174)	-	2,564,801
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	16,211,111	136,338,950	-	-	-	-	-	136,338,950
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	1,442,242	5,834,160	-	-	-	(1,789,966)	-	4,044,194
Mineral property	321,818	5,198,000	-	-	-	-	-	5,198,000
Stock-based compensation charged to operations	-	-	-	-	-	7,591,338	-	7,591,338
Net loss and comprehensive loss	-	-	-	-	-	-	(62,385,848)	(62,385,848)
Balances, December 31, 2008	133,193,282	$ 200,570,743	-	-	-	$13,134,518	$ (124,740,571)	$ 88,964,690

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

SOUTHGOBI ENERGY RESOURCES LTD.

Consolidated Statements of Cash Flows

Years Ended December 31, 2008 and 2007

(Stated in U.S. dollars)

	2008	2007
Operating Activities		
Net loss from continuing operations	**$ (54,474,596)**	$ (22,082,506)
Items not requiring use of cash		
Depreciation and depletion	**493,527**	96,313
Stock-based compensation	**6,100,288**	6,001,142
Accrued interest expense	**-**	1,358,742
Interest accretion on line of credit facility	**279,048**	2,237,248
Interest expense on line of credit converted to shares	**108,176**	-
Unrealized foreign exchange loss/(gain)	**4,464,481**	(6,220)
Write off of interest in joint venture	-	31,141
Loss on disposal of plant and equipment	**5,663**	-
Accretion of asset retirement obligation	**19,498**	-
Changes in non-cash working capital items (Note 17(a))	**(12,926,679)**	(813,365)
Cash used in continuing operations	**(55,930,594)**	(13,177,505)
Cash used in discontinued operations (Note 13)	**(5,786,403)**	(3,805,627)
Cash used in operating activities	**(61,716,997)**	(16,983,132)
Investing Activities		
Expenditures on mineral properties, plant and equipment	**(62,496,420)**	(604,852)
Proceeds from disposal of plant and equipment	**10,295**	-
Cash used for continuing operations	**(62,486,125)**	(604,852)
Cash provided by discontinued operations (Note 13)	**2,946,602**	(31,564)
Cash used for investing activities	**(59,539,523)**	(636,416)
Financing Activities		
Share capital issued, net of issue costs	**140,383,144**	2,564,802
Increase in line of credit facility	**2,000,000**	15,500,000
Repayment of line of credit facility	**(8,077,470)**	-
Cash provided by financing activities	**134,305,674**	18,064,802
Effect of foreign exchange rate on cash	**(4,102,776)**	(17,116)
Increase in cash and cash equivalents	**8,946,378**	428,138
Cash and cash equivalents, beginning of year	**1,393,632**	965,494
Cash and cash equivalents, end of year	**10,340,010**	$ 1,393,632
Comprised of:		
Cash of continuing operations	**10,117,311**	1,216,954
Cash of discontinued operations	**222,699**	176,678
	10,340,010	1,393,632
Cash	**6,659,328**	1,393,632
Money market instruments	**3,680,682**	-
	10,340,010	1,393,632

Supplemental cash flow information (Note 17)

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

1. NATURE OF OPERATIONS

SouthGobi Energy Resources Ltd, (the "Company" or "SouthGobi") is a coal producer and a coal exploration and development company. These consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and settlement of liabilities in the normal course of business. The Company has incurred losses since inception and has an accumulated deficit of $124,740,571. The Company's ability to continue as a going concern is dependent upon establishing profitable operations, the confirmation of economically recoverable reserves, and the ability of the Company to obtain further financing to develop properties.

Management is of the opinion that additional financing will be available to continue its planned activities in the normal course. However, there is no certainty that additional financing will be obtained.

These financial statements do not give effect to adjustments that may be necessary should the Company be unable to continue as a going concern.

In December 2008, the Company announced that it had sold its Metals Division to Ivanhoe Mines Ltd. (Ivanhoe) for $3 million. The sale was effective December 30, 2008 and closed on February 2, 2009. The Metals Division consists of certain base and precious metals properties in Mongolia and Indonesia. The Company will now be focused on coal production, development and exploration.

2. SIGNIFICANT ACCOUNTING POLICIES

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

(a) Principles of consolidation

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

Variable Interest Entities ("VIEs"), which include, but are not limited to, special purpose entities, trusts, partnerships, and other legal structures, as defined by the Accounting Standards Board in Accounting Guideline ("AcG") 15, "Consolidation of Variable Interest Entities" ("AcG 15"), are entities in which equity investors do not have the characteristics of a "controlling financial interest" or there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIEs are subject to consolidation by the primary beneficiary who will absorb the majority of the entities' expected losses and/or expected residual returns. The Company has not identified any VIEs at December 31, 2008.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Measurement uncertainties

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

The consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. The most significant estimates relate to asset retirement obligations; capital assets, including coal reserves and resources, depreciation and depletion; recoverability of accounts receivable, inventory valuation; valuation of future income tax amounts, impairment testing and the calculation of stock based compensation.

(c) Foreign currencies

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

(d) Cash and cash equivalents

Cash and cash equivalents include cash on deposit and money market investments with maturities from the date of acquisition of three months or less, which are readily convertible to known amounts of cash.

(e) Inventory

Coal inventory is valued at the lower of production cost and net realizable value. Production cost includes direct and indirect labour, operating materials and supplies, transportation costs, and an applicable portion of operating overhead, including depreciation and depletion. Net realizable value is the expected difference between the average selling price of the finished product less the costs to get the product into saleable form and to the selling location.

Supplies inventory consists of consumable parts and supplies which are valued at the lower of average cost and net realizable value. Net realizable value is actual cost less any provision for obsolescence.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Mineral properties, plant and equipment

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

On the commencement of commercial production, depletion of each mining property is provided on a unit-of-production basis using estimated resources as the depletion base.

Plant and equipment are stated at cost less accumulated depreciation. Plant and equipment are depreciated over their expected economic lives using either the unit-of-production method or the straight-line method, as appropriate.

Stripping costs incurred during the development of a mine are capitalized. Stripping costs incurred during the production phase are variable production costs that are included in the costs of inventory produced during the period that the stripping costs are incurred, unless the stripping activity can be shown to be a betterment of the mineral property, in which case the stripping costs would be capitalized. Betterment occurs when stripping activity increases future output of the mine by providing access to a new ore body. These stripping costs are depleted on a unit-of production basis, using estimated resources as the depletion base. At December 31, 2008, the balance of deferred stripping charges was $3,038,797 (2007 – nil). The company capitalized stripping costs of $3,113,072 (2007 – nil) and depleted $74,275 (2007 – nil) for the year ended December 31, 2008.

The Company reviews the carrying values of its mineral properties, plant and equipment whenever events or changes in circumstances indicate that the carrying values may exceed the estimated recoverable amounts determined by reference to estimated future operating results and undiscounted net cash flows. If the estimated undiscounted future cash flows from the asset are less than its net book value, the asset is written-down to its fair value. Fair value is generally determined based on the estimated discounted future cash flows of the asset. An impairment loss is recognized when the carrying value of a property is not recoverable and exceeds its fair value.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(g) Asset retirement obligations

The Company recognizes liabilities for statutory, contractual or legal obligations associated with the reclamation of mineral properties, plant and equipment, when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, a liability for an asset retirement obligation is recognized at its fair value in the period in which it is incurred. Upon initial recognition of the liability, the corresponding asset retirement cost is added to the carrying amount of the related asset and the cost is amortized as an expense over the economic life of the asset using either the unit-of-production method or the straight-line method, as appropriate. Following the initial recognition of the asset retirement obligation, the carrying amount of the liability is increased for the passage of time and adjusted for changes to the amount or timing of the underlying cash flows needed to settle the obligation.

(h) Financial instruments – recognition and measurement

All financial instruments are initially recorded at fair value. Financial assets are designated upon inception into one of the following 4 categories: held-to-maturity, held-for-trading, available-for-sale or loans-and-receivables. Financial liabilities are designated upon inception as either held-for-trading or other-financial-liabilities.

Financial instruments classified as held-for-trading are measured at fair value with unrealized gains and losses recognized in net income for the period. The Company's cash and short-term money market investments are classified as held-for-trading.

Financial instruments classified as loans-and-receivables, held-to-maturity and other-financial-liabilities are measured at amortized cost. The Company's accounts receivable are classified as loans-and-receivables while accounts payable, deposits and long-term liabilities are classified as other-financial-liabilities.

Financial instruments classified as available-for-sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) except for losses in value that are considered other than temporary. Transactions costs associated with held-for-trading financial instruments are expensed as incurred, while transaction costs associated with all other financial instruments are included in the initial carrying amount of the instrument.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Revenue recognition

Sales revenues are recognized when the risks and rewards of ownership pass to the buyer, collection is reasonably assured and the price is reasonably determinable. This occurs when coal is either loaded onto a truck or when it is unloaded at the final destination, depending on the terms of the contract.

(j) Income taxes

Future income tax assets and liabilities are computed based on temporary differences between the carrying amounts of assets and liabilities on the balance sheet and their corresponding tax values, using the substantively enacted income tax rates when the differences are expected to reverse. Future income tax assets also result from unused loss carry-forwards and other unused deductions. The valuation of future income tax assets is reviewed on a regular basis and adjusted, if necessary, by use of a valuation allowance to reduce the asset to its estimated realizable amount. A future tax asset is recognized if it is more likely than not to be realized.

(k) Stock-based compensation

The Company accounts for stock-based compensation using the Black-Scholes option pricing model. Accordingly, the fair value of the options at the date of grant is accrued with a corresponding credit to contributed surplus, and charged to earnings using the graded vesting method. If and when the stock options are exercised, the applicable amounts of contributed surplus are transferred to share capital.

(l) Loss per share

The basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the year. The diluted per share amounts reflect the potential dilution of common share equivalents, such as outstanding stock options and share purchase warrants, in the weighted average number of common shares outstanding during the year, if dilutive. The "treasury stock method" is used for the assumed proceeds upon the exercise of the options and warrants that are used to purchase common shares at the average market price during the year. During the years ended December 31, 2008 and 2007, all of the outstanding stock options and warrants were anti-dilutive. At December 31, 2007 the weighted average number of common shares outstanding - basic and diluted was presented as 27,222,351 and the loss per share as $0.98. This has been amended to weighted average number of common shares outstanding – basic and diluted, and loss per share of 51,070,891 and $0.52, respectively.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(m) Recent accounting pronouncements

i. In February 2008, the CICA issued Section 3064 - Goodwill and Intangible Assets, which replaces Section 3062 - Goodwill and Other Intangible Assets and Section 3450 - Research and Development Costs. The new standard establishes the recognition, measurement, presentation and disclosure of goodwill subsequent to initial recognition and of intangible assets by profit-oriented enterprises. The section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008, and is not expected to have a material impact on the Company's financial condition or operation results.

ii. In February 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly accountable enterprises will be required to adopt International Financial Reporting Standards (IFRS) for financial periods beginning on and after January 1, 2011. In Staff Notice 52-321 – Early Adoption of International Financial Reporting Standards, Use of US GAAP and Reference to IFRS-IASB, the Canadian Securities Administrators (CSA) has indicated that it would be prepared to provide exemptive relief to permit a Canadian reporting issuer to prepare its financial statements in accordance with IFRS for financial periods beginning before January 1, 2011.

In March 2009, the Company was granted exemptive relief under Staff Notice 52-321 and has been permitted to adopt IFRS for Canadian reporting purposes for reporting periods beginning on or after January 1, 2009. The Company plans to adopt IFRS with an adoption date of January 1, 2009 and a transition date of January 1, 2005. IFRS employs a conceptual framework that is similar to Canadian GAAP; however significant differences exist in certain matters of recognition, measurement and disclosure. While the adoption of IFRS will not change the actual cash flows of the Company, the adoption will result in changes to the reported financial position and results of operations of the Company.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(m) Recent accounting pronouncements (Continued)

iii. In January 2009, the CICA issued Section 1582 – Business Combinations, which replaces Section 1581 – Business Combinations, and Section 1601 – Consolidated Financial Statements and Section 1602 – Non-Controlling Interests, which replace Section 1600 – Consolidated Financial Statements. These new sections are effective for years beginning on or after January 1, 2011 with earlier adoption permitted. Section 1582 and 1602 will require net assets, non-controlling interests and goodwill acquired in a business combination to be recorded at fair value and non-controlling interests will be reported as a component of equity. In addition, the definition of a business is expanded and is described as an integrated set of activities and assets that are capable of being managed to provide a return to investors or economic benefits to owners. As well acquisition costs are not part of the consideration and are to be expensed when incurred. These new sections are not expected to have a material impact on the Company's financial condition or operation results.

(n) Comparative figures

Certain figures previously reported for 2007 have been reclassified to conform with the basis of presentation adopted in the current year.

3. 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 new standard did not have a material impact on the Company's consolidated financial statements.

3. 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.

4. INVENTORIES

	2008	2007
Stockpiles	**$ 13,158,009**	$ -
Materials and supplies	**518,707**	-
	$ 13,676,716	$ -

The amount of inventories recognized as an expense during the year is $1,211,691 (2007 – nil) and is included in operating expenses and depreciation, depletion and accretion.

5. MINERAL PROPERTIES, PLANT AND EQUIPMENT

	2008		
	Cost	**Accumulated Depreciation**	**Net Book Value**
Plant and equipment	**$ 52,374,564**	**$ 3,706,862**	**$ 48,667,702**
Office equipment	**713,577**	**278,234**	**435,343**
Mineral property interests	**16,814,156**	**84,938**	**16,729,218**
	$ 69,902,297	**$ 4,070,034**	**$ 65,832,263**

	2007		
	Cost	Accumulated Depreciation	Net Book Value
Plant and equipment	$ 845,849	$ 35,626	$ 810,223
Office equipment	308,904	114,883	194,021
	$ 1,154,753	$ 150,509	$ 1,004,244

6. ASSET RETIREMENT OBLIGATION

Reclamation and closure costs have been estimated based on the Company's 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.

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 $2,115,817 and are required to satisfy the obligations, discounted using credit adjusted risk-free rates between 8% and 11%. The settlement of the obligations will occur through to 2025.

The following is an analysis of the asset retirement obligation:

Balance, January 1, 2007 and December 31, 2007	**$ -**
Additions to future costs for the year ended December 31, 2008	**492,866**
Accretion incurred in the year ended December 31, 2008	**19,498**
Balance at December 31, 2008	**$ 512,364**

7. INCOME TAXES

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

	Year ended December 31,	
	2008	2007
Loss from continuing operations	**$ 54,474,596**	$ 22,082,506
Statutory tax rate	**31.00%**	34.12%
Recovery of income taxes based on combined Canadian and provincial statutory rates	**$ 16,887,125**	$ 7,534,552
Deduct:		
Lower effective tax rate in foreign jurisdictions	**(1,873,110)**	(1,109,587)
Tax effect of losses not recognized	**(9,398,887)**	(4,950,350)
Change in future tax rate	**(1,641,008)**	(302,162)
Non-deductible expenses	**(3,974,120)**	(1,172,453)
	$ -	$ -

7. INCOME TAXES (Continued)

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

		2008		2007
Future income tax assets				
Tax loss carryforwards	**$**	**15,733,722**	$	7,679,214
Mineral properties, plant and equipment		**906,505**		61,477
Share issue costs		**687,111**		16,194
Other assets		**1,146,156**		-
Total future income tax assets		**18,473,494**		7,756,885
Valuation allowance		**(18,473,494)**		(7,756,885)
Net future income tax assets	**$**	**-**	$	-

At December 31, 2008, the Company and its subsidiaries have no unrecognized capital losses and have non-capital losses for income tax purposes of approximately $64 million that may be used to offset future taxable income as follows:

		Local Currency	U.S. Dollar Equivalent	Expiry Dates
Non-capital losses				
Canadian Dollar	$	$ 19,360,700	$ 15,885,051	2009-2028
Mongolian Tugrik	MNT	48,539,151,254	39,991,600	2009-2019
Indonesian Rupiah	IDR	68,225,355,210	6,135,374	2011-2013
Singapore Dollar	SGD	3,441,522	2,406,491	indefinite
			$ 64,418,516	

8. AMOUNTS DUE UNDER LINE OF CREDIT FACILITIES

(a) In April 2006, the Company entered into a line of credit facility (the "First Funding Agreement") with Ivanhoe Mines Ltd. ("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 CDN $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 CDN $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.

(b) 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.

(c) On December 30, 2008, the Company established a credit facility with Ivanhoe which allows the Company to obtain advances from Ivanhoe to an aggregate maximum of $30 million. The credit facility is for a one year term and the Company may request a one year extension. Such an extension shall be at the sole discretion of Ivanhoe. The credit facility is unsecured and carries an interest rate equal to LIBOR plus 7.5 basis points. The effective interest rate at December 31, 2008 was 8.925%. At December 31, 2008, the Company had not drawn down on the credit facility. In February 2009, the Company received advances of $5 million against the credit facility.

9. SHARE CAPITAL

(a) *Common and preferred shares*

Authorized	Unlimited common shares with no par value
	Unlimited preferred shares with no par value
Issued and outstanding	133,193,282 (2007 – 74,932,657) common shares
	Nil (2007 – 25,576,383) preferred shares

Refer to the Consolidated Statements of Shareholders' Equity (Deficiency) for movement in share capital for the year ended December 31, 2008.

(b) *Stock-based compensation – officers and employees*

The Amended Equity Incentive Plan, approved on May 29, 2007 provides for a rolling rather than a fixed maximum number of common shares which may be issued pursuant to incentive stock options and other equity incentives, awards and issuances. The Company is authorized to issue options for a maximum of 10% of the issued and outstanding common shares pursuant to the stock option plan. The general terms of stock options granted under the amended plan include a maximum exercise period of 5 years and a vesting period of 3 years with one-third of the grant vesting on the first anniversary of the grant, one-third vesting on the second anniversary of the grant and one-third vesting on the third anniversary of the grant.

During the year ended December 31, 2008, the Company granted 3,184,000 (2007 – 3,252,500) stock options to officers, employees and directors at prices ranging from CDN $5.10 to CDN $18.86 with expiry dates ranging from January 7, 2013 to November 27, 2013 (2007 – CDN $2.10 to CDN $7.16 with expiry dates ranging from February 20, 2012 to October 18, 2012).

The weighted average fair value of the options issued was estimated at $5.72 (CDN $6.07) per option at the grant date using the Black-Scholes option pricing model. The weighted average assumptions used for the calculation were:

	2008	2007
Risk free interest rate	**2.78%**	4.23%
Expected life	**3 years**	3 years
Expected volatility	**74%**	78%
Expected dividend per share	**$nil**	$nil

9. SHARE CAPITAL (Continued)

(b) Stock-based compensation – officers and employees (Continued)

A compensation cost of $18,210,147 for the options granted in the year ended December 31, 2008 (2007 - $9,979,374) will be amortized over the vesting period, of which $5,088,754 was recognized in the year ended December 31, 2008 (2007 - $6,316,335).

The total stock-based compensation calculated for the year ended December 31, 2008 was $7,591,336 (2007 - $6,827,189). Stock-based compensation of $3,153,217 (2007 - $3,378,761) has been allocated to exploration expense and loss from discontinued operations, $339,381 (2007 – Nil) has been allocated to mine administration costs and $4,098,738 (2007 - $3,448,428) has been allocated to general and administration.

(c) Outstanding stock options

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

	2008		2007	
	Number of Options	Weighted Average Exercise Price (CDN $)	Number of Options	Weighted Average Exercise Price (CDN $)
Balance, beginning of year	**4,994,632**	**$ 3.55**	2,953,702	$ 1.94
Options granted	**3,184,000**	**11.27**	3,252,500	4.55
Options exercised	**(1,442,244)**	**2.80**	(1,145,566)	2.31
Options forfeited	**(150,333)**	**15.25**	(66,004)	2.15
Balance, end of year	**6,586,055**	**$ 7.18**	4,994,632	$ 3.55

The following table summarizes information about stock options outstanding and exercisable at December 31, 2008:

	Options Outstanding			**Options Exercisable**		
Exercise Prices (CDN $)	Options Outstanding	Weighted-average Exercise Price (CDN $)	Weighted-average Remaining Contractual Life (years)	Options Outstanding and Exercisable	Weighted-average Exercise Price (CDN $)	Weighted-average Remaining Contractual Life (years)
$0.86 - $3.00	1,857,066	$ 2.01	2.22	1,443,734	$ 1.91	2.13
$3.70 - $6.00	2,754,489	5.55	4.06	966,156	5.89	3.46
$7.16 - $13.80	874,500	11.48	4.18	22,500	7.16	3.80
$15.07 - $18.86	1,100,000	18.86	4.59	-	-	-
	6,586,055	$ 7.18	3.65	2,432,390	$ 3.54	2.67

10. LISTING FEES

Listing fees, consisting of legal, accounting and related professional fees, relate to initial listing application costs for a secondary listing on an Asian stock exchange. The Company has appointed a project sponsor for a simultaneous listing and equity fundraising. The Company had planned to treat the charges as share issue costs upon a successful equity fundraising. However, current liquidity issues in the credit markets, along with the increased cost of obtaining capital and the reduced availability of equity funding have led to a decision to expense these costs. The Company recorded a charge of $6,715,220 for the year ended December 31, 2008. The Company is continuing with the secondary listing application.

11. OTHER INCOME/(EXPENSE)

	2008	2007
Interest income	**$ 1,869,894**	$ 44,082
Foreign exchange gain/(loss)	**(4,579,797)**	47,545
Coal transaction costs	**-**	(26,547)
Write-off of interest in joint venture	**-**	(35,009)
	$ (2,709,903)	$ 30,071

12. RELATED PARTY TRANSACTIONS

(a) The Company incurred the following expenses, recorded on a cost recovery basis with Ivanhoe and with I2MS.NET PTE LTD (I2MS) and Global Mining Management ("GMM"), companies related by way of directors or shareholders in common. As at December 31, 2008, Ivanhoe owned directly and indirectly approximately 80% of the outstanding common shares of the Company.

	2008	2007
Office and administrative	**$ 1,893,424**	$ 725,716
Salaries and benefits	**1,823,798**	1,415,785
Interest [(i)]	**413,235**	1,358,741
Interim coal expenditures	**-**	13,021,624
	$ 4,130,457	$ 16,521,866

(i) In 2008, the amounts due under the line of credit facilities were fully settled (Note 8).

12. RELATED PARTY TRANSACTIONS (Continued)

The breakdown between the related parties is as follows:

	2008	2007
GMM	**$ 2,455,334**	$ 2,141,501
Ivanhoe	**413,235**	14,380,365
I2MS	**1,261,888**	-
	$ 4,130,457	$ 16,521,866

(b) Current liabilities include the following amounts:

	2008	2007
Amounts due for administration to GMM	**$ 230,712**	$ 211,045
Accounts payable to Ivanhoe	**60,682**	52,045
Accounts payable to I2MS	**285,372**	-
Deposit received from Ivanhoe for sale of metals division	**3,000,000**	-

(c) On December 30, 2008, the Company established a credit facility with Ivanhoe (Note 8).

13. DISCONTINUED OPERATIONS – METALS DIVISION

The Company sold the Metals Division, effective December 30, 2008 with a closing date of February 2, 2009 to Ivanhoe for $3 million. In addition, Ivanhoe will provide the Company with a $30 million credit facility for a one year period (Note 8). Ivanhoe will also provide the Company with the economic equivalent of a 1% Net Smelter Royalty on the Sulawesi and Kerta Projects in Indonesia. The Metals Division consists of certain base and precious metals properties in Mongolia and Indonesia. The Company received the proceeds of $3 million in December 2008 and this receipt is reflected in the 2008 consolidated balance sheet and statement of cash flows.

The Metals Division has been presented as a discontinued operation and financial results are presented as separate items in the consolidated statements of operations and comprehensive loss, and cash flows. The Metals Division assets and liabilities consolidated by the Company in 2008 and 2007 have been segregated in the consolidated balance sheets as assets and liabilities held for sale.

Prior to the sale of the Metals Division, the Company reported information for its three reportable operating segments – Coal Division, Metals Division and Corporate Division. With the sale of the Metals Division and the classification of the Metals Division as a discontinued operation, the Company now has two reportable operating segments – Coal Division and Corporate Division.

13. DISCONTINUED OPERATIONS – METALS DIVISION (Continued)

The loss from discontinued operations is as follows:

		2008		**2007**
Exploration	**$**	**7,911,252**	$	4,647,426
Net loss from discontinued operations	**$**	**7,911,252**	$	4,647,426
Basic and diluted loss per share from discontinued operations	**$**	**0.06**	$	0.09

The carrying values of the net assets related to the discontinued operations are as follows:

		2008		**2007**
Assets				
Current				
Cash	**$**	**222,699**	$	176,678
Accounts receivable		**184,022**		76,216
Prepaid expenses		**133,664**		316,879
Mineral properties, plant and equipment		**97,215**		-
		637,600		569,773
Long Term				
Mineral properties, plant and equipment		**-**		562,495
Total Assets	**$**	**637,600**	$	1,132,268
Liabilities				
Accounts payable	**$**	**255,080**	$	269,795
Net assets of discontinued operations	**$**	**382,520**	$	862,473

14. SEGMENT DISCLOSURES

(a) Geographic information

At December 31, 2008, the Company operated in Mongolia, Canada and Indonesia.

	Mongolia	Canada	Indonesia	Total
December 31, 2008				
Revenues	**$ 3,125,851**	**$ -**	**$ -**	**$ -**
Mineral properties, plant and equipment	**52,122,718**	**20,570**	**13,688,975**	**65,832,263**
Total assets (i)	**76,795,366**	**21,067,749**	**1,631,428**	**99,494,543**
December 31, 2007				
Mineral properties, plant and equipment	$ 898,027	$ 106,217	$ -	$ 1,004,244
Total assets (i)	2,509,471	1,968,336	-	4,477,807

(i) Total assets exclude assets held for sale of $637,600 (2007 - $1,132,269).

(b) Operating segments

The Company's operations are primarily directly towards the acquisition, exploration and production of coal.

	Coal Division	Corporate Division	Total
December 31, 2008			
Total assets (i)	**78,426,794**	**21,067,749**	**$ 99,494,543**
Capital expenditures	**62,480,754**	**15,666**	**$ 62,496,420**
December 31, 2007			
Total assets (i)	2,509,471	1,968,336	$ 4,477,807
Capital expenditures	467,182	137,670	$ 604,852

(i) Total assets exclude assets held for sale of $637,600 (2007 - $1,132,269).

14. SEGMENT DISCLOSURES (Continued)

	COAL		CORPORATE		TOTAL	
	2008	2007	**2008**	2007	**2008**	2007
Revenue	**$ 3,125,851**	$ -	**$ -**	$ -	**$ 3,125,851**	$ -
Operating expenses	**1,930,762**				**1,930,762**	
Depreciation, depletion and accretion	**313,741**	-	**-**	-	**313,741**	-
Income from mine operations	**881,348**	-	**-**	-	**881,348**	-
Corporate administration	**-**	-	**9,329,972**	6,349,768	**9,329,972**	6,349,768
Exploration	**36,173,614**	12,166,819	**-**	-	**36,173,614**	12,166,819
Operating loss from continuing operations	**(35,292,266)**	(12,166,819)	**(9,329,972)**	(6,349,768)	**(44,622,238)**	(18,516,587)
Other income/(expense)						
Interest Expense	**-**	-	**(148,187)**	(1,358,742)	**(148,187)**	(1,358,742)
Interest accretion on line of credit facilities	**-**	-	**(279,048)**	(2,237,248)	**(279,048)**	(2,237,248)
Listing Fees	**-**	-	**(6,715,220)**	-	**(6,715,220)**	-
Other income/(expense)	**-**	-	**(2,709,903)**	30,071	**(2,709,903)**	30,071
	-	-	**(9,852,358)**	(3,565,919)	**(9,852,358)**	(3,565,919)
Loss from continuing operations	**$ (35,292,266)**	$ (12,166,819)	**$ (19,182,330)**	$ (9,915,687)	**$ (54,474,596)**	$ (22,082,506)

At December 31, 2008, the Mongolia coal division had two customers with the largest customer accounting for 61% of revenues and the other customer accounting for 39% of revenues.

15. FINANCIAL INSTRUMENTS

(a) Categories of financial instruments

	2008	2007
Financial assets		
Cash and cash equivalents	**$ 10,117,311**	$ 1,216,954
Accounts receivable	**7,289,726**	683,312
	$ 17,407,037	$ 1,900,266
Financial liabilities		
Trade and other payables	**$ 10,400,009**	$ 1,497,989
Amounts due under line of credit facilities, at amortized cost	**-**	35,107,804
	$ 10,400,009	$ 36,605,793

(b) Fair value

The fair value of the Company's financial instruments approximates their carrying value as at December 31, 2008 because of the demand or short-term maturity of these instruments.

(c) Financial risk management objectives and policies

The Company's financial instruments include cash, short-term money market investments, accounts receivable, deposits and accounts payable. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. Management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

(i) Currency risk

The Company's borrowings, major operating expenses and acquisition costs are denominated in US dollars and a minor portion of the expenses of the Company are in Canadian dollars. The Company's corporate office is based in Canada and the exposure to exchange rate fluctuations arise mainly on foreign currencies against the functional currency of the relevant group entities which is the US dollar. The Company does not have any significant foreign currency denominated monetary liabilities. The Company is principally engaged in the acquisition, exploration and development of mineral properties in Mongolia and Indonesia.

The Company has not entered into any derivative instruments to manage foreign exchange fluctuations, however, management monitors foreign exchange exposure.

15. FINANCIAL INSTRUMENTS (Continued)

(c) Financial risk management objectives and policies (Continued)

The carrying amount of the Company's foreign currency denominated monetary assets at the respective balance sheet dates are as follows:

	2008	2007
Assets		
Canadian dollar	**$ 3,872,037**	$ 224,814
Mongolian Tugriks	**103,825**	4,510
Indonesian Rupiah	**15,436**	-
	$ 3,991,298	$ 229,324

Foreign currency sensitivity analysis

The following table details the Company's sensitivity to a 5% increase and decrease in the US dollar against the Canadian dollar. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 5% change in foreign currency rates. A positive number indicates a decrease in loss for the year where the Canadian dollar strengthens against the US dollar. The opposite number will result if the Canadian dollar depreciates against the US dollar.

	2008	2007
Decrease in		
Loss for the year	**$ 187,923**	$ 11,026

(ii) Interest rate risk

The Company is exposed to cash flow interest rate risk with respect to the variable rate of interest incurred on the amounts due under line of credit facilities for the year ended December 31, 2007. During the year ended December 31, 2008, the amounts due under line of credit facilities were fully converted into shares of the Company. The Company currently does not have any cash flow interest rate risk exposure. The fair value interest rate risk on bank deposits is insignificant as the amounts are short-term.

15. FINANCIAL INSTRUMENTS (Continued)

(c) Financial risk management objectives and policies (Continued)

(iii) 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. Credit risk for the Company is primarily associated with trade accounts receivable, value added tax (VAT) receivable, goods and services tax (GST) receivable and cash equivalents.

The credit risk on trade accounts receivable is managed through an internal process whereby any potential customer is investigated before a sales contract is signed. Risk is further mitigated as the payment terms for all customers range from 10 days to 14 days, which allows the Company to actively monitor the amounts owed by customers and identify any credit risks in a timely manner and reduce the risk of a credit related loss. In addition, the Company reviews the recoverable amount of its receivables at each balance sheet date to ensure that adequate impairment losses are made for unrecoverable amounts. In this regard, the Company considers that the credit risk is significantly reduced. At December 31, 2008, the Mongolia coal division had two customers, with one customer accounting for 61% of revenues and 46% of trade accounts receivable and the other customer accounting for 39% of revenues and 54% of trade account receivable.

The VAT/GST receivable includes amounts that have been accumulated in various subsidiaries since inception. At December 31, 2008 97% of the VAT/GST receivable was due from the Mongolian taxation authority. Verification, by the Mongolian government taxation authority, of the collectability of the funds was conducted in the fourth quarter and the Company anticipates full recoverability of amounts due on account.

The following table provided an aged analysis of the Company's accounts receivable as at December 31, 2008.

	Less than 1 month	1 - 3 months	3 - 6 months	Over 6 months	Total
As at December 31, 2008					
Trade and other receivables	$ 1,850,988	$ 76,214	$ 5,194	$ -	$ 1,932,396
VAT/GST receivable	183,320	366,640	1,699,410	3,107,960	5,357,330
	$ 2,034,308	**$ 442,854**	**$ 1,704,604**	**$ 3,107,960**	**$ 7,289,726**
As at December 31, 2007					
Trade and other receivables	$ 33,829	$ -	$ -	$ -	$ 33,829
VAT/GST receivable	134,827	269,658	244,998	-	649,483
	$ 168,656	$ 269,658	$ 244,998	$ -	$ 683,312

15. FINANCIAL INSTRUMENTS (Continued)

(c) Financial risk management objectives and policies (Continued)

The credit risk on cash equivalents is limited because the cash equivalents are composed of financial instruments issued by Canadian banks and companies with high credit ratings as assigned by international credit-rating agencies. Therefore, the Company is not exposed to significant credit risk and overall the Company's credit risk has not changed significantly from prior years.

(iv) Liquidity risk

In the management of liquidity risk of the Company, the Company maintains a balance between continuity of funding and the flexibility through the use of borrowings. Management closely monitors the liquidity position and expects to have adequate sources of funding to finance the Company's projects and operations.

The following table details the Company's expected remaining contractual maturities for its financial liabilities. The table is based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to satisfy the liabilities.

	Less than 1 month	1 - 3 months	3 - 6 months	Over 6 months	Total undiscounted cash flows	Total
As at December 31, 2008						
Trade and other payables	**$ 3,607,249**	**$ 3,792,760**	**$ -**	**$ -**	**$ 7,400,009**	**$ 7,400,009**
As at December 31, 2007						
Trade and other payables	$ 368,758	$ 351,035	$ 778,016	$ -	$ 1,497,809	$ 1,497,809
Amounts due under line of credit facilities -At amortized cost (i)	-	-	-	36,452,669	36,452,669	35,107,804
	$ 368,758	$ 351,035	$ 778,016	$ 36,452,669	$ 37,950,478	$ 36,605,613

(i) The weighted average effective interest rate is 6.92%.

(v) Commodity price risk

Profitability of the Company depends on the coal prices. Coal prices are affected by numerous factors such as interest rates, exchange rates, inflation or deflation and global and regional supply and demand.

The Company enters into sales contracts with its customers to manage the risk of a significant decrease in the price of coal. The Company has not entered into any coal hedging instruments to manage its exposure to fluctuations in coal prices.

16. CAPITAL MANAGEMENT

The Company includes as capital its 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 support the Company's normal operating requirements, continue the development and exploration 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. In order 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 operations, 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.

In order to maximize ongoing development efforts, the Company does not pay 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 regard to the expected timing of expenditures from operations.

The Company expects its current capital resources and projected free cash inflow from continuing operations will be sufficient to carry its operations, exploration and development plans through its current fiscal year.

17. SUPPLEMENTAL CASH FLOW INFORMATION

(a) Changes in non-cash working capital items

	Year Ended December 31,	
	2008	2007
Net (increase) in:		
Accounts receivable	**$ (7,166,492)**	$ (523,386)
Prepaid expenses	**(1,005,230)**	(1,417,793)
Inventories	**(10,856,935)**	-
Net increase in:		
Accounts payable and accrued liabilities	**6,101,978**	1,127,814
	$ (12,926,679)	$ (813,365)

17. SUPPLEMENTAL CASH FLOW INFORMATION (Continued)

(b) Non-cash financing and investing activities

	Year Ended December 31,	
	2008	2007
Conversion of line of credit facility (First funding agreement)	**$ 32,498,927**	$ -
Conversion of preferred shares to common shares	**75,419**	-
Transfer of contributed surplus upon exercise of options	**1,789,966**	1,354,174
Purchase of plant and equipment through the issuance of common shares	**-**	243,500
Acquisition of mineral properties, plant and equipment through the issuance of common shares	**5,198,000**	20,000
Equity component of line of credit facility	**-**	3,055,359
Increase in line of credit facility upon assumption of coal transaction costs	**-**	13,231,672
	$ 39,562,312	$ 17,904,705

(c) Operating activities included the following cash payments

	Year Ended December 31,	
	2008	2007
Interest Paid	**$ 77,470**	$ -

18. COMMITMENTS

At December 31, 2008, the Company had outstanding commitments of $16 million for coal mining equipment. Included in the $16 million is $15 million for the purchase of a second fleet of coal mining equipment for the development of its Ovoot Tolgoi Project in Mongolia. Delivery and commissioning of the equipment is scheduled for the second quarter of 2009. The Company also has the option to purchase truck and shovel fleets for delivery in 2010 and 2011 with prices to be negotiated at the time of the orders.

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

December 31, 2008

(Stated in U.S. Dollars)

SOUTHGOBI ENERGY RESOURCES LTD

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
December 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") is an integrated coal and energy development company. Since acquiring significant coal assets in Mongolia in a series of transactions (the "coal transaction") with Ivanhoe Mines Ltd ("Ivanhoe"), the Company's strategic focus has been developing and operating coal mining projects.

The Company's common shares trade on the TSX Venture Exchange ("TSX-V") under the symbol SGQ.

Prior to the May 2007 coal transaction, the Company was a mineral exploration company with a focus on precious and base metal exploration and development in Mongolia, and elsewhere. Having completed the coal transaction in May 2007 and with the sale of its metals division on December 30, 2008, the Company's principal focus is now on its Mongolian coal operation at Ovoot Tolgoi and coal exploration and development in southern Mongolia and Indonesia.

Recent Developments

Ovoot Tolgoi Project Development

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 April 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.

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

The equipment was purchased through a local equipment distributor in Mongolia, and is valued at approximately $31 million. The second fleet is scheduled for delivery late in the second quarter of 2009 with a final amount owing of approximately $15 million. The Company also has the option to purchase additional truck and shovel fleets for delivery in 2010 and 2011. The purchase of the larger

capacity fleet is expected to allow the Company to expand the annual production capacity and accelerate development at the Ovoot Tolgoi open-pit mine.

Pre-development of the Ovoot Tolgoi open pit mine began during the first quarter of 2008. The initial workforce for the Ovoot Tolgoi open-pit mine has been recruited, along with senior mine management staff.

Road construction, site clearing, drainage control and topsoil removal from the planned coal stockpile area continued throughout the second quarter and third quarter of 2008. During the fourth quarter, waste removal continued and coal was stockpiled with coal shipments taking place throughout the quarter. The Company reached its 2008 target production of 1 million tonnes, ahead of schedule, at the end of November 2008.

The mancamp and permanent shop facility plans were approved and construction detail layouts have commenced.. The mancamp and shop facilities are scheduled for completion in mid 2009, and the mine airstrip surfacing has been completed and final permitting is expected in March 2009.

In early January 2008, the Mongolian Government's Mineral Resources and Petroleum Authority selected SouthGobi as Mongolia's "Best Exploration Company of 2007", and in January 2009 the Mongolian Government formally recognized the Company's strong exploration program and timely government reporting process.

On June 4, 2008, the Company held the official opening ceremony at the Ovoot Tolgoi open-pit mine site.

In July 2008, the Company announced that it had received an updated resource estimate in respect of the West Field portion of the Ovoot Tolgoi coal project in Mongolia from an independent third party technical consultant. The consultant subsequently advised the Company, and the Company announced in March 2009, that errors had been discovered in the resource estimate and that these errors resulted in an overstatement of the resources in the West Field reported by the Company in July 2008, primarily in the indicated and inferred categories. See "MINERAL PROPERTIES – Properties in Mongolia – Ovoot Tolgoi Open Pit Project".

The results of the 2008 drilling program resulted in the discovery of multiple, near surface coking and thermal coal seams at the Sumber coal project. Previously referred to as part of the Alphabet fields, the Sumber coal project is 16 kilometers ("km") east of the current Ovoot Tolgoi coal mine. In October 2008, the Company announced the discovery of a new coal occurrence approximately 10 km southeast of the current Ovoot Tolgoi coal mine.

Mamahak Project

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

In September 2008, based on positive exploration results, the Company increased its working interest in MCM to 85%. The cost to increase its working interest was $13.2 million, comprised of cash and shares of the Company.

In early January 2009, the Company announced that a location permit was issued, which allows the Company to commence surface coal mining on MCM.

In February 2009, the Company announced that it had received an initial resource estimate from its independent consultants, SMG Consultants ("SMG") in respect of the E resource block and the SW resource block on the MCM concession. See "MINERAL PROPERTIES – Properties in Indonesia – Mamahak Coal Project.

Financing Activities

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 acquired as part of the coal transaction into common shares of the Company. Subsequently, the Company repaid all non-convertible indebtedness owing to Ivanhoe.

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, directly and indirectly, currently owns 106,804,155 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 thereunder 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 of up 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 gross proceeds of C$6.4 million ($6,484,296).

The Company subsequently entered into a subscription agreement with its Mongolian mining 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 ($24,785,076). This private placement closed on May 30, 2008.

The bulk of the proceeds of these equity private placements were 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.

Corporate Activity

On December 31, 2008 the Company announced the sale of its Metals Division to Ivanhoe for $3 million and other non-cash consideration, with an effective date of December 30, 2008 and a closing date of February 2, 2009. As part of the sale transaction, the Company obtained a $30 million working capital credit facility from Ivanhoe.

On February 10, 2009 the Company announced the appointment of Alex Molyneux as its new President, effective April 27, 2009. Based in Hong Kong, Mr. Molyneux will be responsible for business and corporate development initiatives. He was most recently Managing Director, Head of Metals & Mining Investment Banking, Asia Pacific, with Citigroup.

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

The preparation of financial statements in conformity with Canadian generally accepted accounting principles ("GAAP") requires the Company to establish accounting polices and to make estimates that affect both the amount and timing of the recording of assets, liabilities, revenues and expenses.

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, 2008.

The following is an outline of the estimates that the Company considers as critical in the preparation of its consolidated financial statements for year ended December 31, 2008.

Mineral Property and Exploration Costs

All direct costs related to the acquisition of mineral property interests are capitalized by property or project. Exploration costs are charged to operations until such time as it has been determined that a property has economically recoverable reserves, in which case 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 the carrying values may exceed the estimated net recoverable amounts. An impairment loss is recognized when the carrying value of those assets is not recoverable and exceeds their fair value.

Asset retirement obligations

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 accretion expense charged in a period.

Inventory valuation

Coal and supplies inventory is valued at the lower of cost and net realizable value. Coal inventory includes direct and indirect expenses associated with extracting and processing, including labor, operating materials, supplies, transportation costs and an applicable portion of overhead including depreciation and depletion.

Changes in estimates of net realizable value may result in reductions in the carrying value of inventory and corresponding charges to the cost of product sold in future periods.

Overburden removal costs

The Company has adopted the guidance of CICA Emerging Issues Committee EIC-160, Stripping Costs Incurred in the Production Phase of a Mining Operation. The guidance was effective for years commencing on or after July 1, 2006. The abstract requires the cost of the stripping activities during the production phase of the mine to be accounted for according to the benefit received. Generally, such costs are expensed as variable production costs; however, the costs are capitalized if they can be shown to represent a betterment to the mineral property. A betterment occurs when the stripping activity increases future output of the mine by providing access to a new ore body. Any capitalized stripping costs are described as investing activities in the cash flow statement and are depleted on a unit-of-production basis using estimated resources as the depletion base.

Effective April 2, 2008, on commencement of mining operations, the Company has capitalized its stripping costs.

Income taxes

The Company must make significant estimates in respect of the provision for income taxes and the composition of its future income tax assets and future income tax liabilities. The Company's operations are, in part, subject to foreign tax laws where interpretations, regulations and legislation are complex and continually changing. As a result, there are usually some tax matters in question which may, on resolution in the future, result in adjustments to the amount of the future income tax assets and future income tax liabilities, and those adjustments may be material to the Company's financial position and results of operations.

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 substantively enacted 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 determination of the ability of the Company to utilize tax loss carry-forward amounts to offset future income taxes payable requires management to exercise judgment and make assumptions about the future performance of the Company. Management is required to assess whether the Company is "more likely than not" to be able to benefit from these tax losses. Changes in the economic conditions, commodity prices and other factors could result in revisions to the estimates of the benefits to be realized or the timing of utilizing the losses.

Stock-based compensation

The Company accounts for stock options granted to directors, officers, employees and service providers using the Black-Scholes option pricing model. Accordingly, the fair value of the options at the date of the grant is accrued with a corresponding credit to contributed surplus, and charged to earnings using the grade vesting method. 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.

Revenue recognition

Coal revenues are recognized when the risk and rewards of ownership pass to the buyer, collection is reasonably assured and the price is reasonably determinable. This occurs when the coal is either loaded onto transportation equipment or when it is unloaded at the final destination, depending on the terms of the sales contract.

Depletion and depreciation of property, plant and equipment

Property, plant and equipment comprise the largest component of the Company's assets and, as such, the depreciation of these assets has a significant effect on the Company's financial statements.

On the commencement of commercial production, depletion of each individual mining property is provided on the unit-of-production basis using estimated resources as the depletion basis.

The mining plant and equipment and other capital assets are depreciated, over their expected economic lives using either the unit-of-production or straight-line method. Capital projects in progress are not depreciated until the capital asset has been put into operation.

The estimates of the resources for the depletion basis are determined based on professional evaluation, but may change based on additional knowledge gained subsequent to the initial assessment. A change in the original resource estimates would result in a change in the rate of depletion of the related mining assets.

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 in accordance with the new standard.

   Coal inventory is valued at the lower of cost and net realizable value. Production costs include direct and indirect labor, operating materials and supplies, transportation costs, an applicable portion of operating overhead, including depreciation. Net realizable value is the expected difference between the average selling price for the finished product less the costs to get the product into saleable form and to the selling location.

   Supplies inventory consists of consumable parts and supplies, which are valued at the lower of average cost and net realizable value. Net realizable value is actual cost less any provision for obsolescence.

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.

NON-GAAP FINANCIAL MEASURES

This management discussion and analysis refers to certain financial measures, such as “cash costs”, which are not standardized measures recognized under GAAP in Canada and do not have a standardized meaning prescribed by GAAP. These measures are commonly utilized in the mining industry and are considered informative for management, shareholders and analysts. These measures may differ from those made by other corporations and accordingly may not be comparable to such measures as reported by other companies.

Cash costs is the term used by the Company to describe the cash production costs and consists of cost of product, which includes direct and indirect costs of production.

	2008	2007	2006
Cash costs, continuing operations			
Operating expenses per financial statements	**$ 1,931**	-	-
Less non-cash adjustments	**(339)**	-	-
Total cash costs	**1,592**	-	-
Coal sales *(tonnes)*	**113,000**	-	-
Total cash costs of product sold *(per tonne)*	**$ 14.09**	-	-

	2008	2007	2006
Cash costs, continuing operations			
Direct cash costs of product sold *(per tonne)*	**$ 8.30**	-	-
Mine administration cash costs of product sold *(per tonne)*	**5.79**	-	-
Total cash costs of product sold *(per tonne)*	**$ 14.09**	-	-

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 former Metals Division was prepared by, or under the supervision of, Richard R. Gosse, P.Geo, formerly the Vice President Exploration, of the 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, and 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").

Coal Group Profile

Mongolia Exploration Licenses

The coal transaction was completed in May 2007, when the Company acquired Ivanhoe's coal division, including 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 January 31, 2009 the Company held 45 licenses, which in total cover an area of approximately 2.0 million ha.

Unless stated otherwise, the Company has a 100% interest in its coal projects.

Properties in Mongolia

Ovoot Tolgoi Open Pit Project

The Nariin Sukhait property was renamed "Ovoot Tolgoi" to differentiate the Company'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 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. Resources at the Ovoot Tolgoi property are found in two different areas, referred to as the South-East and the West Fields. The Company's independent consultant, Norwest Corporation ("Norwest") estimated that, as of December 31, 2006, the South-East Field hosted 49.8 million tonnes of measured resources, 15.9 million tonnes of indicated resources and 6.5 million tonnes of inferred resources. Norwest also estimated 55.1 million tonnes of measured resources, 28.7 million tonnes of indicated resources and 22.6 million tonnes of inferred resources for the West Field.

In July 2008, the Company announced that its independent technical consultant, The Americas Group, Inc. ("TAG") of Lakewood, Colorado had prepared a new resource estimate for the West Field portion of the Ovoot Tolgoi coal project in Mongolia. TAG subsequently advised the Company, and the Company announced in March 2009, that errors had been discovered in the resource estimate and that these errors resulted in an overstatement of the resources in the West Field reported by the Company in July 2008, primarily in the indicated and inferred categories. However, the current resource estimates for the separate South-East Field and the Ovoot Tolgoi underground project are not affected by the errors. The current mining plan and operations at Ovoot Tolgoi, which are based on an earlier estimate of the West Field coal resources as of December 31, 2006, are also unaffected.

The Company will appoint a major international engineering firm to complete a new technical report for the Ovoot Tolgoi project incorporating outstanding data obtained from drilling to the end of 2008, reflecting a redesign of the surface mine to a depth of 300 metres from the present 250 metres, updating the resource models and delineating reserves based on at least a pre-feasibility level of engineering. The Company expects to receive this report later in 2009. Management believes this new report will more fully demonstrate the potential of the Ovoot Tolgoi coal deposit.

The Company made considerable progress in identifying additional resources at Ovoot Tolgoi in 2008, drilling over 23,200 metres down to a depth of 800 metres in the West Field. In addition, there are 3,800 metres of drill data from 2007 in the South-East Field that still require modelling. Based on 2008 drill data, the coal potential is continuous along strike and at depth. Management is very encouraged by the results from the drilling completed in 2008 and believes that the data obtained will provide a basis for establishing additional resources. Further drilling is planned for the summer of 2009 to provide additional support for further expanding the resources identified to date at Ovoot Tolgoi.

The incorrect West Field resource estimate prepared by TAG is shown in Table 1 below:

Table 1: TAG Surface Coal Resources Summary for the West Field of the Ovoot Tolgoi Project as of June 20, 2008 (incorrect –as originally reported in July 2008)

Resource Area	ASTM Coal Rank	Resources at Ovoot Tolgoi		
		Measured (tonnes)	Indicated (tonnes)	Inferred (tonnes)
West Field	**hvB to hvA**	79,567,545	113,623,016	138,821,278
Total		193,190,561		138,821,278

According to TAG, an arithmetical error in calculating the resources and an error in the resource model resulted in the resource estimate being overstated. TAG has since corrected the errors and re-calculated the resource estimate as shown in Table 2 below:

Table 2: TAG Surface Coal Resources Summary for the West Field of the Ovoot Tolgoi as of June 20, 2008
(corrected)

Resource Area	ASTM Coal Rank	Resources at Ovoot Tolgoi		
		Measured (tonnes)	Indicated (tonnes)	Inferred (tonnes)
West Field	**hvB to hvA**	74,972,951	27,687,201	18,761,047
Total		102,660,152		18,761,047

Including the restated West Field resource estimate, the estimated combined resources for the South-East Field and the West Field of the Ovoot Tolgoi Project are shown in Table 3 below. The restated West Field resource estimate is based on data to June 20, 2008. The resource estimate for the South-East Field is based on data to December 31, 2006.

Table 3: Restated Ovoot Tolgoi West Field and South-East Field In-Place Surface Coal Resources Summary

Resource Area	ASTM Coal Rank	Resources at Ovoot Tolgoi		
		Measured (tonnes)	Indicated (tonnes)	Inferred (tonnes)
South-East Field	**hvB to hvA**	49,752,000	15,987,000	6,502,000
West Field	**hvB to hvA**	74,972,951	27,687,201	18,761,047
Total		**168,399,152**		**25,263,047**

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 2008 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.

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 approved and construction started in the second quarter of 2008. The exploration camp was winterized in 2007 and commissioned in early 2008 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.

Upon receiving the Permit to Mine, SouthGobi Energy began mining and stockpiling coal at its Ovoot Tolgoi Project in April 2008. As of December 31, 2008, the total waste mined was 2.5 million Bank Cubic Meters ("BCM") and the total coal mined was 1.16 million tonnes at a strip ratio of approximately 2.19 BCM waste per tonne of saleable coal. Of the total coal mined, approximately 220,000 tonnes are oxidized steam coal and 940,000 tonnes are premium coal. Coal sales at the mine gate were initiated in late September 2008 and were approximately 113,000 tonnes to December 31, 2008. The average selling price for existing contracts is approximately $29 per tonne.

At the beginning of June 2008, the mine started operating on a full time 24 hour basis. Regular manpower rotation at the site is in effect with crew rotations every 14 days. At December 31, 2008, SouthGobi employed 222 employees in Mongolia of which ten are expatriates and 212 are Mongolian nationals. Of the 222 employees, 33 are in the Ulaanbaatar office, 185 are at the mine site and the remainder is at outlying smaller offices close to the mine site.

On April 15, 2008, the Company purchased a second fleet of coal mining equipment for the open pit mine, which is scheduled for delivery late in the second quarter of 2009. This second fleet of equipment is valued at approximately $31 million. The additional equipment will expand annual production capacity for the Ovoot Tolgoi mine to approximately 2.9 million tonnes in 2009.

Work on the new shop complex, mancamp and airstrip surfacing at Ovoot Tolgoi continued throughout the fourth quarter. The airstrip surfacing project was completed at year end and is expected to be certified in early 2009. The mancamp and shop building contractor has agreed to work throughout most of the winter months, which should allow for completion of both the mancamp and the shop facilities by mid-2009.

A Beijing representative office has been established in China. The Beijing office has also hired an Inner Mongolian representative who will be located in Ejina (near Ceke), People's Republic of China (PRC) to deal with transportation matters involving coal export and supply imports into Mongolia.

The Ovoot Tolgoi mine is 45 km north of Mongolia's border with China. A Chinese steel mill has built a railway line to the Ceke border point, where a major automated railcar loading facility opened last year. In December 2008, the Company entered into preliminary discussions with major railway contractors on the development of a coal railway from the Ovoot Tolgoi mine to a point across the Chinese border. These discussions also contemplated a mine loadout facility and a coal distribution centre in Ceke. The Company intends to carry out further studies with respect to these proposed facilities during the first half of 2009.

The Company has been engaged in ongoing discussions with the Mongolian government with the objective of establishing a border crossing at the Ceke border point that will be open for a full 24 hours per day. This is expected to allow daily distribution of Ovoot Tolgoi coal to customers in

China. SouthGobi has purchased an automated 150 tonne scale which has been set up at the border to expedite coal traffic crossing the border into China from Ovoot Tolgoi.

To date, the Company has experienced difficulty, from time to time, in expediting the movement of its coal shipments through the Ceke border point due to relatively erratic and unpredictable opening hours and sporadic closures. The Mongolian government and the Company are coordinating efforts to resume regular border crossing access for the Company's coal shipments. Through early 2009 limited shipments crossed the border point. As a result the Company has initiated a production curtailment program to preserve cash flow and decrease current stockpiles.

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 300 to 700 m that is designated for the underground development is located inside the existing Ovoot Tolgoi mining license.

In March 2008, TAG prepared a resource estimate for underground resources in the West Field. Estimated resources for the West Field are approximately 3.9 million tonnes of measured resources, 12.6 million tonnes of indicated resources and 36.7 million tonnes 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 set out in the Technical Report entitled "Underground Resources at Ovoot Tolgoi – West Field" dated March 28, 2008 and available at www.sedar.com.

The 2008 exploration program concentrated on the underground West Field. This drilling was conducted to obtain additional information respecting the structure and quality of the deep underground coal mineralization. This same type of program is planned to be carried out in 2009 on the South East Field at Ovoot Tolgoi. 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 2008 program in the West Field has extended the depth of the potential mine to 700m. The No. 5 coal seam continues to be open to depth and along strike.

Sumber Project

The Sumber Project is comprised of N, O and E Fields. This coal field starts 16 km east of Ovoot Tolgoi and stretches for approximately 18 km to the east. The N, O and E fields are covered by Mineral Exploration License #9443, which also encompasses part of the Ovoot Tolgoi project. N field is located approximately 16 km east of the Ovoot Tolgoi South-East pit and 8 km west of O Field. E Field is located approximately 10 km west of O Field.

In 2005, coal occurrences were identified in the N and O fields. N Field coal occurrences have been identified approximately two km north of the east-west trending Nariin Sukhait thrust fault, the major structural feature of the Ovoot Tolgoi region. Further exploration drilling in 2006 suggests 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.

In June 2008, the Company announced that it has intersected significant thicknesses in near-surface seams of high-quality coking and thermal coal, including one intercept of 51.5 m. The 2008 drilling program was completed during the fourth quarter of 2008 and the results are expected to provide the basis for a resource estimate in 2009. Once completed, mine planning will be initiated and an application for a mining license will be submitted for development of this project.

Tsagaan Tolgoi 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 the basis for a resource estimate. A resource estimate prepared by Norwest in February 2008, estimated 23.4 million tonnes of measured resources, 13.0 million tonnes of indicated resources 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 appear to be amenable to 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 set out in the Technical Report entitled "Coal Geology and Resources – Tsagaan Tolgoi Property" dated March 25, 2008 and available at www.sedar.com.

The Company's plans for the Tsagaan Tolgoi coal field are presently uncertain. Any development of the field would be expected to occur only if Tsagaan Tolgoi were to be selected as a supplier of thermal coal for a power plant to be constructed to support Ivanhoe's Oyu Tolgoi copper and gold project. The timing of the continued development of the Oyu Tolgoi project is contingent upon a number of factors beyond the control of the Company and Ivanhoe, including the approval by the government of Mongolia of an investment agreement.

Tavan Tolgoi Extension Project

The Tavan Tolgoi Extension Project is composed of eight exploration licenses located east of Dalanzadgad, the provincial capital in the Omnogovi Aimag. The Company also holds an option to acquire three additional exploration licenses from Ivanhoe covering areas in the vicinity.

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. Exploration work on the extension continued in 2008.

Mamahak Coal Project – Indonesia

The Company holds its interest in the Mamahak coal project through a joint venture. In September 2008, the Company increased its working interest in the joint venture from 56% to 85%. Under the terms of the Joint Venture Earn-In Agreement ("JVA") the Company has the right to increase its working interest position based on a predetermined pricing mechanism. The Company elected to increase its working interest to 85% by paying its co-venturer $13.2 million, comprised of $8.0 million cash and 320,000 common shares of the Company at a deemed value of C$16.15 per share. The terms of the JVA allow the Company to increase its working interest to 100% in the project.

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.

SouthGobi has commenced the development of greenfields surface coal deposits in four concessions covering 22,976 ha in East Kalimantan, Indonesia, through its participation in the Mamahak project.

The 2008 drilling program has identified quantities of high fluidity coking coal that appear to be amenable to surface mining. At the end of 2008, 220 drill holes had been completed on the SW and E resource blocks on the MCM concession. The SW and E blocks cover approximately 638 hectares of the MCM concession. Further drilling is ongoing. The intent of the drilling program is to determine down-dip continuity, thickness variations, coal quality and structure. Reconnaissance and initial field mapping has been initiated over the larger concession areas.

The drilling results received to date support the quality data from the initial field outcrop test results. In November 2008 the company received independent laboratory analysis of a recent bulk sample that confirms high volatile, high-fluidity metallurgical coking coal at the project. The bulk sample was taken on the SW resource block within the MCM concession and was comprised of proportioned blending of several coal seams from an area where the company plans to commence mining in 2009. The proximate analysis and related testing of the bulk sample raw coal was carried out by PT Geoservices Ltd. of Jakarta, Indonesia.

The Company has contracted the Jakarta office of Australian based SMG to assist in the field programs. All drill holes are being geophysically logged with detailed intersection data delivered to the SMG office in Jakarta for the preparation of a geological model to be used for mine planning.

Initial independent resource estimates have been prepared for the Mamahak coal project by the Company's independent consultants, SMG who have estimated that the E resource block on the MCM concession contains 5.0 million tonnes of measured resources, 7.3 million tonnes of indicated resources and 2.7 million tonnes of inferred resources, while the SW resource block contains 2.6 million tonnes of inferred resources. The resource estimates have been calculated to Joint Ore Reserves Committee Standards ("JORC"), which in relation to these deposits classify the same measured, indicated and inferred resource areas as National Instrument 43-101.

Required permit applications for mining, coal transportation and a barge load-out facility for the area have been filed. In December 2008 a permit was issued, which will allow the Company to commence surface coal mining at the SW deposit on the MCM concession. A site office, accommodation camp and a satellite communication system are being mobilized for the project. An administrative project office has been established at the port village of Melak on the Mahakam River approximately 90 km from the site. Construction activity continued through year end at the project site and is focused on the completion of a 30 km haul road from the SW deposit to the barge port on the Mahakam River. Construction is in progress on the installation of a river barge loading terminal which will be located at Long Habung on the Mahakam River.

The Indonesian central Government has announced new Mining Legislation at the end of 2008, which was signed on January 12, 2009. The new law is known as the Minerba. The Company is currently reviewing the details, but the new law seeks to clarify the issues on the role of government in the mining license process; the introduction of two new types of mining concessions; changes regarding related parties and mining services agreements; a transition period for the current Contract of Work system and a change that allows direct ownership of mining concessions by foreign companies, thus eliminating some of the title risks associated with the previous mining law.

Metals Group Profile and Discontinued Operations

On December 31, 2008, the Company announced the sale of the Metals Division to Ivanhoe for $3 million and other non-cash consideration. The Metals Division consists of a series of base and precious metal exploration properties in Mongolia and Indonesia, related assets, employees and contracts. As part of the sale transaction, the Company obtained a credit facility from Ivanhoe, which allows SouthGobi to receive loan advances from Ivanhoe to an aggregate maximum of $30 million. The credit facility is for a one year term with a one year discretionary extension. The credit facility is unsecured and carries an interest rate equal to LIBOR plus 7.5 basis points.

The Company also received a 1% net returns royalty in certain mineral projects in Indonesia, and retained the rights to the Kharmagtai and Chandman Uul properties in Mongolia.

SouthGobi retained an independent advisor to prepare a valuation report in respect of the transaction, which closed on February 2, 2009 following receipt of regulatory approval.

Properties in Mongolia

Mongolia Exploration Licenses

As of February 2, 2009, the Metals Division held 26 exploration licenses for copper and gold exploration in Mongolia covering an aggregate area of approximately 215,000 ha. Eighteen of these licenses, comprising an area of approximately 149,000 ha, the West Gobi Properties, are located in the west-central portion of the Omnogovi Aimag (province) approximately 510 km southwest of Ulaanbaatar, Mongolia. Two of the remaining licenses are known as the Oyut Ovoo property and are located approximately 270 km southwest of Ulaanbaatar. In addition, three licenses are held in Khuvsgul Aimag in northern Mongolia, one license is held as part of a joint venture agreement with Gallant Minerals Ltd. ("Gallant") in the West Gobi and two are located in the Tsagaan Tolgoi region.

Properties in Indonesia

Indonesia Exploration Licenses

The Company began evaluating copper and gold projects in Indonesia in 2005. As of February 2, 2009, the Metals Division was involved in 11 projects with five Indonesian partners. A total of 28 licenses were held for an aggregate area of approximately 104,574 ha and there were an additional 5 licenses under application covering an aggregate area of approximately 216,824 ha.

Summarized Annual Financial Results ***(thousands of dollars)***

	2008	2007	2006
Revenue	**$ 3,126**	$ -	$ -
Operating loss from continuing operations	**$ (44,622)**	$ (18,517)	$ (2,425)
Loss from continuing operations	**$ (54,475)**	$ (22,083)	$ (2,793)
Loss from discontinued operations	**$ (7,911)**	$ (4,647)	$ (6,569)
Net loss	**$ (62,386)**	$ (26,730)	$ (9,362)
Loss per share from continuing operations	**$ (0.43)**	$ (0.43)	$ (0.17)
Loss per share from discontinued operations	**$ (0.06)**	$ (0.09)	$ (0.39)
Net loss per share	**$ (0.49)**	$ (0.52)	$ (0.56)
Total assets	**$ 100,132**	$ 5,610	$ 2,052
Total long term liabilities	**$ 512**	$ 35,108	$ 5,836

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

Prior to the completion of the coal transaction in May 2007, the Company was a mineral exploration company with a principal focus on precious and base metals exploration and development.

In 2006, the Company's Metals Division explored for precious and base metals in Mongolia, Bulgaria and Indonesia. Exploration for precious and based metals continued into 2007; however the principal focus, beginning in June 2007, was on the exploration and development of the Coal Division in Mongolia and Indonesia.

In early 2008, the Company completed a series of equity financings that enabled it to further develop its projects.

Throughout 2008, the Company continued to explore for precious and base metals, however the purchase of the Coal Division from Ivanhoe transformed SouthGobi into a coal exploration, development and production company with revenue, operating expenses and significantly higher corporate administrative and exploration costs. The increase in total assets relates to the expansion of the Coal Division.

In December 2008 the Company sold its Metals Division to Ivanhoe for $3 million and other non-cash consideration. The transaction closed on February 2, 2009. As part of the transaction, the Company obtained a credit facility from Ivanhoe, which allows it to obtain loan advances from Ivanhoe to an aggregate maximum of $30 million.

The sale of the Metals Division is disclosed as a discontinued operation and its financial results are separately classified in our financial results for the year ended December 31, 2008.

SELECTED QUARTERLY DATA

Selected Quarterly Data

($ in thousands, except per share information)

	2008				2007			
QUARTER ENDED	**31-Dec**	**30-Sep**	**30-Jun**	**31-Mar**	31-Dec	30-Sep	30-Jun	31-Mar
Revenue	**$ 3,126**	**$ -**	**$ -**	**$ -**	$ -	$ -	$ -	$ -
Exploration expenses	**8,117**	**11,441**	**10,310**	**6,306**	4,692	4,242	3,233	-
Loss from continuing operations	**14,772**	**21,371**	**11,096**	**7,236**	7,734	6,877	6,689	783
Loss from discontinued operations	**2,549**	**1,667**	**2,392**	**1,303**	1,266	963	1,551	867
Net loss	**17,321**	**23,038**	**13,488**	**8,539**	9,000	7,840	8,240	1,650
Net loss per share	**(0.13)**	**(0.17)**	**(0.10)**	**(0.07)**	(0.12)	(0.11)	(0.22)	(0.10)

Selected Quarterly Information

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.

Revenue from coal sales, which began at the end of September 2008, increased during the quarter ended December 31, 2008. Exploration expenses will vary from quarter to quarter depending on the number of projects and the related seasonality of the exploration programs. Exploration costs for the Metals Division are classified as a loss from discontinued operations and were incurred for exploration projects in Mongolia, Bulgaria and Indonesia. Coal expenditures in Mongolia were initially incurred during the quarter ended June 30, 2007. Expenditures on the Indonesian coal division began in 2008.

RESULTS OF OPERATIONS

Fourth Quarter

The Company incurred a net loss for the three months ended December 31, 2008 of $17.3 million compared to a net loss of $9.0 million for the same period in 2007. This change is due to the factors discussed below.

Revenue, operating expenses, depreciation, depletion and accretion relate to the Company's operations in Mongolia. The Company commenced initial deliveries of coal in late September 2008, with increased shipments continuing throughout the fourth quarter. The Company has incurred operating expenses of $1.9 million in the fourth quarter, which relate to the cost of the product sold and mine administration costs. Depreciation, depletion and accretion costs are charges for equipment depreciation, stripping costs and asset retirement obligation accretion.

Exploration expenses for the three months ended December 31, 2008 were lower than the quarter ended September 30, 2008 due to the decreased winter drilling activity on the Mongolian coal projects. The Coal Division continued its exploration activities in Indonesia throughout the fourth quarter with expenditures of approximately $3.1 million. The Metals Division activities in the fourth quarter consisted of exploration in both Mongolia and Indonesia.

Corporate administration costs for the quarter ended December 31, 2008 were $3.1 million compared to $1.4 million for the quarter ended December 31, 2007. The amounts consist of the following major categories broken down for comparative purposes.

Office and administration fees increased in the three months ended December 31, 2008 compared to the same period in 2007. The increases relate to added personnel and office and administration support costs, insurance and public relation 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.

Professional fees have increased for the three months ended December 31, 2008 as compared to the same period in 2007. Quarterly charges include the cost of quarterly reviews and accruals for the year end audit of the Company's financial statements. The current quarter increases consist of increased year end audit accruals, internal control documentation, internal corporate tax planning and preparation costs, statutory filing and disclosure costs.

Salaries and benefits, excluding stock based compensation costs, increased in the three months ended December 31, 2008 to $382,000 as compared to $341,000 for the three months ended December 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, and an increase in director fees for the period ended December 31, 2008.

The amounts for other income and expenses are as follows. Interest income will increase or decrease in a quarter depending on the cash position, and related spending on operations. Interest expense is $nil for the three months ended December 31, 2008 as compared to $547,000 in the same period in

2007, which relates to the lines of credit from Ivanhoe. Interest accretion on line of credit expense was $nil in the current period and in 2007 the amount 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 losses/(gains) are primarily the result of changes of the U.S. to Canadian dollar exchange rates during the period.

Listing fees, consisting of legal, accounting and professional fees, consist of initial listing application costs for a secondary listing on an Asian stock exchange. The Company has appointed a project sponsor for a simultaneous listing and equity fundraising. The Company had planned to treat the charges as share issue costs upon a successful equity fundraising. However, current liquidity issues in the credit markets, along with the increased cost of obtaining capital and the reduced availability of equity funding have led to a decision to expense these costs. The Company is continuing with the secondary listing application.

Results of Operations

		2008		2007		2006
Volumes, Prices and Costs						
Coal production *(millions of tonnes)*		**1.16**		-		-
Coal sales *(millions of tonnes)*		**0.11**		-		-
Average sales price *(per tonne)*	**$**	**29.20**		-		-
Total cash costs of product sold *(per tonne)*	**$**	**14.09**		-		-
Direct cash costs of product sold *(per tonne)*	**$**	**8.30**		-		-
Operating Statistics						
Total waste material moved *(millions of bank cubic metres)*		**2.54**		-		-
Strip ratio *(bank cubic metres of waste rock per tonne of clean coal produced)*		**2.19**		-		-
Operating Results ***(thousands of dollars)***						
Revenue	**$**	**3,126**	$	-	$	-
Operating expenses		**1,931**		-		-
Depreciation, depletion and accretion		**314**		-		-
Income from mine operations		**881**		-		-
Corporate adminstration		**9,330**		6,350		2,425
Exploration		**36,173**		12,167		-
Operating loss from continuing operations	**$**	**(44,622)**	$	(18,517)	$	(2,425)

The Company incurred an operating loss from continuing operations for the year ended December 31, 2008 of $44.6 million as compared to $18.5 million for the same period in 2007. Exploration, stock based compensation expense, legal, office, and professional fees were higher for the year ended December 31, 2008 as compared to the same period in 2007 and 2006.

Revenue, net of royalty expense, continued to grow in the fourth quarter. The Company shipped approximately 113,000 tonnes of coal at an average realized selling price of approximately $29 per tonne. Operating expenses are categorized into two components; cost of product sold of $938,000 at an average cash cost of product sold of $8.30 per tonne, and mine administration costs of $993,000. These latter costs are composed of mining operations costs and include Mongolian office, site administration costs and allocated stock based compensation costs of $339,000. Depreciation, depletion and accretion costs are charges for equipment depreciation, stripping costs and asset retirement obligation accretion.

In 2008, 1,160,000 tonnes of coal was produced (534,000 tonnes in the fourth quarter) with a strip ratio of 2.19 BCM waste per tonne of saleable coal.

Exploration expenditures from continuing operations during 2008 were $36.2 million as compared to $12.2 million for the same period in the 2007. The increase for 2008 relates predominantly to the

activity on the Indonesian and Mongolian coal projects. In 2007, the Indonesian Coal Division had not been established, and the Mongolian Coal Division had begun operations in June 2007.

With the completion of the coal transaction in May 2007, certain interim Coal Division expenditures made by Ivanhoe after the agreement in principle was reached but prior to closing were added to the indebtedness outstanding under the line of credit at June 30, 2007. The total coal expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007, and accepted by SouthGobi, were approximately $13.2 million of which $13.0 million were exploration costs. These expenditures have been treated as an additional contribution and recorded as a capital transaction and charged directly to deficit in the current comparative year to date 2007 results.

Corporate administration costs for the year ended December 31, 2008 were $9.3 million compared to $6.3 million for the year ended December 31, 2007. The amounts consist of the following categories broken down for comparative purposes.

Legal fees increased for the year ended December 31, 2008 compared to the same period ended 2007. The majority of these charges were for costs associated with the Company's regulatory affairs including expenses associated with corporate governance, filing, registration and disclosure.

Office and administration costs increased in the period ended 2008 compared to the same period in 2007. The increases are for the development of the Company projects, added personnel and related office and administration support costs, including insurance and public filing fees.

Included in professional fees are costs for the quarterly reviews of the Company's financial statements, accrued year end audit, recruitment expenses, internal control documentation, tax planning, new computer system consulting fees, and professional fees for the metals division sale.

Salary and benefits expense was $5.9 million for the year ended December 31, 2008 and $4.6 million for the year ended December 31 2007. Stock based compensation expense allocated to salary and benefits expense was $4.1 million for the year ended December 31, 2008 and $3.4 million for the same period in 2007. The majority of the increase in salary and benefits expense consists of additional personnel costs and an increase in director fees. The stock based compensation expense reflects additional stock option grants during the year and the related vesting and volatility pattern of the underlying stock options that gave rise to the compensation expense.

EXPLORATION COSTS AND DISCONTINUED OPERATIONS BY DIVISION

	Three Months Ended December 31,		Year Ended December 31,	
	2008	2007	**2008**	2007
Coal Division	**$ 8,117**	$ 4,692	**$ 36,174**	$ 12,167
Metals Division - Discontinued Operations	**2,549**	1,266	**7,911**	4,647
Total Exploration	**$ 10,666**	$ 5,958	**$ 44,085**	$ 16,814

Coal Division

The total coal exploration expenditures in the three months ended December 31, 2008 were $8.1 million compared to $4.7 million for the same period in 2007. For the year ended December 31, 2008 coal exploration expenditures were $36.2 million as compared to $12.2 million for the same period in 2007.

The Mongolia coal division started exploration and development subsequent to the completion of the coal transaction at the end of May 2007. The Indonesian coal division began development and exploration activities in early 2008.

With the completion of the coal transaction, certain interim Coal Division expenditures made by Ivanhoe after the agreement in principle was reached but prior to closing were added to the indebtedness outstanding under the line of credit at June 30, 2007. The total coal expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007, and accepted by SouthGobi, were approximately $13.2 million, of which $13.0 million have been treated as an additional contribution and recorded as a capital transaction and charged directly to deficit in 2007.

Exploration expenditures in Mongolia were approximately $26.4 million for the year ended December 31, 2008 compared to $12.2 million for the year ended December 31, 2007 and includes consulting-geological, drilling, license fees, office and salary and benefits.

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

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. The Company’s 2008 exploration program concentrated on drilling in the West Field. The exploration continues 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 the deposit. A similar exploration and

development program is planned for the South-East field surface and underground areas at Ovoot Tolgoi in the 2009 exploration program.

In Indonesia, exploration expenditures were $9.8 million for the year ended December 31, 2008. The Company began its exploration activities in Indonesia in 2008. The drilling results received to date support the quality data from the initial field outcrop test results. The 2008 drilling program has identified quantities of coking coal that appear to be amenable to surface mining. To date, the Company has incurred expenditures to carry out geological reconnaissance, licensing, mapping, initial drilling, and a documentation program on the new concessions in East Kalimantan.

In January 2009, a permit was issued which will allow the Company to commence surface coal mining at the SW deposit on the MCM concession.

Metals Division – Discontinued Operations

The Company sold the Metals Division to Ivanhoe in December 2008. The Metals Division consists of a series of base and precious metal exploration properties in Mongolia and Indonesia. The proceeds of $3 million are classified as a deposit received for the sale of the division.

The sale of the Metals Division has been disclosed as a discontinued operation and its financial results are presented as separate items in the consolidated balance sheets and statements of operations, comprehensive loss and cash flows.

The Company continued to explore on the Indonesian and Mongolian properties during 2008. During the year ended December 31, 2008, exploration expenses were $7.9 million as compared to exploration expenses of $4.6 million the same period in 2007. During 2008 the majority of the expenses incurred in Mongolia and Indonesia were related to ongoing license fees, drilling, and salaries.

The exploration expenditures of $7.9 million in 2008 and $4.6 million in 2007 have been classified as a loss from discontinued operations. The basic and diluted loss per share from discontinued operations is $0.06 for 2008 and $0.09 for 2007.

Other income/(expense) (*thousands of dollars*)

	2008	2007	2006
Interest expense	**$ (148)**	$ (1,359)	$ (179)
Interest accretion on line of credit facilities	**(279)**	(2,237)	-
Listing fees	**(6,715)**	-	-
Interest income	**1,870**	44	50
Foreign exchange	**(4,580)**	48	(20)
Other income/(expense)	**-**	(62)	(219)
	$ (9,852)	$ (3,566)	$ (368)

Interest income has increased in 2008, which relates to the completion of the financings in 2008. Lower interest income during the 2007 period reflects lower average cash balances during this period.

Interest and accretion expense was higher in 2007 compared to the same period in 2008. This is related to advances on the line of credit to fund operations in 2007, including the accretion on the liability component of the loan. In January 2008 with the completion of the additional equity private placements, the First Funding Agreement line of credit facility and the Second Funding Agreement were terminated.

A foreign exchange loss of $4.6 million was recorded for the year ended December 31, 2008 as compared to a gain of $48,000 for the year ended December 31 2007. These amounts are primarily reflective of the larger US and Canadian cash balances due to the completion of the private equity placements in 2008 and the related changes in the value of the Canadian dollar versus its US counterpart during these periods and to a lesser extent the effect of the Mongolian Tugrik, and the Indonesian Rupiah.

Listing fees consist of legal, accounting and professional fees for the initial listing application costs for a secondary listing on an Asian stock exchange. The Company has appointed a project sponsor for a simultaneous listing and equity fundraising. The Company had planned to treat the charges as share issue costs upon a successful equity fundraising. However, current liquidity issues in the credit markets, along with the increased cost of obtaining capital and the reduced availability of equity funding have led to a decision to expense these costs. The Company recorded a charge of $6.7 million for the year ended December 31, 2008. The Company is continuing with the secondary listing application.

Other expenses in 2006 consist of coal transaction costs.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Highlights

		Year ended December 31, 2008		Year ended December 31, 2007
Cash used in operating activities	**$**	**(61,717)**	$	(16,983)
Cash used in investing activities		**(59,540)**		(636)
Cash provided by financing activities		**134,306**		18,065
Effect of foreign exchange rate changes on cash		**(4,103)**		(17)
Cash balance, beginning of year		**1,394**		965
Increase in cash for the year		**8,946**		429
Cash balance, end of year		**10,340**		1,394

General market conditions

Current problems in the credit markets and deteriorating global economic conditions have led to a general weakening of commodity prices. Volatility has been unusually high and it is difficult to forecast the price of and related demand for our coal products. Credit market conditions have also increased the cost of obtaining capital and limited availability of funds. Limited access to the Ceke border crossing have impacted our 2009 production levels and coal deliveries. Accordingly, management is reviewing the effects of the current conditions on our business plans for the upcoming year.

Cash used in operating activities

At December 31, 2008, the Company had cash resources of $10.3 million compared to $1.4 million as at December 31, 2007, and $38.8 million at September 30, 2008.

Cash used in continuing operations increased to $55.9 million for the year ended December 31, 2008 from $13.2 million for the year ended December 31, 2007. Cash used in discontinued operations was $5.8 million for the year ended December 31, 2008 compared to $3.8 million for the same period in 2007.

The Company incurred a net loss from continuing operations of $54.5 million for the year ended December 31, 2008 compared to a $22.1 million loss for the same period in 2007. Continuation of the Company's build out of the Ovoot Tolgoi mining operation, higher administration and corporate costs, along with increased exploration activities in Mongolia and Indonesia, and listing fees contributed to the higher losses in 2008. With the increased activities at the Ovoot Tolgoi site and the operations in Mongolia, accounts receivable, prepaids, inventory and accounts payable increased significantly during 2008 as compared to 2007.

Foreign exchange losses are primarily reflective of the larger US and Canadian cash balances due to the completion of the private equity placements in 2008 and the related changes in the value of the

Canadian dollar versus its US counterpart during these periods and to a lesser extent the effect of the Mongolian Tugrik, and the Indonesian Rupiah.

Accounts receivable include funds due from government taxation authorities (Goods and Services Tax or Value Added Tax). Verification of the collectability of the funds from government taxation authorities was conducted in the fourth quarter and the Company anticipates full recoverability of amounts due on account. Payment of accounts receivable due from government taxation authorities in Mongolia could be delayed throughout 2009, and may be used to offset future income taxes payable on account.

The Company is also closely monitoring collectability of outstanding accounts for current coal sales. Although all accounts are currently in order, unfavorable market conditions may have an impact on future collectability.

Prepaid balances have increased during 2008. The increase relates to the timing of prepayments for Mongolian exploration licenses, supplies, insurance, and additional lease deposits.

Coal and supplies inventory have increased to $13.7 million in the current quarter from $7.3 million at the quarter ended September 30, 2008. Coal and supplies inventory is valued at the lower of cost and net realizable value. Coal inventory cost of $13.2 million includes direct and indirect expenses associated with extracting and processing, including labor, operating materials, supplies, transportation costs and an allocation of overhead including depreciation and depletion. Supplies inventory includes items related to mining equipment and other operating supplies.

The Company had a stockpile of approximately 1.1 million tonnes of coal inventory at December 31, 2008 and approximately 1.2 million at February 28, 2009.

Accounts payable have also increased with the additional coal exploration, administrative and mining activity.

Cash used for investing activities

Cash used for investing activities, which were predominantly from continuing operations, increased to $59.5 million for the year ended December 31, 2008 from $636,000 for the year ended December 31, 2008.

Capital expenditures on mineral properties, plant and equipment increased to $62.5 million during 2008 from $605,000 in 2007.

The Company sold its Metals Division in December 2008 for $3 million, which is included in cash proceeds from investing activities-discontinued operations.

Mineral property interests have increased with the addition of future asset retirement obligation costs and $3 million of deferred stripping costs capitalized to date. In September, the Company increased its working interest in the Mamahak Coal Project in East Kalimantan, Indonesia, from 56% to 85%. The JVA with its Mamahak co-venturer included a provision allowing for SouthGobi to increase its working interest position based on a predetermined pricing mechanism. SouthGobi has elected to

increase its working interest to 85% by paying the co-venturer $13.2 million, comprised of $8 million cash and 320,000 common shares of the Company at a deemed value of C$16.15 per share, which is included in mineral properties.

The Company's investment in plant and equipment increased during the quarter ended December 31, 2008. The coal mining equipment that was purchased in November 2007 was commissioned for use at Ovoot Tolgoi in March 2008. Deposits for further mining equipment and maintenance facilities are included as plant and equipment.

Cash provided by financing activities

During the quarters ended March 31, 2008 and June 30, 2008, the Company completed a series of equity financing transactions and for total proceeds net of issue costs of $136.3 million.

These amounts plus $4.1 million received from the exercise of stock options provided financing for the Company's operations for the year ended December 31, 2008 of $140.4 million compared to $ 2.6 million for the same period in 2007.

The proceeds from the equity financings in 2008 have been 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 the Ovoot Tolgoi site and development of the Indonesia coal project. Proceeds have also been used for investigating new projects, equipment expenditures and for general corporate and administrative purposes.

On December 31, 2008 the Company announced the sale of its Metal Division to Ivanhoe for $3 million and other non-cash consideration. The sale, with an effective date of December 30, 2008, closed on February 2, 2009. The Metals Division consisted of a series of base and precious metal exploration properties in Mongolia and Indonesia. The transaction enables the Company to focus solely on its principal coal properties.

As part of the sale transaction, the Company obtained a $30 million credit facility from Ivanhoe. The credit facility is for a one year term with a one year discretionary extension. The credit facility is unsecured and carries an interest rate equal to LIBOR plus 7.5 basis points. To date, the Company has received advances of $8 million against the line of credit facility.

Contractual Obligations (Expressed in thousands of U.S. dolars)	Payments Due by		
	Total	**Less than 1 year**	**> 1 year**
Purchase obligations	$ 16,066	$ 16,066	$ -
Total Contractual Obligations	**$ 16,066**	**$ 16,066**	**$ -**

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 $31 million. The second fleet is scheduled for delivery late in the second quarter of 2009 with a final amount owing of approximately $15 million. The Company also has the option 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 is reviewing its commitment obligations and options to purchase additional fleets. The finalization of the delivery of the second fleet is being discussed with the equipment distributor and options to delay delivery payments are being discussed. Further commitments for 2010 and 2011 fleet purchases have not been finalized.

Liquidity, Financing and Working Capital Resources

The Company is an emerging coal exploration, development and production company. The Company's ability to continue as a going concern is dependent upon establishing profitable operations, the confirmation of economically recoverable reserves, and the ability of the Company to obtain further financing to develop properties.

The Company has been reviewing its detailed revenue and expenditure plans, both discretionary and non-discretionary, for 2009 and identified the need for further financing to enhance its working capital resources. The Company is prioritizing its projects with a current emphasis on production and near term cash flow.

As part of the sale of the Metals Division to Ivanhoe in December 2008, the Company obtained a $30 million credit facility from Ivanhoe. The credit facility is for a one year term with a one year discretionary extension. The credit facility is unsecured and carries an interest rate equal to LIBOR plus 7.5 basis points.

The Company will be incurring expenditures for the exploration, development, and production of its current coal assets, and will incur expenditures for the acquisition of further coal assets. Revenue from current operations will not be sufficient to meet current expenditure levels.

Cash generated from operations may grow in 2009, but it may not be sufficient to meet all expenditure levels. Management believes that additional debt or equity financing, beyond the current credit facility with Ivanhoe, is available. The Company will be reviewing all discretionary and non-discretionary spending, which will include a review of future project costs and capital commitments.

RELATED PARTY TRANSACTIONS

The Company is a party to a shareholders' cost-sharing agreement with certain other public and private companies, including Ivanhoe (the "Other Companies") pursuant to which the Company and the Other Companies are equal shareholders in GMM and, through GMM, share office space, furnishings and equipment and communications facilities (on a cost recovery basis) and the employment, on a part-time basis, of various administrative, office and management personnel in Vancouver, British Columbia. Costs of the shared office facilities and the shared part-time employees are recovered from the Company proportionate to the time spent by the shared part-time employees on matters pertaining to the Company. Certain of the directors and officers of the Company are also officers and directors of GMM. The Company has utilized the services of the GMM staff and office since September 1, 2003 and has incurred costs of \$2.5 million and \$2.1 million for the year ended December 31, 2008 and 2007, respectively.

On December 31, 2008, the Company announced the sale of the Metals Division to Ivanhoe for \$3 million and other non-cash consideration. The Metals Division consists of a series of base and precious metal exploration properties in Mongolia and Indonesia, related assets, employees and contracts. As part of the sale transaction, the Company obtained a credit facility from Ivanhoe, which allows SouthGobi to receive loan advances from Ivanhoe to an aggregate maximum of \$30 million. The credit facility is for a one year term with a one year discretionary extension. The credit facility is unsecured and carries an interest rate equal to LIBOR plus 7.5 basis points.

OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value. As at February 25, 2009: 133,298,982 common shares were issued and outstanding and 7,038,685 share purchase options were outstanding. On a diluted basis, 140,337,667 common shares were outstanding.

Ivanhoe, directly and indirectly, currently owns 106,804,155 common shares representing approximately 80% of the issued and outstanding common shares of SouthGobi.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. As part of this evaluation, management has considered the error that occurred in the independent third party resource estimate announced in July 2008 (see "MINERAL PROPERTIES – Properties in Mongolia – Ovoot Tolgoi Open Pit Project") and whether the occurrence of the error indicated a lack

of effectiveness in certain of the Company's disclosure controls and procedures. Based on a thorough review of the facts and circumstances that gave rise to the error and its subsequent discovery, management has concluded that the Company's scientific and technical disclosure compliance department was understaffed and that, as a result, the supervision of the Company's independent third party technical consultant, and the performance of quality assurance procedures with respect to the consultant's work, was inadequate. The Company has sought to address these deficiencies by recruiting additional qualified personnel to its scientific and technical disclosure compliance team. Taking into account these remedial measures, as of December 31, 2008, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company's disclosure controls and procedures, as defined in National Instrument 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financials statements in accordance with Canadian GAAP. Management is also responsible for the design of the Company's internal control over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

The Company's internal controls over financial reporting include policies and procedures that: pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions and disposition of assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with Canadian GAAP and that receipts and expenditures are being made only in accordance with authorization of management and directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

Because of their inherent limitations, internal controls over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management, under the supervision of the Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of our internal controls over financial reporting using the framework and criteria established in *Internal Control-Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the evaluation, management has concluded that internal controls over financial reporting were effective as of December 31, 2008.

There has been no change in the Company's internal controls 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 controls over financial reporting.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Transition to IFRS from GAAP

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly accountable enterprises will be required to adopt International Financial Reporting Standards ("IFRS") for financial periods beginning on and after January 1, 2011. In the Canadian Securities Administrators ("CSA") Staff Notice 52-321 – Early Adoption of International Financial Reporting Standards, Use of US GAAP and Reference to IFRS-IASB, CSA has indicated that it would be prepared to provide exemptive relief to permit a Canadian reporting issuer to prepare its financial statements in accordance with IFRS for financial periods beginning before January 1, 2011.

As previously disclosed, the Company is in the application process for a secondary listing of its common shares on an Asian stock exchange. As part of the application process, the Company is required to provide financial statements under IFRS with three years of comparative data. In order to produce the required International Accounting Standards Board ("IASB") financial statements the Company has produced 2008 interim IFRS statements with an IFRS adoption date of January 1, 2008 and IFRS transition date of January 1, 2005. As per Appendix A of IFRS 1 "An entity cannot have more than one set of IFRS financial statements. Therefore, it must have only one starting point for transition to IFRS". In March 2009, the Company was granted exemptive relief under Staff Notice 52-321 and has been permitted to adopt IFRS for Canadian reporting purposes for reporting periods beginning on or after January 1, 2009. The Company plans to adopt IFRS with an adoption date of January 1, 2009 and a transition date of January 1, 2005.

IFRS Conversion

The Company's IFRS conversion plan is comprehensive and addresses matters including changes in accounting policies, restatement of comparative periods, organizational and internal controls and any required changes to business processes. To facilitate this process and ensure the full impact of the conversion is understood and managed reasonably, the Company retained an external third party accounting firm and has hired an IFRS conversion project manager. The accounting staff have also attended several training courses on the adoption and implementation of IFRS. Through in-depth training and the preparation of reconciliations of historical Canadian GAAP financial statements to IFRS, the Company believes that its accounting personnel have obtained a thorough understanding of IFRS. Further, the accounting personnel at our Mongolian and Indonesian subsidiaries are already familiar with IFRS and have been working with IFRS due to either local adoption of IFRS or convergence of local standards to IFRS in those jurisdictions.

In conjunction with the adoption of IFRS the Company has also started the implementation of a new accounting system which will satisfy all the information needs of the Company under IFRS. The Company has also reviewed its current internal and disclosure control processes and believes they will not need significant modification as a result of our conversion to IFRS.

Impact of IFRS

IFRS employs a conceptual framework that is similar to Canadian GAAP; however significant differences exist in certain matters of recognition, measurement and disclosure. While the adoption of IFRS will not change the actual cash flows of the Company, the adoption will result in changes to

the reported financial position and results of operations of the Company. In order to allow the users of the financial statements to better understand these changes, we have provided the following reconciliations between Canadian GAAP and IFRS for the total assets, total liabilities, shareholders equity and net earnings. The adoption of IFRS has had no impact on the net cash flows of the Company. The changes made to the balance sheets and income statements have resulted in reclassifications of various amounts on the statements of cash flows, however as there has been no change to the net cash flows no reconciliations have been presented.

While these reconciliations do not represent official adoption of IFRS, it provides an indication of the major differences identified to date, relative to our historical financial statements. In preparing the reconciliations, the Company applied the principles and elections of IFRS 1, with a transition date of January 1, 2005, consistent with those assumed in our application documentation for the listing on the Asian stock exchange. As the Company has been permitted to adopt IFRS effective January 1, 2009, it will apply the provisions of IFRS 1 as described under the section entitled "Initial Adoption – IFRS 1", with a January 1, 2005 transition date. The Company will also apply IFRS standards in effect at December 31, 2009 as required by IFRS 1.

(a) Total Assets

		At December 31,				At January 1,
	notes:	**2008**	2007	2006	2005	2005
Total assets under Canadian GAAP		**$ 100,132,143**	$ 5,610,076	$ 2,052,235	$ 3,774,953	$ 8,699,107
Adjustments for differing accounting treatments:						
- Inclusion of coal division assets	(i)	**-**	-	262,688	143,641	34,854
- Adjustment for asset retirement obligation	(v)	**(184,135)**	-	-	-	-
Total assets under IFRS		**$ 99,948,008**	$ 5,610,076	$ 2,314,923	$ 3,918,594	$ 8,733,961

(b) Total Liabilities

		At December 31,				At January 1,
	notes:	**2008**	2007	2006	2005	2005
Total liabilities under Canadian GAAP		**$ 11,167,453**	$ 36,875,588	$ 6,287,041	$ 692,699	$ 1,035,404
Adjustments for differing accounting treatments:						
- Fair value of embedded derivative on debt	(ii)	**107,551,903**	70,565,576	-	-	-
- Conversion of debt	(ii)	**(107,551,903)**	-	-	-	-
- Adjustment for warrant liability	(iv)	**-**	-	221,641	221,641	-
- Conversion of warrant liability	(iv)	**-**	-	(221,641)	-	-
- Adjustment for asset retirement obligation	(v)	**(184,135)**	-	-	-	-
Total liabilities under IFRS		**$ 10,983,318**	$ 107,441,164	$ 6,287,041	$ 914,340	$ 1,035,404

(c) Shareholders' Equity

		At December 31,				At January 1,
	notes:	**2008**	2007	2006	2005	2005
Total equity (deficiency) under Canadian GAAP		**$ 88,964,690**	$ (31,265,512)	$ (4,234,806)	$ 3,082,254	$ 7,663,703
Adjustments for differing accounting treatments:						
- Inclusion of coal results	(i)	**-**	-	262,688	143,641	34,854
- Fair value of embedded derivative on debt	(ii)	**(107,551,903)**	(70,565,576)	-	-	-
- Conversion of debt	(ii)	**107,551,903**	-	-	-	-
- Adjustment for warrant liability	(iv)	**-**	-	-	(221,641)	-
Total equity (deficiency) under IFRS		**$ 88,964,690**	$(101,831,088)	$ (3,972,118)	$ 3,004,254	$ 7,698,557

(d) Net Earnings

	notes:	Year ended December 31, 2008	2007	2006	2005
Loss for the year under Canadian GAAP		**$ 62,385,848**	$ 26,729,932	$ 9,361,815	$ 6,213,957
Basic and Diluted Loss per Share under Canadian GAAP		**$ 0.49**	$ 0.52	$ 0.56	$ 0.41
Adjustments for differing accounting treatments:					
- Inclusion of coal results	(i)	**-**	2,546,368	12,167,928	9,923,018
- Fair value of embedded derivative on debt	(ii)	**7,223,400**	63,286,039	-	-
- Interst accretion on line of credit facility	(ii)	**319,360**	4,224,179	-	-
- Adjustments on stock based compensation	(iii)	**(352,865)**	(50,089)	(250,730)	(107,301)
- Adjustment for warrant liability	(iv)	**-**	-	449,623	80,361
Loss for the year/period under IFRS		**$ 69,575,743**	$ 96,736,429	$ 21,728,636	$ 16,110,035
Basic and Diluted Loss per Share under IFRS		**$ 0.54**	$ 1.89	$ 1.31	$ 1.06

The following describes the differences presented in the above reconciliations:

(i) Coal Transaction

On May 29, 2007, the Company completed the purchase of the Ivanhoe coal division in consideration for the issuance to Ivanhoe of 57,000,000 common shares and 25,576,383 convertible preferred shares.

Under Canadian GAAP – The coal transaction was accounted for as a related party transaction at the carrying value.

Under IFRS - The coal transaction is considered a combination between businesses or entities under common control and is therefore exempt from the scope of IFRS 3, Business Combinations. The Company has accounted for the business combinations of the entities under common control by using the principles of merger accounting as if the current group structure had always been combined.

(ii) Line of Credit Facility

On April 26, 2006, in conjunction with the coal transaction, 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 of up to US$10 million which was extended to a maximum of US$15 million on June 6, 2007. Attached to the First Funding Agreement was a conversion option which became effective upon the completion of the acquisition of the coal transaction. On January 23, 2008, concurrent with the closing of equity private placements and at the Company's request, Ivanhoe converted the then principal balance of US $29,963,354 into 14,709,701 common shares of the Company. As a result of this conversion the amount due under line of credit facility was eliminated.

Under Canadian GAAP – The conversion feature was recorded as a separate component of equity.

Under IFRS – The conversion feature is considered an embedded derivative liability that must be recorded at its fair value upon initial measurement and revalued at each subsequent reporting period.

The difference between the debt host component and the principal amount of the loan outstanding is accreted to income over the remaining term of the debt.

(iii) Stock Based Compensation

Recognition of expense

Under Canadian GAAP – The fair value of stock-based awards with graded vesting was calculated as one grant and the resulting fair value was recognized on a straight-line basis over the vesting period.

Under IFRS – Each tranche of an award with different vesting dates is considered a separate grant for the calculation of fair value, and the resulting fair value is amortized over the respective vesting period of the respective tranches.

Forfeitures

Under Canadian GAAP – Forfeitures of awards were recognized as they occurred.

Under IFRS – Forfeiture estimates are recognized in the current period and revised for actual experiences in subsequent periods.

(iv) Warrant Liability

On June 28, 2005, BHP Billiton World Exploration Inc. ("BHP") purchased 1,153,998 units of the Company for $1 million. Each unit consisted of one common share and one warrant to purchase one-half a common share. The warrants had a term of two years and an exercise price of CDN$1.395 per common share. On June 26, 2006, all outstanding warrants were exercised by BHP and the warrant liability was eliminated.

Canadian GAAP – The warrants were accounted for at carrying value.

IFRS – The exercise price of the warrants is fixed in Canadian dollars. The functional currency of the Company is in USD and therefore the conversion option is considered a derivative as the Company will receive a variable amount of cash when the warrants are exercised. As a result, the BHP warrants meet the definition of a financial liability under IAS 39 and is recorded as a financial liability and stated at fair value at each balance sheet date.

(v) Asset Retirement Obligation (ARO)

At December 31, 2008 the Company did an analysis of its discount rate used to present-value its ARO liability.

Canadian GAAP – A change in the discount rate alone did not result in the in a re-measurement of the ARO liability.

IFRS – Under IAS 37, a change in the current market-based discount rate will result in a change in the measurement of the provision. As a result, the ARO liability recorded in 2008 has been re-

measured using the discount rate in effect at year end and an adjustment has been recorded to the corresponding asset.

Initial Adoption of International Accounting Standards

IFRS 1 ''First Time Adoption of International Accounting Standards'' sets forth guidance for the initial adoption of IFRS. Under IFRS 1 the standards are applied retrospectively at the transitional balance sheet date with all adjustments to assets and liabilities as stated under GAAP taken to retained earnings unless certain exemptions are applied. The Company is not applying any exemptions on first-time adoption.

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.

The Company believes that there are certain risks involved in its operations, some of which are beyond the Company's control. These risks can be broadly categorized into: (i) risks relating to the business of the Company; (ii) risks relating to the Company's projects in Mongolia; and, (iii) risks relating to the Company's projects in Indonesia. Additional risks and uncertainties not presently known to the Company, or not expressed or implied below, or that are presently deemed immaterial, could also harm the Company's business, financial condition and operating results.

Risks Relating To the Business Of The Company

The commercial feasibility of mining at the Company's projects has not been established.

The Company's current intention to develop mines at the Ovoot Tolgoi project (at the surface or underground), the Mamahak project or any of the Company's other projects in the future is based on geological, engineering, environmental and mine planning evaluations. However, the feasibility of sustainable commercial mining at these projects has not been, and may never be, established. Whether a mineral deposit will be commercially sustainable depends on a number of factors, some of which are: the particular attributes of the deposit, such as size, grade and proximity to infrastructure; commodity prices, which are highly cyclical; and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, importing and exporting of mineral resources and environmental protection. If the Company is unable to develop all or any of its projects into a commercial working mine, it may never be able to generate revenues from operations.

The coal resource estimates for the Company's projects in Mongolia and Indonesia are estimates only, and the Company's actual production, revenues and capital expenditures may differ materially from these estimates.

The coal resource estimates on which the Company's production and capital expenditure plans are based are estimates that were made by TAG and Norwest, independent mining and geological consultants. Resource estimates are forward-looking statements inherently subject to error. Although resource estimates require a degree of assurance in the underlying data when the estimates are made, resource estimates are imprecise and depend to some extent on interpretations and assumptions, which may ultimately prove to be inaccurate. Resource estimates are based on a geological assessment of resources and this in itself involves human judgment and estimation of a

complex variety of geological, geophysical, hydrological and engineering assumptions, among others. Such assumptions could be inaccurate or subject to human error in their estimation or calculation of parameters. Actual results may differ from estimates due to unforeseen events and uncontrollable factors including, without limitation: fluctuations in coal prices, production costs, recovery rates and coal transportation costs; geologic uncertainties such as inherent sample variability; variations in mining and processing parameters and adverse changes in environmental or mining laws and regulations. The timing and effects of variances from estimated values cannot be accurately predicted and may materially and adversely affect the Company's business, results of operations, financial condition and growth prospects.

The Company's projects may not be completed as planned, may exceed the Company's original budgets and may not achieve the intended economic results or commercial viability.

The Company's most advanced projects in Mongolia and Indonesia, the Ovoot Tolgoi project and the Mamahak project, respectively, and other future projects could be delayed or adversely affected by a number of factors beyond the Company's control, including, among other things, regulatory approvals and permits, availability of sufficient funding, natural conditions, fuel supply and technical or human resources. The Company's projects are subject to technical risk in that they may not perform as designed. Increased development costs, lower output or higher operating costs may all combine to make a project less profitable than expected at the time of the development decision. This would have a negative impact on the Company's business and results of operations. No assurance can be given that the Company would be adequately compensated by third party project design and construction companies (if not performed by the Company) in the event that a project did not meet its expected design specification.

Actual capital costs may exceed the original budgets. As a result of project delays, cost overruns, changes in market circumstances or other reasons, the Company may not be able to achieve the intended economic benefits or demonstrate the commercial feasibility of these projects, which in turn may materially and adversely affect its business, results of operations and growth prospects.

The Company's business will be dependent on its mine at the Ovoot Tolgoi project (surface) for substantially all of its revenues and cash flows from operating activities in the near term.

The Ovoot Tolgoi project (surface) is likely to be the Company's only significant operational mining project in the short term and the Company expects that this mine will produce substantially all of the Company's revenues and cash flows in the near term. Consequently, delays or difficulties encountered in the progress or development of the Ovoot Tolgoi project (surface) could materially and adversely affect the Company's business and results of operations. In addition, the Company's business and results of operations could be materially and adversely affected by any events which impact the Ovoot Tolgoi project (surface), including among other things, equipment failure or shortages, adverse weather, transportation problems, changes in relevant government policy and/or any permitting or licensing delays.

A higher than expected level of impurities in the coal mined from the Company's projects could lessen demand for the Company's coal products.

The expected levels of sulphur and ash in the Company's coal deposits are derived from estimates based on the results of metallurgical testing. In the event that the actual level of impurities is higher than expected or the coal mined is of a lower quality than expected, the demand for, and realizable price of, the Company's coal products may decrease. Further, in the event that the global supply of

coal increases or there is a down-turn in demand for coal, it is likely that lower-grade coal will be the first to lose market share. Any such decrease in the demand for, or realisable price of, the Company's products could materially and adversely affect the Company's business and results of operations.

The planned exploration, development and mining activities in respect of the Company's projects involve high degrees of risk typically associated with mining operations.

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

In particular, the Ovoot Tolgoi project is located in a geological formation with significant amounts of water. Future excess water inflows to the mine pits (both those existing now and those that may be developed in the future) could slow production.

In addition, the Company's exploration, mining and production operations involve the handling and storage of explosive, toxic and other dangerous articles. There can be no assurance that accidents arising from the mishandling of dangerous articles will not occur in the future. Should any accident occur as a result of the mishandling of dangerous articles, the Company's business and results of operations may be materially and adversely affected, and the Company may be subject to penalties and/or civil and/or criminal liabilities.

*The Company does not insure against all risks which it may be subject to in planned operations and insurance coverage could prove inadequate to satisfy potential claims***.**

For certain aspects of the Company's business operations, insurance coverage is restricted or prohibitively expensive. The Company currently holds its primary policies through Canadian insurance providers, who contract with Mongolian and Indonesian insurance providers to insure the Company's Mongolian and Indonesian properties, respectively. The Company has taken out insurance within ranges of coverage consistent with industry practice in Mongolia and Indonesia, respectively, and intends to maintain insurance within such ranges. However, no assurance can be given that the Company will be able to obtain such insurance coverage at economically reasonable premiums (or at all), or that any coverage the Company obtains will be adequate to cover the extent of any claims brought against it.

Exploration, development and production operations on mineral properties involve numerous risks, including unexpected or unusual geological operating conditions, rock bursts or slides, fires, floods, earthquakes or other environmental occurrences, and political and social instability. The Company does not maintain insurance against any environmental or political risks. Should any liabilities arise for which the Company is not insured or insurance coverage is inadequate to cover the entire liability, they could reduce or eliminate the Company's actual or prospective profitability, result in increasing costs and a decline in the value of the Company's common shares and could materially and adversely affect the Company's business and results of operations.

The areas in which the Company's projects are located lack basic infrastructure

The Company's projects are located in remote areas which lack basic infrastructure, including sources of power, water, housing, food and transport. Although the Company has commenced construction on a permanent accommodation camp at Ovoot Tolgoi, the Company will need to hire additional personnel, construct additional facilities and otherwise establish its own infrastructure before it can commence operations. The inability to make suitable arrangements, coupled with the limit on the number of expatriate workers that mining companies can use, may delay the conduct of the Company's exploration and development programs and prevent it from meeting its stated business objectives.

The remoteness of these projects will also affect the potential viability of mining operations. The availability of such resources may materially and adversely affect mining feasibility and will, in any event, require the Company to arrange significant financing, locate adequate supplies and obtain necessary approvals from national, provincial and regional governments, none of which can be assured.

Licenses and permits are subject to renewal and various uncertainties.

In Mongolia, the Company's mineral exploration licenses are subject to periodic renewal. While the Company anticipates that renewals will be given as and when sought, there is no assurance that such renewals will be given as a matter of course and there is no assurance that new conditions will not be imposed in connection therewith.

In Mongolia, the Company's business objectives may also be impeded by the costs of holding and/or renewing its mineral exploration licenses.. License fees increase substantially upon the passage of time from the original issuance of each individual license.. The Company will need to assess continually the mineral potential of each license particularly at the time of renewal, to determine if the costs of maintaining the licenses are justified by the exploration results to date, and may elect to let some of its licenses lapse. A moratorium on transfers of licenses was recently lifted and there is a risk that it could be re-imposed such that letting the licenses lapse may be the only practical option in some circumstances. In addition, the Company will require mining licenses and permits to mine in order to conduct mining operations at its future Mongolian projects and there can be no assurance that such licenses and permits will be obtained on terms favorable to the Company or at all.

In Mongolia, certain provisions of the Land Law and the Minerals Law provide for the revocation of previously granted land use rights, mineral exploration licenses or mining licenses on the grounds that the affected area of land has been designated as "special needs" territory. The Land Law grants the discretion to declare an area of land for special needs purposes to local governing authorities and identifies various broad categories which qualify as special needs. The Minerals Law requires the local governing authority who decides that an area of land is for special needs purposes to compensate the license holder whose rights or license status are affected.

In Indonesia, all licenses and permits necessary in relation to the Company's projects are owned or held by Indonesian entities in which the Company has no ownership interest or direct control. Some of the licenses and approvals required for the projects have not yet been obtained. Each stage of the projects is subject to the Indonesian entities obtaining the different types of licenses and permits. While the Company anticipates that all necessary licenses and permits will be granted to the Indonesian entities as and when sought, there is no assurance that such licenses and permits will be

given as a matter of course and that the period and content will be sufficient for the projects or that stringent conditions will not be imposed in connection therewith.

The Company's business objectives for the Indonesian projects and any similar future projects may be impeded by the cost of the Indonesian entities applying for, obtaining, complying with and renewing the various and necessary licenses and permits required to complete the Indonesian projects. There can be no assurance that such licenses and permits will be obtained on favorable terms or at all, which may affect the Company's ability to successfully complete its Indonesian projects. Further, there can be no assurance that the relevant Indonesian entities will comply with all obligations and terms of the licenses and permits they hold, and failure to do so could result in the relevant issuing authority revoking such licenses and permits, prior to their expiry date, which may affect the Company's ability to successfully complete its Indonesian projects.

Any disputes or disagreements with the Company's joint venture partners could materially and adversely affect the Company's business and results of operations.

The Company has entered into several earn-in, joint venture and cooperation agreements with joint venture partners. In these circumstances, certain members of the management and boards of directors of the joint venture companies are nominated by the Company's joint venture partners. There is no assurance that the strategic direction of a joint venture will be consistent with the Company's objectives. Any change in the management or strategic direction of one or more of the Company's joint ventures could materially and adversely affect the Company's business and results of operations.

Additionally, if a dispute arises between the Company and a joint venture partner which cannot be resolved amicably, the Company may be involved in lengthy and costly proceedings to resolve the dispute, which could materially and adversely affect the Company's business and results of operations.

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

The Company has no experience in placing mineral properties into commercial production, and its ability to do so will be dependent upon hiring appropriately experienced personnel or entering into agreements with other resource companies or consultants that can provide such expertise. Although the Company has already retained the required personnel to commence commercial production at the Ovoot Tolgoi project, in the future there can be no assurance that the Company will have available to it the necessary expertise to take a mineral deposit into production.

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

The exploration for and mining of mineral resources requires substantial capital investment. The further development and exploration of the Ovoot Tolgoi project, the Mamahak project and other the mineral properties in which the Company holds interests will require capital expenditures and other financial commitments. The Company currently has no significant revenues and negative cash flows from operations. Sales of coal from the Ovoot Tolgoi project (surface) commenced in late September 2008. However, the Company may in the future require additional funding to develop its mining projects and expand the business, the availability of which depends upon the Company's ability to obtain financing through capital markets, or other means.

Prior to 2008, the Company relied upon Ivanhoe to provide funding by way of credit facilities. In early 2008, the Company completed a series of private placements which raised sufficient funds to finance the Company's 2008 exploration and development budgets. The Company now has access to an additional $30 million credit facility from Ivanhoe but there is no assurance that Ivanhoe will provide any additional funding once this facility is fully drawn. There is also no assurance that the Company will be successful in obtaining financing as and when needed in the future. Unfavorable market conditions may make it difficult or impossible for the Company to obtain debt financing or equity financing on acceptable terms or at all. The Company operates in regions of the world that have a tendency to be politically and economically unstable, which may make it more difficult for the Company to obtain debt financing from project lenders. Failure to obtain additional financing on a timely basis, or at all, may cause the Company to postpone its development plans, forfeit rights in respect of some or all of its properties or joint ventures or reduce or terminate some or all of its operations.

Any increase in the price of production inputs, including fuel, explosives, labour, power, water, or mine consumables could materially and adversely affect the Company's business and results of operations.

The cost of production inputs, including, among others, the cost of fuel, explosives, labour, power, water and mine consumables constitutes a significant part of the Company's operating expenses. Input costs can be affected by changes in various factors including market conditions, government policies, exchange rates and inflation rates, which are unpredictable and outside the Company's control. Unanticipated increases in the price of these or other inputs could materially and adversely affect the Company's results of operations.

As an open pit mine matures, its production volumes typically decrease and unit production costs typically increase.

In an open pit mine, the mining process typically starts at the surface level and progresses to deeper levels. More waste must be removed as mining depth increases, resulting in increased operating costs. Once the Company moves into the production phase in respect of its projects, and as production efficiency decreases over time, the Company's business and results of operations could be materially and adversely affected.

Severe weather conditions could materially and adversely affect the Company's business and results of operations.

Severe weather conditions may require the Company to evacuate personnel or curtail operations and may result in damage to the project site, equipment or facilities, which could result in the temporary suspension of operations or generally reduce the Company's productivity. During periods of curtailed activity due to adverse weather conditions, the Company may continue to incur operating expenses while production or exploration has slowed down or stopped altogether. The Company may need to incur costs to replace or repair damaged equipment and facilities. Any damages to the Company's projects or delays in its operations caused by severe weather could materially and adversely affect the Company's business and results of operations.

The Company's business and results of operations are susceptible to the cyclical nature of coal markets and are vulnerable to fluctuations in prices for coal.

The Company expects to derive substantially all of its revenue and cash flow from the sale of coal. Therefore, the market price of the Company's common shares, the Company's ability to raise

additional financing and maintain ongoing operations and the Company's financial condition and results of operations will be directly related to the demand for, and price of, coal and coal-related products. Coal markets are cyclical and have in the past exhibited significant fluctuations in supply, demand and prices from year to year. Coal demand and price are determined by numerous factors beyond the Company's control, including the international demand for steel and steel products, the availability of competitive coal supplies, international exchange rates, political and economic conditions in Mongolia, Indonesia, China and elsewhere in the world, milder or more severe than normal weather conditions, and production costs in major coal producing regions. In the past, there have been periods of oversupply of coal in the market, which has resulted in price decreases. An oversupply of coal in China or a general downturn in the economies of any significant markets for the Company's coal and coal-related products could materially and adversely affect the Company's business and results of operations. The Company's dependence on foreign markets may result in instability due to political and economic factors in those foreign jurisdictions which are beyond its control. The combined effects of any or all of these factors on coal price or volume are impossible for the Company to predict. If realized coal prices fall below the full cost of production of any of the Company's future mining operations and remain at such a level for any sustained period, the Company could experience losses and may decide to discontinue operations, which could require the Company to incur closure costs and result in reduced revenues.

The unavailability or shortage of reliable and sufficient coal transportation capacity could reduce the Company's coal revenue by causing the Company to reduce its production volume or impairing its ability to supply coal to its customers.

The Company anticipates that the majority of its coal production from its projects in Mongolia will be exported to China. Therefore, the Company's future mining operations are anticipated to be highly dependent on road and rail services in Mongolia and, to a lesser extent, in China.

In Mongolia, a bottleneck in the transportation of coal from the Ovoot Tolgoi project to customers in China may arise if the road connecting the Ovoot Tolgoi project to the Ceke border point does not have sufficient capacity to support the increased amount of cargo traffic or is affected by external factors such as disruptions caused by bad weather. There can be no assurance that there would be any other cost effective means of transporting the Company's coal to its primary market in China. Moreover, a significant portion of the Company's total costs is expected to be attributable to the development and maintenance of road transportation, railways and other transportation infrastructure in Mongolia. Contractual disputes, road closures due to environmental degradation, rail capacity issues, prolonged labor stoppages, weather problems or other factors could seriously impact the Company's ability to export its production, which could materially and adversely affect the Company's business and results of operations. Significant cost escalation for these transportation services could also reduce profitability, possibly increasing the full cost of production above realized coal prices. To the extent such increases are sustained, the Company could experience losses and may decide to discontinue operations, which could require the Company to incur closure costs and result in reduced revenues.

While the Company expects to sell and deliver most of its coal products from the Ovoot Tolgoi project at the mine gate, inadequate transportation infrastructure is likely to affect the pricing terms on which the Company can sell the coal to customers, who are likely to factor in any delays and costs in transport in determining the price they are prepared to pay to purchase the Company's coal. As such, any delays or increases in the costs of transportation may materially and adversely affect the Company's business and results of operations.

The Indonesian Government is proposing to enact regulations that will place restrictions on the ability of producers to export coal products. Additional regulations are proposed relating to the price at which coal may be sold. These factors could change the economics of the Indonesian projects.

The Company does not currently have any mineral reserves, and its profitability and growth prospects therefore depend upon its ability to successfully acquire and develop economically attractive mineral reserves at competitive costs.

The Company has not, to date, established any mineral reserves. If and when the Company upgrades its mineral resources to mineral reserves, its mineral reserves will decline in the future as it produces coal. The Company's ability to sustain production levels in the long-term is dependent upon the development or acquisition of new mineral reserves, the development of new coal mining projects and the expansion of existing mining operations. No assurance can be given that the Company's planned development and expansion projects will result in additional economically recoverable mineral reserves or that the Company will succeed in developing new mines.

The Company relies substantially on third party contractors to conduct its exploration operations.

It has been the Company's commercial practice over time, where possible, to sub-contract various exploration services, including drilling, conduct of geophysical surveys and equipment maintenance, on the basis of a competitive bidding process. Although the Company maintains supervision over its contractors, such arrangements with contractors carry with them risks associated with the possibility that the contractors may (i) have economic or other interests or goals that are inconsistent with the Company's, (ii) take actions contrary to the Company's instructions or requests, or (iii) be unable or unwilling to fulfill their obligations. Unanticipated problems with third party contractors could materially and adversely affect the Company's business and results of operations.

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

Recruiting, retaining and training qualified personnel is critical to the Company's success. The number of persons skilled in the acquisition, exploration and development of mining properties is limited and competition within the mining industry for such persons is intense. In particular, Mongolian law requires that at least 90% of a mining company's employees be of Mongolian nationality in order to avoid substantial payments to the Mongolian Government. This provision of the law, coupled with the large number of active mining projects in Mongolia, further limit the number of available personnel and increase competition for skilled personnel. As the Company's business activity grows, it will require additional key financial, administrative, mining, marketing and public relations personnel as well as additional operations staff. If the Company is not successful in attracting such key personnel, or retaining existing key personnel, the Company's business and results of operations could be materially and adversely affected.

In addition, the Company's ability to train operating and maintenance personnel is a key factor for the Company's business activities. If the Company is not successful in recruiting and training such personnel, the Company's business and results of operations could be materially and adversely affected.

Increasing competition may hinder the Company's exploration and development plans.

Significant and increasing competition exists for mineral deposits. As a result of this competition, much of which is with large established mining companies with substantially greater financial and

technical resources than the Company's, the Company may be unable to acquire additional attractive mining claims or financing on terms it considers acceptable. In addition, the mining industry has historically experienced a demand for mining equipment and related services that has outpaced supply. Shortages of, or higher costs for, equipment and services could restrict the Company's ability to carry out its exploration, development and production activities and increase the Company's costs of operations and adversely affect the Company's future plans.

Competition in the Chinese coal industry may increase and the Company's business and prospects may be adversely affected if it is not able to compete effectively.

The Company intends to sell a significant portion of the coal it produces to China. Competition in the Chinese coal industry is based on many factors, including, among others, price, production capacity, coal quality and characteristics, transportation capability and costs, blending capability and brand name. The Company's coal business will most likely compete in China with other large Chinese and international coal mining companies. Some of the Company's international competitors may have greater coal production capacity as well as greater financial, marketing, distribution and other resources than the Company does, and may benefit from more established brand names in international markets. Due to their location, some of the Company's Chinese competitors may have lower transportation costs than the Company. The Chinese coal market is highly fragmented and the Company also faces price competition from some small local coal producers that produce coal for significantly lower costs than the Company, due to various factors, including their lower expenditure on safety and regulatory compliance.

Increased competition in the future, including competition from new competitors who may emerge as a result of the consolidation of the coal industry in China, could materially and adversely affect the Company's business and results of operations.

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

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

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

Mongolia and China have ratified the Kyoto Protocol and have committed to limit their net greenhouse gas emissions. However, neither China nor Mongolia has introduced comprehensive regulations addressing greenhouse gas emissions, including emission targets for specific industrial sectors. The primary source of greenhouse gas emissions in both Mongolia and China is the use of hydrocarbon energy. The Company's operations depend significantly on hydrocarbon energy sources to conduct daily operations, and there are currently no economic substitutes for these forms of energy. The Mongolian and Chinese governments have not finalized any formal regulatory programs to control greenhouse gases, and it is not yet possible to reasonably estimate the nature, extent, timing and cost of any programs contemplated or their potential effects on the Company's operations. The broad adoption of emission limitations or other regulatory efforts to control

greenhouse gas emissions may materially and adversely affect the demand for coal as well as increase production and transportation costs.

Complying with environmental and regulatory requirements may be more costly than anticipated.

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

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

Amendments to current laws, regulations and permit requirements governing operations and activities of mining companies, or more stringent implementation thereof, could materially and adversely affect the Company and cause increases in capital expenditures or production costs or reductions in levels of production at producing properties or require abandonment or delays in development of new mining properties.

Environmental liability could materially and adversely affect the Company's business and results of operations.

The Company's operations are subject to and affected by laws and regulations relating to the environment, health and safety and other regulatory matters. The risk of environmental liability is inherent in the operation of the Company's business and there can be no assurance that environmental liabilities will not materially and adversely affect the Company's business and results of operations.

In the future, claims may be asserted against the Company arising out of its operations in the normal course of business, including claims relating to land use, safety, health and environmental matters. Such matters are subject to many uncertainties and it is not possible to determine the probable outcome of, or the amount of liability, if any, from these matters. There can be no assurance that an adverse outcome in any such litigation would not materially and adversely affect on the Company's business and results of operations.

The Company's mining operations have a finite life and eventual closure of these operations will entail costs and risks regarding ongoing monitoring, rehabilitation and compliance with environmental standards.

The Company's mines contain a finite amount of recoverable resources and will eventually close. The key tasks in relation to the closure of its mines are (i) long-term management of permanent

engineered structures (for example, spillways, roads, waste dumps); (ii) achievement of environmental closure standards; (iii) orderly retrenchment of employees and contractors; and (iv) relinquishment of the site with associated permanent structures and community development infrastructure and programs to new owners. The successful completion of these tasks is dependent on the ability to successfully implement negotiated agreements with the relevant government, community and employees. The consequences of a difficult closure range from increased closure costs and handover delays to ongoing environmental impacts and corporate reputation damage if desired outcomes cannot be achieved, which could materially and adversely affect the Company's business and results of operations.

Foreign currency fluctuations could affect expenses and any future earnings.

The Company attempts to minimize the risks associated with foreign currency fluctuations by holding essentially all of its cash and short-term investments in U.S. and Canadian dollars rather than the local currency in Mongolia and Indonesia. However, salaries for local labour in both Mongolia and Indonesia are paid in local currency, which exposes the Company to foreign currency fluctuations with respect to the Mongolian tugrik and the Indonesian rupiah, respectively. In addition, since the Company's financial results are reported in U.S. dollars, its financial position and results are impacted by exchange rate fluctuations between the Canadian and U.S. dollars. Furthermore, sales of coal into China may be at prices denominated in Renminbi. As a result, foreign exchange currency exposure may materially and adversely affect the Company's financial condition and results of operations.

The Company expects that a majority of its coal sales will be made in China. Accordingly, the Company's results of operations are subject, to a significant extent, to economic, political and legal developments in China.

The Company expects that a majority of coal sales from the Ovoot Tolgoi project will be made to customers located in China. Accordingly, the economic, political and social conditions, as well as government policies, of China may affect the Company's business. The Chinese economy differs from the economies of most developed countries in many respects, including: (i) structure; (ii) level of government involvement; (iii) level of development; (iv) growth rate; (v) control of foreign exchange and (vi) allocation of resources. For the past two decades, the Chinese government has implemented economic reform measures emphasizing the utilization of market forces in the development of the Chinese economy. However, the Chinese government indirectly influences coal prices through its regulation of power tariffs and its control over allocation of the transportation capacity of the national rail system. Since mid-2003, coal prices in China have increased significantly, reaching their highest level in recent years. Any significant downturn in coal prices in China could materially and adversely affect the Company's business and results of operations. Any significant decline in demand for, or over-supply of, coal could materially and adversely affect the Company's revenues from coal export sales, and could also materially and adversely affect the Company's revenues from domestic coal sales to the extent that such decline has affected coal prices in the domestic coal market.

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

Certain directors are directors or officers of, or have shareholdings in, other mineral resource companies and, to the extent that such other companies may participate in ventures in which the

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

The Company is controlled by Ivanhoe, whose interests may differ from those of the Company's other shareholders.

Ivanhoe holds, directly and indirectly, approximately 80% of the Company's issued and outstanding common shares. The interests of Ivanhoe may conflict with the interests of the Company's other shareholders, and there is no assurance that Ivanhoe will vote its common shares in a way that does not prejudice the interests of the Company's minority shareholders. Ivanhoe's ownership interest enables Ivanhoe to elect the entire Board without the concurrence of any of the Company's other shareholders. Accordingly, unless applicable laws or regulations would require approval by the Company's minority shareholders, Ivanhoe is in a position to:

- control the policies, management and affairs of the Company;
- subject to applicable laws, regulations and the Company's constating documents, adopt amendments to certain provisions of the Company's constating documents; and
- otherwise determine the outcome of most corporate actions, including a change in control, merger or sale of all or substantially all of the Company's assets.

Third parties may be discouraged from making a tender offer or bid to acquire the Company because of this concentration of ownership.

Information in this MD&A regarding future plans reflects current intentions and is subject to change.

Whether the Company ultimately implements the business plans described in this MD&A, and whether it achieves the objectives described in this MD&A, will depend on a number of factors including, but not limited to: the availability and cost of capital; current and projected coal prices; coal markets; costs and availability of drilling rigs and other equipment, supplies and personnel; success or failure of activities in similar areas to those in which the Company's projects are situated; and changes in estimates of project completion costs. The Company will continue to gather information about its projects, and it is possible that additional information will cause it to alter its

schedule or determine that a project should not be pursued at all. Accordingly, the Company's plans and objectives may change from those described in this MD&A.

Equity markets are volatile.

There are risks involved with any investment in listed equity securities. The market price of the Company's common shares may rise or fall depending upon a range of factors and stock market conditions, which are unrelated to the Company's future financial performance. Movements on international stock markets, local interest rates and exchange rates, domestic and international economic and political conditions, as well as government, taxation and other policy changes may affect the stock market. As the Company is a listed company on the TSX-V, the market price of its common shares will be subject to numerous influences, which may affect both the broad trend in the share market and the share prices of individual companies or sectors.

In addition, the market price of the Company's common shares could decline as a result of future sales of substantial amounts of the outstanding common shares in the public market, including sales by Ivanhoe or other substantial shareholders, or the issuance of new common shares by the Company, or the perception that such sales or issuances may occur. Future sales, or perceived possible sales, of substantial amounts of the common shares could also materially and adversely affect the Company's ability to raise capital in the future at a time and at a price favorable to it, and the Company's shareholders may experience dilution in their holdings upon issuance or sale of additional common shares or other securities in the future.

Risks Relating To The Company's Projects In Mongolia

Legislation in developing countries such as Mongolia can be difficult to interpret and conflicting interpretations by government bureaucrats and civil servants may have adverse consequences.

The Mongolian legal system shares several of the qualitative characteristics typically found in a developing country and a developing democracy insofar as many of its laws, particularly with respect to matters of taxation, tend to be basic and have not evolved to a point where they contemplate or recognize more sophisticated transactions and business structures involving relatively well-established Western legal concepts such as joint ventures and beneficial, as opposed to legal, ownership of assets. Likewise, government officials responsible for administering these laws may lack experience in assessing these types of transactions such that a transaction or business structure that would likely be regarded under a Western legal system as appropriate and relatively straightforward is just as likely to be regarded by Mongolian government officials as novel and without precedent and therefore outside the scope of Mongolian law. As a result, structuring business arrangements with third parties and engaging in tax planning within the limited ambit of settled Mongolian law may carry significant risks. In particular, when business objectives and practicalities dictate the use of arrangements and structures that, while not necessarily contrary to settled Mongolian law, are sufficiently novel within a Mongolian legal context, it is possible that such arrangements may be impugned after the fact by Mongolian government officials who are unfamiliar with the arrangement or structure. As a result, Mongolian government officials may apply the law in a way that the Company considers arbitrary and that could materially and adversely affect the parties to the arrangement or structure.

In addition to the above, the legal system in Mongolia has inherent uncertainties that could limit the legal protections available to the Company. The following risks relating to the Mongolian legal system create uncertainties, many of which do not exist in countries with more developed market

economies: (i) inconsistencies between laws; (ii) limited judicial and administrative guidance on interpreting Mongolian legislation; (iii) substantial gaps in the regulatory structure due to delay or absence of implementing regulations; (iv) the relative inexperience of judges and courts in interpreting new principles of Mongolian legislation, particularly those relating to business, corporate and securities laws; (v) a lack of judicial independence from political, social and commercial forces; and (vi) bankruptcy procedures that are not well developed and are subject to abuse.

In general, the Mongolian judicial system is relatively inexperienced in enforcing the laws and regulations that currently exist, leading to a degree of uncertainty as to the outcome of any litigation. Further, it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction. Another risk is that the introduction of new Mongolian laws and regulations and the interpretation of existing ones may be subject to policy changes reflecting domestic political or social changes.

In addition, while legislation has been enacted to protect private property against expropriation and nationalization, due to the lack of experience in enforcing these provisions and political factors, these protections may not be enforced in the event of an attempted expropriation or nationalization. Expropriation or nationalization of any of the Company's assets, or portions thereof, potentially without adequate compensation, could materially and adversely affect the Company's business and results of operations.

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

In 2006, the Mongolian Government enacted a new minerals law. The Minerals Law preserves to a limited extent some of the substance of the former 1997 minerals legislation, which was drafted with the assistance of Western legal experts and was widely regarded as progressive, internally consistent and effective legislation. However, the Minerals Law contains new provisions that have increased the potential for political interference and weakened the rights and security of title of holders of mineral tenures in Mongolia. Certain provisions of the Minerals Law are ambiguous and it is unclear how they will be interpreted and applied in practice. As such, the impact, if any, of these provisions of the Minerals Law on the Company's projects cannot be measured with any certainty.

In addition, there can be no assurance that future political and economic conditions in Mongolia will not result in the Mongolian Government adopting different policies in relation to foreign development and ownership of mineral resources. Any such changes in government or policy may result in changes in laws affecting ownership of assets, environmental protection, labour relations, repatriation of income, return of capital, investment agreements and other areas, each of which may materially and adversely affect both the Company's ability to undertake exploration and development activities in the manner currently contemplated. Future changes in the government, major policy shifts or lack of consensus among the various political groups could lead to political instability and could also materially and adversely affect the mineral sector in general.

There can also be no assurance that income tax laws, royalty regulation and government incentive programs relating to the mining industry in Mongolia will not be changed in a manner which materially and adversely affects the Company's business and results of operations.

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

The Company's ability to efficiently conduct its exploration and development activities is subject to changes in legislation or government regulations or shifts in political attitudes within Mongolia that are beyond its control.

Government policy may change to discourage foreign investment, nationalisation of mining industries may occur or other government limitations, restrictions or requirements not currently foreseen may be implemented. There is no assurance that the Company's assets will not be subject to nationalization, requisition or confiscation, whether legitimate or not, by any authority or body.

There is no assurance that provisions under Mongolian law for compensation and reimbursement of losses to investors under such circumstances would be effective to restore the value of the Company's original investment. Similarly, the Company's operations may be affected in varying degrees by government regulations with respect to restrictions on production, price controls, export controls, income taxes, environmental legislation, mine safety and annual fees to maintain mineral licenses in good standing. There can be no assurance that Mongolian laws protecting foreign investments will not be amended or abolished or that existing laws will be enforced or interpreted to provide adequate protection against any or all of the risks described above.

In addition, Mongolia may experience political instability. Such instability could have a material adverse effect on economic or social conditions in Mongolia and may result in outbreaks of civil unrest, terrorist attacks or threats or acts of war in the affected areas, any of which could materially and adversely affect the Company's business and results of operations.

The Mongolian Government could determine that any one or more of the Company's projects in Mongolia is a Mineral Deposit of Strategic Importance.

Under the Minerals Law, the parliament of Mongolia has wide discretion to designate mineral deposits to be Mineral Deposits of Strategic Importance. The Mongolian Government is empowered to participate on an equity basis with the license holder in the exploitation and/or mining of each Mineral Deposit of Strategic Importance on terms to be negotiated between the Mongolian Government and such license holder. Details of any minerals reserves must be filed by the relevant license holder with the Mongolian Government, and those deposits on the Strategic Deposits List represent most of the largest and highest profile deposits in Mongolia. In addition to deposits currently on the Strategic Deposits List and the additional Tier 2 Deposits List, the Mongolian Parliament may at any time designate other deposits not yet currently on either list to be Mineral Deposits of Strategic Importance, add such deposits to either the Strategic Deposits List or the Tier 2 Deposits List and, in the former case, commence negotiations with the relevant license holder with respect to the terms under which the Mongolian Government will take an interest in such deposit. Whilst the Mongolian Government is in the process of adding the exact location and coordinates for each Mineral Deposit of Strategic Importance, a number of deposits on the Strategic Deposits List are identified by name only with no indication of the latitude and longitude coordinates for the deposit, and it is therefore not always possible to precisely determine the intended geographic area covered by each designated Mineral Deposit of Strategic Importance or to accurately determine whether or not any given license area is within—or overlaps — a Mineral Deposit of Strategic Importance.

Under the Minerals Law, the size of the Mongolian Government's participation is determined largely by the level of state funding which has been provided for the exploration and development of any

deposit, with the Mongolian Government entitled to participate up to 50% in the event that there has been state funding of such depositor up to 34% if there has not. However the Minerals Law is very vague as to the details and method by which the Mongolian Government will take its interest and the final arrangements in respect of the Mongolian Government's interest in each Mineral Deposit of Strategic Importance, including the amount of compensation to be paid to the license holder and the actual form of the Mongolian Government's interest are subject to negotiation between the Mongolian Government and the license holder.

The Minerals Law also contains provisions requiring any company which holds a Mineral Deposit of Strategic Importance to list no less than 10% of its shares on the Mongolian Stock Exchange. This particular provision of the Minerals Law has not yet been enforced and it is not clear how it will work in practice.

Over the past 12 months there have been a number of proposed amendments to the Minerals Law suggested by various parties, many of which have centered on amending the Minerals Law to increase the Mongolian Government's participating interest in excess of 50%. Whilst the Minerals Law provides that the interest of the Mongolian Government should take the form of an equity interest, based on past practice, and depending on the results of individual negotiations, the interest maybe in the form of production or profit sharing or some other arrangement negotiated between the license holder and the Mongolian Government. There can be no assurance that legislation will not be enacted which further strengthens the Mongolian Government's right to participate in privately held mineral resources in Mongolia. None of the deposits covered by the Company's existing approval to mine, mining license and MELs are currently designated as Mineral Deposits of Strategic Importance. However, there can be no assurance that any one or more of these deposits will not be so designated in the future, in which case the Company's business and results of operations may be materially and adversely affected.

If the Company elects or is required to enter into an Investment Agreement with the Mongolian Government, the Company's prospects of obtaining such an Investment Agreement are uncertain.

Although there is no legal requirement that the Company enter into an Investment Agreement with the Mongolian Government before commencing development and mining operations at the Ovoot Tolgoi project, the Company believes that entering into a mutually satisfactory Investment Agreement with the Mongolian Government in the future would provide increased stability with respect to the Company's long term operations in Mongolia. However, the Company may be unsuccessful in negotiating such an Investment Agreement with the Mongolian Government for the Ovoot Tolgoi project or may only be able to obtain an agreement on terms that are adverse to the economic viability of the project. Delays in obtaining, or a failure to obtain, a reasonable Investment Agreement from the Mongolian Government could materially and adversely affect the development of the Ovoot Tolgoi project or the Company's other projects in Mongolia, the Company's results of operations or the Company itself.

The Company's customers may not have the necessary authorization to import coal into China or to export coal out of Mongolia

The Company expects to sell the majority of the coal from its Mongolian mining operations to customers in China. Chinese law requires specific authorization to be obtained by entities responsible for the import of coal into China. In the event that the Company's customers, or the agents of such customers who are responsible for importing coal into China on their behalf, are not

able to obtain and retain the necessary authorizations, their ability to import the Company's coal into China may be affected, which could materially and adversely affect the Company's business and results of operations. In addition, Chinese law imposes certain requirements on entities in order for them to obtain or maintain the authorization to import coal and on the end-users of coal including in relation to production safety, energy conservation and environmental protection. There is no assurance that the Chinese government will not impose more rigorous requirements in the future. In the event that the end-users of the Company's coal are unable to meet such requirements and the Company is not able to find alternative customers for its products, either at similar prices or at all, the Company's business and results of operations could be materially and adversely affected. Similarly, any restrictions imposed, or Mongolian Government charges levied or raised (including royalty fees), under Mongolian law on the export of coal could harm the competitiveness of the Company, and materially and adversely affect the Company's business and results of operations.

Risks Relating To The Company's Projects In Indonesia

Indonesian law does not permit the Company to hold Indonesian mining rights and all licenses and permits necessary for the Indonesian projects are owned or held by Indonesian entities in which the Company has no ownership interest or direct control.

Under Indonesian law, foreign companies such as the Company are not permitted to operate directly in Indonesia, and cannot hold, directly or indirectly, shares in an Indonesian entity holding mineral exploration or mining licenses. The Company therefore has no interest in any of the mineral exploration licenses covering its projects in Indonesia.. Rather, it carries out its mining business in Indonesia through its Indonesian subsidiaries operating under contractual arrangements with independent Indonesian entities, , which hold the relevant authorizations. As a result, the Company must rely on the continued compliance with and enforceability of contracts with these Indonesian entities.. Further, some of the provisions of and/or descriptions in the contractual arrangements between the Company and the Indonesian project entities are open to varying interpretation. If any Indonesian entity ceases to comply with the relevant contracts, or if the contracts are construed against the Company, it may be difficult for the Company to obtain a remedy of specific performance so as to ensure continued access to the mineral deposits; as such arrangements may not be deemed to comply with applicable law. This could include a situation where the Indonesian entity becomes insolvent. The Company and its subsidiaries must also rely on the Indonesian entities for certain key matters including obtaining, complying with and maintaining mineral exploration licenses and other regulatory approvals as well as dealing with landowners in the exploration and mining area. In addition, the relevant mineral exploration licenses do not carry with them the right to use the relevant land, which must be secured separately by the relevant Indonesian entities holding the mineral exploration licenses.. The Company may not be able to exercise the same control over their business in Indonesia as that they might in countries where the Company enjoys direct ownership of mining rights and operations and, as a result, the Company's business and results of operations in Indonesia may be materially and adversely affected.

The Company's interest in mining rights and exploration rights in Indonesia may be uncertain.

The mining permission process in Indonesia is decentralized and permits must be sought from different government bodies depending on the location of the proposed mining area, including from provincial or regency governments where relevant. In addition, mineral exploration licenses have been issued to certain Indonesian project entities that exceed the maximum size allowed by law (although such infringement may be deemed to have been waived through the issuance of the mineral exploration licenses). Due to the lack of coordination between the central government and

provincial and regional government bodies, it is not uncommon to find cases of overlapping mining titles in Indonesia or mining titles that overlap with other land use rights. In the event that such overlap occurs in the future with respect to any of the Company's Indonesian projects preventing the Company or the relevant Indonesian entities from performing their respective contractual obligations in respect of the Company's Indonesian projects, the Company's business and results of operations in Indonesia may be materially and adversely affected.

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

The Indonesian Government has been proposing major changes to the Indonesian mining law regime for over five years. The draft of the revised mining laws previously made available is complex and subject to change, and there is no clear timing for finalization and enactment. In addition, after a significant new law is enacted in Indonesia, it is common for proper implementation to be delayed until the required implementing regulations are also enacted. This can take months or even years, creating an intervening period of uncertainty. Moreover, even after the necessary implementing regulations are enacted, it may be unclear how the new laws will be interpreted and applied in practice. As such, it may not be possible to measure the impact, if any, of prospective reform of mining laws on the Company's Indonesian projects.

There can also be no assurance that environmental laws, income tax laws, foreign investment laws and laws relating to indigenous people and surface rights in Indonesia will not be changed in a manner which materially and adversely affects the Company. Further, the tax treatment of the arrangements under which the Indonesian projects will be carried out is uncertain. Although arrangements comparable to those entered into by the Company in respect of its Indonesian projects are not uncommon, it is possible that parties with competing or vested interests could raise objections to the legal structure of the Indonesian projects.

Further, the tax treatment of arrangements for the Indonesian projects has not yet been confirmed. Any increase in tax burden resulting from how the tax authorities will treat the Indonesian projects may affect the economics of the Indonesian projects, which may materially and adversely affect the Company's business and results of operations.

The Indonesian Government is proposing to enact regulations that will place restrictions on the ability of producers to export coal products.

New measures have been proposed in order to ensure greater domestic use of and development based on resources in Indonesia. It is possible that during the period of implementation and running of the Indonesian projects, steps will be taken to prohibit or restrict the export of coal products. The actual form scope of these regulations remain to be determined. The manner in which any such prohibitions or restrictions would operate and their potential impact on the Indonesian projects cannot be assessed.

OUTLOOK

The Company's principal business is the exploration and development of its coal properties in Indonesia and Mongolia. Although the Company is uncertain what impact the current volatility in the global economic market place will have on the short term fundamentals for coal demand we are encouraged by long-term fundamentals, in general.

Coal is still considered a prime low cost energy source, and countries such as India and China account for a large percentage of the world's coal demand.

The Company expects coal demand growth to resume in the future and considers its current projects in Mongolia and Indonesia ideally located to supply the Japanese, Korean, Indian and Chinese coastal markets.

Mongolia

The Company has established a schedule for the development of commercial operations on the Ovoot Tolgoi project. In the third quarter coal customers were assembling truck transportation fleets and completing final permits in China and Mongolia. The Company commenced initial deliveries of coal in late September 2008. The first coal shipment is part of a one-year contract and second sales contract is in place for additional tonnages. Increased shipping continued throughout the fourth quarter, with revenue surpassing $3 million.

In February 2009, the Company concluded an additional sales contract with a Mongolian company for 500,000 tonnes of premium and steam coal.

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.

SouthGobi continued to drill on the Sumber and Ovoot Tolgoi Underground coal projects. The results of the 2008 drilling programs are expected to form the basis of resource estimates for both areas.

In early October the Company announced the discovery of a new coal formation approximately 10 km southeast of the current Ovoot Tolgoi coal mine. Multiple seams have been uncovered and a drilling program has commenced and will continue into 2009.

The Company has been engaged in ongoing discussions with the Mongolian government with the objective of establishing a border crossing at the Ceke border point that will be open for a full 24 hours per day. This is expected to allow daily distribution of Ovoot Tolgoi coal to customers in China. SouthGobi has purchased an automated 150 tonne scale which has been set up at the border to expedite coal traffic crossing the border into China from Ovoot Tolgoi.

In 2009, the Company has experienced difficulty, from time to time, in expediting the movement of its coal shipments through the Ceke border point due to relatively erratic and unpredictable opening hours and sporadic closures. The Mongolian government and the Company are coordinating efforts to resume regular border crossing access for the Company's coal shipments. Through early 2009

limited shipments crossed the border point. As a result the Company has initiated a production curtailment program to preserve cash flow and decrease current coal stockpiles.

For 2009 the Company anticipates approximately 2.9 million tonnes of shipments from its Ovoot Tolgoi operations, and believes that these revenue projections will be under final sales contracts in early 2009. However, the impact of the intermittent shipping through the Ceke border crossing could have an impact on our anticipated results for 2009.

Indonesia

During the quarter, the Company continued an integrated exploration and development program on the Indonesian projects. The 2008 drilling program has identified direct shipping, semi-soft coking coal amenable to surface mining. While further drilling is ongoing, work to date on the MCM concession supports SouthGobi's objective to develop an open-pit mining operation. The intent of the drilling program is to determine down-dip continuity, thickness variations, coal quality and structure. A bulk sample was taken on the coals in the initial mining area and results were announced on November 5, 2008. The results have confirmed high quality metallurgical coking coal.

Work has continued on the upgrading of existing logging roads. Our barging port on the Mahakam River is being constructed, which will facilitate barge loading activities during wet-season periods. Fabrication and commissioning of the facility is expected to be completed by the end of March 2009.

In January 2009 a permit was issued, which will allow the Company to commence surface coal mining at the SW resource block on the MCM concession.

Management is currently working with interested parties and is anticipating that final sales contracts will be completed in 2009. The Company will be outsourcing the mining services and is currently establishing a capped mining rate contract for these services. Near term development of the MCM concession, however, will depend on demand and economical pricing for its products.

The Company has also initiated reconnaissance evaluation of up to five new concession areas, which are contiguous to the MCM concessions. These areas have the potential of doubling the resource potential for the Mamahak coal project.

Overview

With the continued slowdown of the global economy and deteriorating global market conditions there has been a weakening of commodity prices. The Company will continue to review its current detailed revenue and expenditure plans and prioritize its production projects. For the longer term, the Company believes that the fundamentals remain strong for coal both on the supply and demand side.

For 2009 our objectives are to significantly advance our key growth projects and improve our knowledge of key exploration successes and potential successes both in Mongolia and Indonesia; to maintain a strong working capital position to fund our growth projects and maintain strong performance metrics.

The Company is committed to bringing it principal projects into production and continues to focus its efforts on expanding and developing its coal assets in Mongolia and Indonesia that have the potential for near term development and cash flows.

March 11, 2009