SouthGobi Energy Resources Ltd.
CONSOLIDATED INTERIM FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)
(Stated in U.S. dollars)

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SOUTHGOBI ENERGY RESOURCES LTD.
Consolidated Interim Statement of Comprehensive Income
(Unaudited)
(Stated in U.S. dollars)

	Notes	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Continuing operations					
Revenue		**$ 11,870,845**	$ -	**$ 26,077,803**	$ -
Cost of sales	8	**(8,636,872)**	-	**(20,988,873)**	-
Income from mine operations		**3,233,973**	-	**5,088,930**	-
Administration expenses	9	**(6,233,815)**	(10,338,713)	**(16,783,348)**	(12,850,768)
Evaluation and exploration expenses	10	**(5,010,777)**	(11,355,984)	**(13,781,444)**	(28,088,514)
Impairment charge on Mamahak Coal project	7	**(23,029,013)**	-	**(23,029,013)**	-
Operating loss from continuing operations		**(31,039,632)**	(21,694,697)	**(48,504,875)**	(40,939,282)
Finance costs	11	**(643,520)**	(5,167)	**(1,061,141)**	(7,966,271)
Interest income		**3,898**	589,311	**16,272**	1,697,623
Loss before tax		**(31,679,254)**	(21,110,553)	**(49,549,744)**	(47,207,930)
Current income tax expense		**(711,855)**	-	**(711,855)**	-
Deferred income tax recovery		**8,608,766**	-	**8,608,766**	-
Loss from continuing operations		**(23,782,343)**	(21,110,553)	**(41,652,833)**	(47,207,930)
Loss from discontinued operations	6	**-**	(1,666,884)	**-**	(5,362,114)
Net loss and comprehensive loss attributable to equity holders of the Company		**$ (23,782,343)**	$ (22,777,437)	**$ (41,652,833)**	$ (52,570,044)
Basic and diluted loss per share from:					
Continuing operations	12	**(0.18)**	(0.16)	**(0.31)**	(0.37)
Discontinued operations	12	**-**	(0.01)	**-**	(0.04)
Continuing and discontinued operations		**(0.18)**	(0.17)	**(0.31)**	(0.41)
Weighted average number of basic and diluted shares outstanding	12	**133,407,751**	132,778,768	**133,341,543**	126,775,043

The accompanying notes are an intergral part of these Consolidated Interim Financial Statements.

SOUTHGOBI ENERGY RESOURCES LTD.
Consolidated Interim Statement of Financial Position
(Unaudited)
(Stated in U.S. dollars)

	Notes	As at September 30, 2009	As at December 31, 2008	As at December 31, 2007
Assets				
Current assets				
Cash and cash equivalents		**$ 2,710,766**	$ 10,117,311	$ 1,393,632
Trade and other receivables		**14,798,663**	7,289,726	759,528
Inventories	13	**10,707,439**	13,676,716	-
Prepaid expenses and deposits		**7,176,448**	2,578,527	1,890,177
		35,393,316	33,662,280	4,043,337
Assets classified as held for sale	6	**-**	637,600	-
Total current assets		**35,393,316**	34,299,880	4,043,337
Non-current assets				
Property, plant and equipment	15	**65,791,565**	52,439,911	1,123,380
Intangible assets	14	**-**	13,208,218	443,360
Deferred income tax assets		**8,608,766**	-	-
Other receivables		**108,333**	-	-
Total non-current assets		**74,508,664**	65,648,129	1,566,740
Total assets		**$ 109,901,980**	$ 99,948,009	$ 5,610,077
Equity and liabilities				
Current liabilities				
Trade and other payables		**$ 11,210,514**	$ 7,400,009	$ 1,767,784
Amounts due under line of credit facilities	16	**37,030,151**	-	-
Deposit received for sale of metals division	6	**-**	3,000,000	-
		48,240,665	10,400,009	1,767,784
Current liabilities classified as held for sale	6	**-**	255,080	-
Total current liabilities		**48,240,665**	10,655,089	1,767,784
Non-current liabilities				
Amounts due under line of credit facilities	16	**-**	-	105,673,380
Asset retirement obligation	17	**984,822**	328,229	-
Total non-current liabilities		**984,822**	328,229	105,673,380
Total liabilities		**49,225,487**	10,983,318	107,441,164
Shareholders' equity (deficiency)				
Common shares	18	**291,320,990**	289,512,074	30,229,785
Preferred shares	18	**-**	-	4,189,154
Share option reserve	19	**21,713,315**	12,775,076	7,496,691
Accumulated deficit	20	**(252,357,812)**	(213,322,459)	(143,746,717)
Total shareholders' equity (deficiency)		**60,676,493**	88,964,691	(101,831,087)
Total equity and liabilities		**$ 109,901,980**	$ 99,948,009	$ 5,610,077

The accompanying notes are an intergral part of these Consolidated Interim Financial Statements.

APPROVED BY THE BOARD:

"Andre Deepwell"
Director

"Pierre Lebel"
Director

SOUTHGOBI ENERGY RESOURCES LTD.
Consolidated Interim Statement of Changes in Equity
(Unaudited)
(Stated in U.S. dollars)

	Common Shares		Preferred Shares				
	Number of shares	Amount	Number of shares	Amount	Share option reserve	Accumulated deficit	Total
Balances, January 1, 2008	74,932,657	$ 30,229,785	25,576,383	$ 4,189,154	$ 7,496,691	$ (143,746,717)	$ (101,831,087)
Shares issued for:							
Cash	16,211,111	139,642,368	-	-	-	-	139,642,368
Share issue costs	-	(3,303,418)	-	-	-	-	(3,303,418)
Mineral property	321,818	5,198,000	-	-	-	-	5,198,000
Conversion of line of credit	14,709,071	107,551,903	-	-	-	-	107,551,903
Conversion of preferred shares	25,576,383	4,189,154	(25,576,383)	(4,189,154)	-	-	-
Exercise of stock options	1,442,242	6,004,282	-	-	(1,960,086)	-	4,044,196
Stock-based compensation charged to operations	-	-	-	-	7,238,471	-	7,238,471
Net loss and comprehensive loss for the year	-	-	-	-	-	(69,575,742)	(69,575,742)
Balances, December 31, 2008	133,193,282	$ 289,512,074	-	$ -	$ 12,775,076	$ (213,322,459)	$ 88,964,691
Shares issued for:							
Exercise of stock options	349,767	1,808,916	-	-	(802,935)	-	1,005,981
Stock-based compensation charged to operations	-	-	-	-	9,741,174	-	9,741,174
Gain on sale of Metals Division (Note 6)	-	-	-	-	-	2,617,480	2,617,480
Net loss and comprehensive loss for the period	-	-	-	-	-	(41,652,833)	(41,652,833)
Balances, September 30, 2009	**133,543,049**	**$ 291,320,990**	**-**	**$ -**	**$ 21,713,315**	**$ (252,357,812)**	**$ 60,676,493**
Balances, January 1, 2008	74,932,657	$ 30,229,785	25,576,383	$ 4,189,154	$ 7,496,691	$ (143,746,717)	$ (101,831,087)
Cash	16,211,111	139,642,368	-	-	-	-	139,642,368
Share issue costs	-	(3,303,418)	-	-	-	-	(3,303,418)
Mineral property	1,818	30,000	-	-	-	-	30,000
Conversion of line of credit	14,709,071	107,551,903	-	-	-	-	107,551,903
Conversion of preferred shares	25,576,383	4,189,154	(25,576,383)	(4,189,154)	-	-	-
Exercise of stock options	1,408,542	5,891,215	-	-	(1,925,691)	-	3,965,524
Stock-based compensation charged to operations	-	-	-	-	4,773,140	-	4,773,140
Net loss and comprehensive loss for the period	-	-	-	-	-	(52,570,044)	(52,570,044)
Balances, September 30, 2008	132,839,582	$ 284,231,007	-	$ -	$ 10,344,140	$ (196,316,761)	$ 98,258,386

The accompanying notes are an intergral part of these Consolidated Interim Financial Statements.

SOUTHGOBI ENERGY RESOURCES LTD.

Consolidated Interim Statement of Cash Flows

(Unaudited)
(Stated in U.S. dollars)

	Notes	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Operating activities					
Loss for the period from continuing operations before tax		**$ (31,679,254)**	$ (21,110,553)	**$ (49,549,744)**	$ (47,207,930)
Adjustments for:					
Depreciation and depletion		**2,226,532**	50,718	**4,274,070**	184,426
Share-based compensation		**2,623,405**	1,540,934	**9,741,174**	3,625,580
Fair value change on embedded derivative		**-**	-	**-**	7,223,399
Interest income		**(3,898)**	(589,311)	**(16,272)**	(1,697,623)
Accrued interest expense		**632,456**	-	**1,030,151**	134,186
Interest accretion on line of credit facility		**-**	-	**-**	598,408
Unrealized foreign exchange loss		**110,718**	1,948,221	**1,307,348**	565,612
Loss on disposal of property, plant and equipment		**2,904**	2,659	**115,824**	5,663
Listing fees previously deferred		**-**	3,236,318	**-**	-
Accretion of asset retirement obligation		**11,064**	5,167	**30,990**	10,278
Impairment charge on Mamahak Coal project	7	**23,029,013**	-	**23,029,013**	-
Operating cash flows before movements in working capital		**(3,047,060)**	(14,915,847)	**(10,037,446)**	(36,558,001)
(Increase)/decrease in inventories		**(2,771,562)**	(3,691,006)	**130,816**	(6,404,075)
(Increase)/decrease in trade and other receivables		**1,994,637**	(1,352,604)	**(9,654,687)**	(4,231,438)
(Increase)/decrease in prepaid expenses and deposits		**(3,263,036)**	953,143	**(4,597,921)**	207,715
Increase in trade and other payables		**2,967,801**	3,002,873	**3,942,740**	7,043,511
Cash used in continuing operations		**(4,119,220)**	(16,003,441)	**(20,216,498)**	(39,942,288)
Cash used in discontinued operations	6	**-**	(1,467,048)	**-**	(4,238,230)
Cash used in operating activities		**$ (4,119,220)**	$ (17,470,489)	**$ (20,216,498)**	$ (44,180,518)
Investing activities					
Purchase of property, plant and equipment		**$ (8,547,483)**	$ (4,397,303)	**$ (24,123,956)**	$ (45,428,722)
Purchase of intangible assets		**-**	(9,209,929)	**-**	(8,013,800)
Interest received		**3,898**	589,311	**26,114**	1,697,623
Proceeds from disposal of property, plant and equipment		**-**	10,295	**25,675**	10,295
Increase in other receivables		**(54,166)**	-	**(108,333)**	-
Cash used in continuing operations		**(8,597,751)**	(13,007,626)	**(24,180,500)**	(51,734,604)
Cash used in discontinued operations	6	**-**	(31,866)	**(222,699)**	(47,376)
Cash used in investing activities		**$ (8,597,751)**	$ (13,039,492)	**$ (24,403,199)**	$ (51,781,980)
Financing activities					
Proceeds from issuance of common shares, warrants and exercise of stock options		**$ 626,246**	$ 629,011	**$ 1,005,981**	$ 140,304,475
Drawings under line of credit facilities	16	**12,000,000**	-	**36,000,000**	2,000,000
Repayment of line of credit facility		**-**	-	**-**	(8,077,470)
Cash generated from financing activities		**$ 12,626,246**	$ 629,011	**$ 37,005,981**	$ 134,227,005
Effect of foreign exchange rate changes on cash		**(4,808)**	(2,259,975)	**(15,528)**	(866,200)
(Decrease)/increase in cash and cash equivalents		**(95,533)**	(32,140,945)	**(7,629,244)**	37,398,307
Cash and cash equivalents, beginning of period		**2,806,299**	70,932,884	**10,340,010**	1,393,632
Cash and cash equivalents, end of period		**$ 2,710,766**	$ 38,791,939	**$ 2,710,766**	$ 38,791,939
Comprised of:					
Cash and cash equivalents of continuing operations		**$ 2,710,766**	$ 38,549,320	**$ 2,710,766**	$ 38,549,320
Cash and cash equivalents of discontinued operations		**-**	242,619	**-**	242,619
Total cash and cash equivalents		**$ 2,710,766**	$ 38,791,939	**$ 2,710,766**	$ 38,791,939
Cash		**$ 2,710,766**	$ 13,025,914	**$ 2,710,766**	$ 13,025,914
Money market instruments		**-**	25,766,025	**-**	25,766,025
Total cash and cash equivalents		**$ 2,710,766**	$ 38,791,939	**$ 2,710,766**	$ 38,791,939

Supplemental cash flow information (Note 23)

The accompanying notes are an integral part of these Consolidated Interim Financial Statements.

1. CORPORATE INFORMATION

SouthGobi Energy Resources Ltd. is a publicly listed company incorporated in Canada with limited liability under the legislation of the Province of British Columbia and its shares are listed on the TSX Venture Exchange. The company together with its subsidiaries (collectively referred to as the "Company") is principally engaged in the acquisition, exploration, development and production of coal properties in Mongolia and Indonesia. The Company's parent is Ivanhoe Mines Ltd. (the "parent" or "Ivanhoe").

The head office, principal address and registered and records office of the Company are located at 999 Canada Place, Suite 654, Vancouver, British Columbia, V6C 3E1.

The Consolidated Interim Financial Statements are presented in U.S. dollars and all values are rounded to the nearest dollar except where otherwise indicated.

The Company is a coal producer and a coal exploration and development company. These Consolidated Interim 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 $252,357,812. 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 to obtain further financing to develop properties (Note 25).

Management is of the opinion that additional financing will be available to continue its planned activities in the normal course of its operations. There can, however, be no assurance the financing discussed in Note 25 will close in a timely manner or at all.

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. for $3 million. The sale was effective December 30, 2008 and closed on February 2, 2009. The Metals Division consisted of certain base and precious metals properties in Mongolia and Indonesia. The Company will now be focused solely on coal production, development and exploration.

2. BASIS OF PREPARATION

2.1 Statement of compliance

These Consolidated Interim Financial Statements are unaudited and have been prepared in accordance with International Accounting Standards ("IAS") 34 *'Interim Financial Reporting*' ("IAS 34") using accounting policies consistent with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC").

These are the Company's third IFRS Consolidated Interim Financial Statements for part of the period covered by the Company's first IFRS Consolidated Annual Financial Statements for the year ending December 31, 2009. Previously, the Company prepared its Consolidated Annual and Consolidated Interim Financial Statements in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

As these are the Company's third set of Consolidated Interim Financial Statements in accordance with IFRS, the Company's disclosures exceed the minimum requirements under IAS 34. The Company has elected to exceed the minimum requirements in order to present the Company's accounting policies in accordance with IFRS and the additional disclosures required under IFRS, which also highlight the changes from the Company's 2008 annual Consolidated Financial Statements prepared in accordance with Canadian GAAP. In 2010 and beyond, the Company may not provide the same amount of disclosure in the Company's Consolidated Interim Financial Statements under IFRS as the reader will be able to rely on the annual consolidated financial statements which will be prepared in accordance with IFRS.

2.2 Basis of presentation

The Consolidated Interim Financial Statements have been prepared on the historical cost basis except for certain non-current assets and financial instruments, which are measured at fair value, as explained in the accounting policies set out in Note 4. The comparative figures presented in these Consolidated Interim Financial Statements are in accordance with IFRS and have not been audited.

2. BASIS OF PREPARATION (Continued)

2.3 Adoption of new and revised standards and interpretations

The IASB issued a number of new and revised IASs, IFRSs, amendments and related IFRICs (hereinafter collectively referred to as the "new IFRS") which are effective for the Company's financial year beginning on January 1, 2009. For the purpose of preparing and presenting the Financial Information of the relevant periods, the Company has consistently adopted all these new standards for the relevant reporting periods.

At the date of authorization of these Financial Statements, the IASB and IFRIC has issued the following new and revised standards, amendments and interpretations which are not yet effective during the Relevant Periods.

- IFRS (Amendments) — Amendment to IFRS 5 as part of Improvements to IFRS issued in 2008 (i)
- IFRS (Amendments) — Improvements to IFRS issued in 2009 (ii)
- IAS 24 (Revised) — Related Party Disclosures (iii)
- IAS 27 (Revised) — Consolidated and Separate Financial Statements (i)
- IAS 32 (Amendment) — Classification of Rights Issues (iv)
- IAS 39 (Amendment) — Eligible Hedged Items (i)
- IFRS 2 (Amendment) — Company Cash-settled Share-based Payment Transactions (v)
- IFRS 3 (Revised) — Business Combinations (i)
- IFRIC 17 — Distributions of Non-cash Assets to Owners (i)
- IFRIC 18 — Transfers of Assets from Customers (vi)

(i) Effective for annual periods beginning on or after July 1, 2009
(ii) Amendments that are effective for annual periods beginning on or after July 1, 2009 or January 1, 2010, as appropriate
(iii) Effective for annual periods beginning on or after January 1, 2011
(iv) Effective for annual periods beginning on or after February 1, 2010
(v) Effective for annual periods beginning on or after January 1, 2010
(vi) Effective for transfers on or after July 1, 2009

The Company anticipates that the application of these standards, amendments and interpretations will have no material impact on the results and financial positions of the Company.

(Stated in U.S. dollars)

3. FIRST TIME ADOPTION OF IFRS

The Company has adopted IFRS on January 1, 2009 with a transition date of January 1, 2005. Under IFRS 1 *'First-time Adoption of International Financial Reporting Standards'*, the IFRS are applied retrospectively at the transition 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 of IFRS.

Below is the Company's Consolidated Statement of Financial Position as at the transition date of January 1, 2005 under IFRS.

	As at January 1, 2005 (Unaudited)
Assets	
Current assets	
Cash and cash equivalents	$ 8,222,182
Trade and other receivables	79,737
Prepaid expenses and deposits	124,276
Total current assets	8,426,195
Non-current assets	
Property, plant and equipment	149,382
Intangible assets	158,384
Total non-current assets	307,766
Total assets	$ 8,733,961
Equity and liabilities	
Current liabilities	
Trade and other payables	$ 1,035,404
Total current liabilities	1,035,404
Total liabilities	1,035,404
Shareholders' equity	
Common shares	14,183,003
Additional paid in capital	1,690,842
Share option reserve	996,330
Accumulated deficit	(9,171,618)
Total shareholders' equity	7,698,557
Total equity and liabilities	$ 8,733,961

(Stated in U.S. dollars)

3. FIRST TIME ADOPTION OF IFRS (Continued)

IFRS employs a conceptual framework that is similar to Canadian GAAP. While the adoption of IFRS has not changed the actual cash flows of the Company, the adoption has resulted in significant changes to the reported financial position and results of operations of the Company. Presented below are reconciliations prepared by the Company to reconcile to IFRS the assets, liabilities, equity, net loss and cash flows of the Company from those reported under Canadian GAAP:

3.1 Total assets

		At December 31,				At January 1,
	Notes	2008	2007	2006	2005	2005
Total assets under Canadian GAAP		$ 100,132,144	$ 5,610,077	$ 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		$ 99,948,009	$ 5,610,077	$ 2,314,923	$ 3,918,594	$ 8,733,961

3.2 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

3.3 Total equity (deficiency)

		At September 30,	At December 31,				At January 1,
	Notes	2008	2008	2007	2006	2005	2005
Total equity (deficiency) under Canadian GAAP		$ 98,258,385	$ 88,964,691	$ (31,265,512)	$ (4,234,806)	$ 3,082,254	$ 7,663,703
Adjustments for differing accounting treatments:							
- Inclusion of coal division results, net of contribution by Ivanhoe	(i)	-	-	-	262,688	143,641	34,854
- Fair value of embedded derivative on debt	(ii)	(107,551,903)	(107,551,903)	(70,565,575)	-	-	-
- Conversion of debt	(ii)	107,551,903	107,551,903	-	-	-	-
- Adjustment for warrant liability	(iv)	-	-	-	-	(221,641)	-
Total equity (deficiency) under IFRS		$ 98,258,385	$ 88,964,691	$ (101,831,087)	$ (3,972,118)	$ 3,004,254	$ 7,698,557

(Stated in U.S. dollars)

3. FIRST TIME ADOPTION OF IFRS (Continued)

3.4 Net loss

	Notes	Three months ended September 30, 2008	Nine months ended September 30, 2008	Year ended December 31, 2008	2007	2006	2005
Net loss and comprehensive loss for the period under Canadian GAAP		$ 23,038,318	$ 45,065,191	$ 62,385,848	$ 26,729,932	$ 9,361,815	$ 6,213,957
Basic and Diluted Loss per Share under Canadian GAAP		$ 0.17	$ 0.36	$ 0.49	$ 0.52	$ 0.56	$ 0.41
Adjustments for differing accounting treatments:							
- Inclusion of coal division results	(i)	-	-	-	2,546,368	12,167,928	9,923,018
- Fair value of embedded derivative on debt	(ii)	-	7,223,400	7,223,400	63,286,039	-	-
- Interest accretion on line of credit facility	(ii)	-	319,360	319,360	4,224,179	-	-
- Adjustments on stock based compensation	(iii)	(260,881)	(37,907)	(352,866)	(50,089)	(250,730)	(107,301)
- Adjustment for warrant liability	(iv)	-	-	-	-	449,623	80,361
Net loss and comprehensive loss for period under IFRS		$ 22,777,437	$ 52,570,044	$ 69,575,742	$ 96,736,429	$ 21,728,636	$ 16,110,035
Basic and Diluted Loss per Share under IFRS		$ 0.17	$ 0.41	$ 0.54	$ 1.89	$ 1.31	$ 1.06

3.5 Cash flows

The adoption of IFRS has had no impact on the net cash flows of the Company. The changes made to the Consolidated Statements of Financial Position and Consolidated Statements of Comprehensive Income have resulted in reclassifications of various amounts on the Consolidated Statements of Cash Flows, however as there have been no changes to the net cash flows, no reconciliations have been presented.

Notes to the IFRS reconciliation above:

(i) ***Inclusion of coal division results***

On May 29, 2007, the Company completed the purchase of the Ivanhoe coal division (Note 22) 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.

3. FIRST TIME ADOPTION OF IFRS (Continued)

Notes to the IFRS reconciliation above (continued)

(ii) ***Fair value of embedded derivative on debt***

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 coal transaction. From April 26, 2006 to May 1, 2007 the Company accounted for any amounts drawn down on the credit facility as a liability at amortized cost and considered the fair value of the conversion feature to be insignificant because the significant milestones discussed below had not been achieved. On May 1, 2007 the conversion feature was considered to have a significant value as significant milestones surrounding the completion of the coal transaction had been achieved. These significant milestones included: (i) the signing of the definitive agreement with respect to the Company's acquisition of the coal division; (ii) approval of the coal transaction by the minority shareholders of the Company; and (iii) transfer of the coal mining licenses to the Company by Ivanhoe. From May 1, 2007 onwards the Company assigned a value of $3.1 million to the conversion feature. 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 (Note 16). As a result of this conversion the amount due under the line of credit facility was eliminated.

Under Canadian GAAP – After the achievement of the significant milestones discussed above, the conversion feature was recorded as a separate component of equity.

Under IFRS – After the achievement of the significant milestones discussed above, 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.

3. FIRST TIME ADOPTION OF IFRS (Continued)

Notes to the IFRS reconciliation above (continued)

(iii) *Adjustment on stock based compensation*

Recognition of expense

Under Canadian GAAP – Prior to 2008, the Company used the straight-line method of calculating vested options. 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. In 2008, the Company changed from the straight-line method to the graded-vesting method.

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 vesting period of the respective tranches.

Forfeitures

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

Under IFRS – Forfeiture estimates are recognized on the grant date and revised for actual experiences in subsequent periods.

3. FIRST TIME ADOPTION OF IFRS (Continued)

Notes to the IFRS reconciliation above (continued)

(iv) *Adjustment for 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.

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

Under IFRS – The exercise price of the warrants is fixed in Canadian dollars. The functional currency of the Company is in U.S. dollars 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 derivative liability under IAS 39 *'Financial Instruments: Recognition and Measurement'* and is recorded as a financial liability and stated at fair value at each date of the statement of financial position.

(v) *Adjustment for asset retirement obligation ("ARO")*

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

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

Under IFRS – Under IAS 37 *'Provisions, Contingent Liabilities and Contingent Assets'* 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.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

4.1 Basis of consolidation

The Consolidated Financial Statements include the financial statements of the Company and its controlled subsidiaries (Note 21). Control is achieved when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the Consolidated Statement of Comprehensive Income from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All intra-Company transactions, balances, income and expenses are eliminated in full on consolidation.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Company's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination (see Note 4.2) and the minority interests' share of changes in equity since the date of the combination. Losses applicable to the minority interests in excess of their interest in the subsidiary's equity are allocated against the interests of the Company except to the extent that the minority interests have a binding obligation and are able to make an additional investment to cover the losses.

4.2 Business combinations

Acquisitions of subsidiaries and businesses (other than entities which were under the control of the parent) are accounted for using the acquisition method. The cost of the business combination is measured as the aggregate of the fair value (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquiree, plus any acquisition-related costs incurred to effect a business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 *'Business Combinations'* are recognized at their fair value at the acquisition date except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *'Non-current Assets Held for Sale and Discontinued Operations,'* which are recognized and measured at fair value less cost to sell.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.2 Business combinations (continued)

Goodwill arising on acquisition is recognized as an asset and initially measured at cost, being the excess of the cost of the business combination over the Company's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognized. If, after reassessment, the Company's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognized immediately in profit or loss.

A business combination involving businesses under common control is a business combination in which all of the combining businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory. Business combinations under common control are accounted for in accordance with the principle of merger accounting. In applying the principle of merger accounting, the consolidated financial statements incorporate the financial statement items of the combining businesses in which the common control combination occurs as if they had been combined from the date when the combining business first came under the control of the controlling party.

The net assets of the combining businesses are combined using the existing book values prior to the common control combinations from the controlling parties' perspective. No amount is recognized in respect of goodwill or excess of acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost at the time of common control combination, to the extent of the continuation of the controlling party's interest.

The Consolidated Statement of Comprehensive Income includes the results of each of the combining businesses from the earliest date presented or since the date when the combining businesses first came under common control, where this is a shorter period, regardless of the date of common control combination.

4.3 Interest income

Interest income from financial assets is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.4 Foreign currencies

The Company's reporting currency and the functional currency of all of its operations is the U.S. dollar as this is the principal currency of the economic environment in which they operate.

Transactions in foreign currencies are initially recorded at the functional currency rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the end of each reporting period.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

4.5 Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalized as part of the cost of that asset. Other borrowing costs not directly attributable to a qualifying asset are expensed in the period incurred.

4.6 Retirement benefit costs

Payments to retirement benefit costs are charged as an expense when employees have rendered services entitling them to the contributions.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.7 Inventories

Coal inventories are stated at lower of production cost and net realizable value. Production costs include direct and indirect labour, operating materials and supplies, transportation costs and an appropriate portion of fixed and variable overhead expenses, including depreciation and depletion. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

Materials and supplies inventory consists of consumable parts and supplies which are valued at lower of weighted average cost and net realizable value. Supplies used in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. Net realizable value is defined as the selling price of the finished product less any provisions for obsolescence and costs of completion.

4.8 Property, plant and equipment ("PPE")

PPE is stated at cost less accumulated depreciation and accumulated impairment losses. The cost of an item of PPE consists of the purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

Depreciation is provided at rates calculated to write off the cost of PPE, less their estimated residual value, using the straight line method or unit-of-production method over the following expected useful lives:

• Mobile equipment	5 years
• Computer equipment	1 to 5 years
• Furniture and fixtures	5 years
• Machinery and equipment	3 to 10 years
• Buildings and roads	5 to 15 years
• Construction in progress	see below
• Mineral assets	based on resources on a unit-of-production basis

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.8 Property, plant and equipment ("PPE") (Continued)

Construction in progress includes PPE in the course of construction for production or for its own use purposes. Construction in progress is carried at cost less any recognized impairment loss. Construction in progress is classified to the appropriate category of PPE when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

Mineral assets include deferred stripping costs and asset retirement obligations related to the reclamation of mining properties.

An item of PPE is derecognized upon disposal, when held for sale or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on disposal of the asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in the Consolidated Statement of Comprehensive Income.

The Company conducts an annual assessment of the residual balances, useful lives and depreciation methods being used for PPE and any changes arising from the assessment are applied by the Company prospectively.

4.9 Stripping costs

Stripping costs incurred during the development of a mine are capitalized into PPE. 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 give rise to future benefits from the mineral property, in which case the stripping costs would be capitalized into PPE. Future benefits arise when stripping activity increases the future output of the mine by providing access to a new ore body. Capitalized stripping costs are depleted on a unit-of production basis, using estimated resources as the depletion base.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.10 Mineral properties

All direct costs related to the acquisition of mineral property interests are capitalized into intangible assets 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 into PPE. 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 will be provided on a unit-of-production basis using estimated resources as the depletion base.

4.11 Decommissioning, restoration and similar liabilities ("Asset retirement obligation" or "ARO")

The Company recognizes provision for statutory, contractual, constructive or legal obligations, including those associated with the reclamation of mineral properties and mineral assets under PPE, when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, a provision for an asset retirement obligation is recognized as its present value in the period in which it is incurred. Upon initial recognition of the liability, the corresponding asset retirement obligation 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 current market-based discount rate, amount or timing of the underlying cash flows needed to settle the obligation.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.12 Share-based payments

Share-based payment transactions

Employees (including directors and senior executives) of the Company receive a portion of their remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

In situations where equity instruments are issued and some or all of the goods or services received by the entity as consideration cannot be specifically identified, they are measured at fair value of the share-based payment. Otherwise, share-based payments are measured at the fair value of good or services received.

Equity-settled transactions

The costs of equity-settled transactions with employees are measured by reference to the fair value at the date on which they are granted.

The costs of equity-settled transactions are recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense is recognized for equity-settled transactions at each reporting date until the vesting date reflects the Company's best estimate of the number of equity instruments that will ultimately vest. The profit or loss charge or credit for a period represents the movement in cumulative expense recognized as at the beginning and end of that period and the corresponding amount is represented in share option reserve. No expense is recognized for awards that do not ultimately vest.

Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

The dilutive effect of outstanding options is reflected as additional dilution in the computation of earnings per share.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.13 Taxation

Income tax expense represents the sum of tax currently payable and deferred tax.

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the end of each reporting period.

Deferred income tax

Deferred income tax is provided using the liability method on temporary differences, at the end of each reporting period, between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry forward of unused tax credits and unused tax losses can be utilized except:

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.13 Taxation (continued)

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, deferred income tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the end of each reporting period.

Deferred income tax relating to items recognized directly in equity is recognized in equity and not in the statement of comprehensive income.

Deferred income tax assets and deferred income tax liabilities are offset if, and only if, a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities which intend to either settle current tax liabilities and assets on a net basis, or to realize the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax assets or liabilities are expected to be settled or recovered.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.14 Financial assets

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held-to-maturity, available-for-sale, loans-and-receivables or at fair value through profit or loss ("FVTPL").

Financial assets classified as FVTPL are measured at fair value with unrealized gains and losses recognized through profit and loss.

Financial assets classified as loans-and-receivables and held-to-maturity are measured at amortized cost using the effective interest method less any allowance for impairment. The Company's trade and other receivables are classified as loans-and-receivables. The effective interest method is a method of calculating the amortized cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period.

Financial assets 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 or a significant or prolonged decline in the fair value of that investment below its cost. At September 30, 2009 the Company has not classified any financial assets as available-for-sale.

Transactions costs associated with FVTPL financial assets are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.15 Financial liabilities

All financial liabilities are initially recorded at fair value and designated upon inception as FVTPL or other-financial-liabilities.

Financial liabilities classified as other-financial-liabilities are initially recognized at fair value less directly attributable transaction costs. After initial recognition, other-financial-liabilities are subsequently measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period. The Company's trade and other payables, deposits received and amounts due under line of credit facilities are classified as other-financial-liabilities.

Financial liabilities classified as FVTPL include financial liabilities held for trading and financial liabilities designated upon initial recognition as FVTPL. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Fair value changes on financial liabilities classified as FVTPL are recognized through the statement of comprehensive income. At December 31, 2007, the conversion option included in amounts due under line of credit facilities was separately accounted for as a financial liability at FVTPL. At September 30, 2009, the Company has not classified any financial liabilities as FVTPL.

At the end of each reporting period subsequent to initial recognition, financial liabilities at FVTPL are measured at fair value, with changes in fair value recognized directly in profit or loss in the period in which they arise. The net gain or loss recognized in profit or loss excludes any interest paid on the financial liabilities

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.16 Impairment of financial assets

The Company assesses at the end of each reporting period whether a financial asset is impaired.

Assets carried at amortized cost

If there is objective evidence that an impairment loss on assets carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is then reduced by the amount of the impairment. The amount of the loss is recognized in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed to the extent that the carrying value of the asset does not exceed what the amortized cost would have been had the impairment not been recognized. Any subsequent reversal of an impairment loss is recognized in profit or loss.

In relation to trade and other receivables, a provision for impairment is made and an impairment loss is recognized in profit and loss when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are written off against the allowance account when they are assessed as uncollectible.

Available-for-sale

If an available-for-sale asset is impaired, an amount comprising the difference between its cost and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to profit or loss. Reversals in respect of equity instruments classified as available-for-sale are not recognized in profit or loss.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.17 Derecognition of financial assets and financial liabilities

Financial assets are derecognized when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Company has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized directly in equity is recognized in profit or loss.

For financial liabilities, they are derecognized when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

4.18 Impairment of non-financial assets

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is an indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the assets belong.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in the statement of comprehensive income.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.19 Cash and cash equivalents

Cash and cash equivalents comprise cash at banks and on hand, and short term money market instruments with an original maturity of three months or less, which are readily convertible into a known amount of cash.

4.20 Revenue recognition

Revenue represents the fair value of consideration received and receivable that are derived from the sales of coal. 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. The revenue from sales of coal in the ordinary course of business is recognized when coal is either loaded onto a truck or when it is unloaded at the final destination, depending on the terms of the contract.

4.21 Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) that has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

4.22 Related party transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control, related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

4.23 Significant accounting judgments and estimates

The preparation of these financial statements requires management to make judgements and estimates and form assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its judgements and estimates in relation to assets, liabilities, revenue and expenses. Management uses historical experience and various other factors it believes to be reasonable under the given circumstances as the basis for its judgements and estimates. Actual outcomes may differ from these estimates under different assumptions and conditions. 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 deferred income tax amounts, impairment testing and the calculation of share-based payments. The most significant judgements relate to recoverability of capitalized amounts, recognition of deferred tax assets and liabilities, determination of the commencement of commercial production and the determination of the economic viability of a project.

5. SEGMENTED INFORMATION

At September 30, 2009, the Company has two reportable operating segments, being the Mongolian Coal Division and Indonesian Coal Division. In prior periods, the Company's Metals Division was a segment of the Company (Note 6).

An operating segment is defined as a component of the Company:

- that engages in business activities from which it may earn revenues and incur expenses;
- whose operating results are reviewed regularly by the entity's chief operating decision maker; and
- for which discrete financial information is available.

For both the Mongolian Coal Division and Indonesian Coal Division, the Company receives discrete financial information that is used by the chief operating decision maker to make decisions about resources to be allocated to the segment and to assess its performance. Both divisions are principally engaged in the acquisition, exploration and development of coal properties in distinct geographical locations. As at September 30, 2009, the Mongolian Coal Division has achieved commercial production and is earning revenue through the sale of coal to external customers.

The Company's Corporate Division only earns revenues that are considered incidental to the activities of the Company and therefore does not meet the definition of an operating segment as defined in IFRS 8 *'Operating Segments'*.

At September 30, 2009, the Mongolian Coal Division had three active customers with the largest customer accounting for 69% of trade receivables and the other customers accounting for the remaining 31% of trade receivables. For the nine months ended September 30, 2009 the largest customer accounted for 62% of revenues and the other customers accounted for the remaining 38% of revenues.

(Stated in U.S. dollars)

5. SEGMENTED INFORMATION (Continued)

The following is an analysis of the carrying amounts of segment assets, segment liabilities and reported segment profit or loss, revenues and depreciation expense analyzed by operating segment and reconciled to the Company's Consolidated Financial Statements:

	Mongolian Coal Division	Indonesian Coal Division	Discontinued Operations (i)	Unallocated (ii)	Consolidated Total
Segment assets					
As at September 30, 2009	$ 104,328,554	$ 2,288,522	$ -	$ 3,284,904	$ 109,901,980
As at December 31, 2008	76,611,232	14,835,690	637,600	7,863,487	99,948,009
As at December 31, 2007	2,509,473	-	1,132,268	1,968,336	5,610,077
Segment liabilities					
As at September 30, 2009	$ 4,314,552	$ 3,513,020	$ -	$ 41,397,915	$ 49,225,487
As at December 31, 2008	3,101,017	810,929	255,080	6,816,292	10,983,318
As at December 31, 2007	835,998	-	269,795	106,335,371	107,441,164
Segment (profits)/losses					
For 3 months ended September 30, 2009	$ (10,195,310)	$ 26,006,205	$ -	$ 7,971,448	$ 23,782,343
For 3 months ended September 30, 2008	8,473,097	2,888,054	1,666,884	9,749,402	22,777,437
For 9 months ended September 30, 2009	(8,223,134)	32,121,702	-	17,754,265	41,652,833
For 9 months ended September 30, 2008	21,495,460	6,603,332	5,362,114	19,109,138	52,570,044
Segment revenues					
For 3 months ended September 30, 2009	$ 11,870,845	$ -	$ -	$ -	$ 11,870,845
For 3 months ended September 30, 2008	-	-	-	-	-
For 9 months ended September 30, 2009	26,077,803	-	-	-	26,077,803
For 9 months ended September 30, 2008	-	-	-	-	-
Capital expenditures					
For 3 months ended September 30, 2009	$ 6,253,723	$ 2,290,879	$ -	$ 2,881	$ 8,547,483
For 3 months ended September 30, 2008	4,065,535	297,979	31,867	1,922	4,397,303
For 9 months ended September 30, 2009	17,806,399	6,255,481	-	62,076	24,123,956
For 9 months ended September 30, 2008	45,125,989	297,979	47,376	4,754	$ 45,476,098
Depreciation and depletion expense					
For 3 months ended September 30, 2009	$ 2,220,546	$ -	$ -	$ 5,986	$ 2,226,532
For 3 months ended September 30, 2008	26,183	-	13,120	24,536	63,839
For 9 months ended September 30, 2009	4,261,068	-	-	13,002	4,274,070
For 9 months ended September 30, 2008	89,641	-	44,322	94,785	228,748
Impairment charge on assets (Note 7)					
For 3 months ended September 30, 2009	$ -	$ 23,029,013	$ -	$ -	$ 23,029,013
For 3 months ended September 30, 2008	-	-	-	-	-
For 9 months ended September 30, 2009	-	23,029,013	-	-	23,029,013
For 9 months ended September 30, 2008	-	-	-	-	-

(i) The Metals Division was treated as discontinued operations throughout the reported periods and the assets and liabilities of the Metals Division were reclassified as held for sale as at December 31, 2008 (Note 6)

(ii) The unallocated amount contains all amounts associated with the Corporate Division

(Stated in U.S. dollars)

5. SEGMENTED INFORMATION (Continued)

The Company operates in four geographical areas, being Canada, Hong Kong, Indonesia and Mongolia. The following is an analysis of the revenues and non-current assets by geographical area and reconciled to the Company's Consolidated Financial Statements:

	Mongolia	Indonesia	Hong Kong	Canada	Consolidated Total
Revenues					
For 3 months ended September 30, 2009	$ 11,870,845	$ -	$ -	$ -	$ 11,870,845
For 3 months ended September 30, 2008	-	-	-	-	-
For 9 months ended September 30, 2009	26,077,803	-	-	-	26,077,803
For 9 months ended September 30, 2008	-	-	-	-	-
Non-current assets					
As at September 30, 2009	$ 74,331,507	$ -	$ 51,041	$ 126,116	$ 74,508,664
As at December 31, 2008	51,938,584	13,688,975	-	20,570	65,648,129
As at December 31, 2007	1,398,348	62,175	-	106,217	1,566,740

(Stated in U.S. dollars)

6. 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 provided the Company with a $30 million credit facility for a one year period (Note 16). Ivanhoe has provided the Company with the economic equivalent of a 1% Net Smelter Royalty on the Sulawesi and Kerta Projects in Indonesia. The Metals Division consisted 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 was reflected in the 2008 Consolidated Statement of Financial Position and Consolidated Statement of Cash Flows. The Company has recorded a gain of $2,617,480 in the nine months ended September 30, 2009 on the sale of the Metals Division and this gain has been recorded directly into equity as the sale of the division was to the parent of the Company.

The Metals Division was presented as a discontinued operation and financial results were presented as separate items in the Consolidated Statement of Comprehensive Income, and Consolidated Statement of Cash Flows. The Metals Division assets and liabilities consolidated by the Company in 2008 were segregated in the Consolidated Statement of Financial Position and classified as assets and liabilities held for sale. Upon the closing of the sale of the Metals Division on February 2, 2009, there was a cash outflow of $222,699 recorded in the nine months ended September 30, 2009, along with the cash and cash equivalents, all other assets and liabilities classified as held for sale as at December 31, 2008 were disposed upon the closing of the sale of the Metals Division.

The loss from discontinued operations for the nine months ended September 30, 2009 and 2008 is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
Evaluation and exploration expenses	$ -	$ 1,666,884	$ -	$ 5,362,114
Net loss from discontinued operations	$ -	$ 1,666,884	$ -	$ 5,362,114
Basic and diluted loss per share from discontinued operations	$ -	$ 0.01	$ -	$ 0.04

(Stated in U.S. dollars)

6. DISCONTINUED OPERATIONS – METALS DIVISION (Continued)

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

	As at September 30, 2009	As at December 31, 2008	As at December 31, 2007
Assets			
Current assets			
Cash and cash equivalents	$ -	$ 222,699	$ -
Trade and other receivables	-	184,022	-
Prepaid expenses and deposits	-	133,664	-
Property, plant and equipment	-	97,215	-
Total current assets	-	637,600	-
Total assets	$ -	$ 637,600	$ -
Current liabilities			
Trade and other payables	$ -	$ 255,080	$ -
Net assets of discontinued operations	$ -	$ 382,520	$ -

7. IMPAIRMENT CHARGE ON MAMAHAK COAL PROJECT

In the third quarter of 2009, Management became aware of the requirement for additional capital expenditure at the Mamahak Coal project ("Mamahak") beyond what was originally budgeted to develop the project. The Company is planning a detailed operational review to confirm the additional capital requirements and to enhance the mine plan and resource base. Pending the results of the planned review, the Company suspended future development works at Mamahak. The Indonesian Coal Division is a reportable segment for the Company as disclosed in Note 5 and is composed entirely of Mamahak.

Based on these new developments the Company conducted an impairment analysis of the Indonesia Coal Division and has concluded that the carrying value for certain assets exceeds their recoverable amount. The Company determined the recoverable amount and calculated the value in use of Mamahak using a discount rate of 11.6%. The Company has recorded an impairment charge of $23,029,013, which represented the full value of the respective assets, in the consolidated statement of comprehensive income for the nine months ended September 30, 2009 allocated as follows:

Intangible assets	$	**13,208,218**
Property, plant and equipment		**7,239,689**
Inventories		**2,581,106**
Impairment charge on Mamahak Coal project	**$**	**23,029,013**

(Stated in U.S. dollars)

8. COST OF SALES

The cost of sales of the Company is broken down into its cash and non-cash components as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Operating expenses (i)	**$ 6,424,184**	$ -	**$16,746,097**	$ -
Depreciation and depletion	**2,212,688**	-	**4,242,776**	-
Cost of sales	**$ 8,636,872**	$ -	**$20,988,873**	$ -

(i) Share-based compensation (a non-cash item) of $297,962 (2008 - $nil) and $1,293,621 (2008 - $nil) has been included in Operating expenses for the three months and nine months ended September 30, 2009, respectively.

9. ADMINISTRATION EXPENSES

The administration expenses for the Company are broken down as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Corporate administration	**$ 679,384**	$ 588,266	**$ 1,725,855**	$ 1,488,497
Legal	**219,243**	26,108	**423,638**	290,990
Professional fees	**575,471**	317,984	**1,723,256**	541,748
Listing fees	**1,599,004**	5,880,057	**1,931,549**	5,880,057
Salaries and benefits (i)	**2,881,970**	1,497,770	**9,701,565**	3,746,274
Depreciation	**5,986**	24,535	**13,002**	94,784
Foreign exchange loss	**272,757**	2,003,993	**1,264,483**	808,418
Administration expenses	**$ 6,233,815**	$ 10,338,713	**$16,783,348**	$ 12,850,768

(i) Share-based compensation (a non-cash item) of $2,231,490 (2008 - $1,022,564) and $8,078,622 (2008 - $2,293,753) has been included in Salaries and benefits for the three months and nine months ended September 30, 2009, respectively.

(Stated in U.S. dollars)

10. EVALUATION AND EXPLORATION EXPENSES

The evaluation and exploration expenses for the Company are broken down as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
Mongolian Coal Division (i)	**$ 2,149,129**	$ 8,467,930	**$ 4,659,780**	$ 21,485,182
Indonesian Coal Division (ii)	**2,861,648**	2,888,054	**9,121,664**	6,603,332
Evaluation and exploration expenses	**$ 5,010,777**	$ 11,355,984	**$13,781,444**	$ 28,088,514

(i) Share-based compensation (a non-cash item) of $21,317 (2008 - $518,370) and $98,848 (2008 - $1,331,827) has been included in Evaluation and exploration expenses for the Mongolian Coal Division for the three months and nine months ended September 30, 2009, respectively.

(ii) Share-based compensation (a non-cash item) of $72,636 (2008 - $nil) and $270,084 (2008 - $nil) has been included in Evaluation and exploration expenses for the Indonesian Coal Division for the three months and nine months ended September 30, 2009, respectively.

11. FINANCE COSTS

The finance costs for the Company are broken down as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
Fair value change on embedded derivative (Note 16.4)	**$ -**	$ -	**$ -**	$ 7,223,399
Interest accretion on line of credit facility	**-**	-	**-**	598,408
Interest expense (Note 16.3)	**632,456**	-	**1,030,151**	134,186
Accretion on asset retirement obligation	**11,064**	5,167	**30,990**	10,278
Finance costs	**$ 643,520**	$ 5,167	**$ 1,061,141**	$ 7,966,271

(Stated in U.S. dollars)

12. LOSS PER SHARE

The calculation of basic and diluted loss per share for the relevant periods is based on the following data:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
Net loss from continuing operations for the purpose of basic and diluted loss per share	**$ 23,782,343**	$ 21,110,553	**$ 41,652,833**	$ 47,207,930
Net loss from discontinued operations for the purpose of basic and diluted loss per share	**$ -**	$ 1,666,884	**$ -**	$ 5,362,114
Weighted average number of shares for the purpose of basic and diluted loss per share	**133,407,751**	132,778,768	**133,341,543**	126,775,043

All of the outstanding preference shares, stock options and warrants were anti-dilutive for the relevant periods.

13. INVENTORIES

The inventories for the Company are categorized as follows:

	As at September 30,	As at December 31,	
	2009	**2008**	**2007**
Stockpiles (i)	**$ 9,922,300**	$ 13,158,009	$ -
Materials and supplies	**785,139**	518,707	-
Total inventories	**$ 10,707,439**	$ 13,676,716	$ -

(i) Coal inventories are stated at production cost

The amount of inventories recognized as an expense during the nine months ended September 30, 2009 is $14,670,361 (2008 - $nil). As at September 30, 2009 the Company anticipates the entire stockpiles balance of $9,922,300 will be realized within twelve months.

(Stated in U.S. dollars)

14. INTANGIBLE ASSETS

The Company's intangible assets are broken down as follows:

	Mineral properties - Indonesian Coal Division	Mineral properties - Metals Division	Total
Balance, As at January 1, 2007	$ -	$ 443,360	$ 443,360
Additions	-	-	-
Depletion	-	-	-
Balance, As at December 31, 2007	-	443,360	443,360
Additions	13,208,218	50,000	13,258,218
Depletion	-	-	-
Impairment	-	(493,360)	(493,360)
Balance, As at December 31, 2008	13,208,218	-	13,208,218
Impairment	(13,208,218)	-	(13,208,218)
Balance, As at September 30, 2009	**$ -**	**$ -**	**$ -**

14.1 Indonesian Coal Division

The Company holds an interest in the Mamahak Coal project in East Kalimantan, Indonesia. The Joint Venture Earn-in Agreement with Score Resources Ltd ("Score") included a provision allowing for the Company to increase its working interest position based on a predetermined pricing mechanism. In 2008, the Company elected to increase its working interest from 56% to 85% by paying Score $13.2 million, comprised of $8,013,800 cash and $5,168,000 settled by 320,000 common shares of the Company at Cdn$16.15 per share as specified in the agreement with Score. The impairment charge in mineral properties related to the Mamahak Coal project of $13,208,218 was made during the nine months ended September 30, 2009, and has been discussed in detail in Note 7.

(Stated in U.S. dollars)

15. PROPERTY, PLANT AND EQUIPMENT

The Property, plant and equipment for the Company is broken down as follows:

	Mobile equipment	Computer equipment	Furniture and fixtures	Machinery and equipment	Buildings and roads	Mineral assets	Construction in progress	Total
Cost								
As at January 1, 2007	$ 202,680	$ 195,274	$ 61,832	$ 108,407	$ -	$ -	$ 150,000	$ 718,193
Additions	152,290	178,725	81,070	214,545	-	-	234,635	861,265
Disposals	(43,483)	-	(14,063)	-	-	-	-	(57,546)
As at December 31, 2007	311,487	373,999	128,839	322,952	-	-	384,635	1,521,912
Additions	38,283,037	272,147	31,934	1,907,359	432,491	3,421,803	11,026,184	55,374,955
Disposals	(49,539)	(119,584)	(68,490)	(19,921)	-	-	-	(257,534)
As at December 31, 2008	38,544,985	526,562	92,283	2,210,390	432,491	3,421,803	11,410,819	56,639,333
Additions	14,592,806	63,348	310,853	68,170	964,556	3,050,411	5,699,412	24,749,556
Disposals	(585,927)	(37,287)	(6,530)	-	-	-	(6,565)	(636,309)
Reclassifications	-	-	-	213,626	13,702,882	-	(13,916,508)	-
As at September 30, 2009	$ 52,551,864	$ 552,623	$ 396,606	$ 2,492,186	$ 15,099,929	$ 6,472,214	$ 3,187,158	$ 80,752,580
Accumulated depreciation and impairment								
As at January 1, 2007	$ (59,779)	$ (95,022)	$ (11,052)	$ (57,067)	$ -	$ -	$ -	$ (222,920)
Charge for the year	(69,828)	(42,323)	(3,348)	(61,518)	-	-	-	(177,017)
Eliminated on disposals	-	-	1,405	-	-	-	-	1,405
As at December 31, 2007	(129,607)	(137,345)	(12,995)	(118,585)	-	-	-	(398,532)
Charge for the year	(3,465,315)	(204,031)	(23,228)	(68,787)	(76,744)	(84,937)	-	(3,923,042)
Eliminated on disposals	11,122	84,148	17,452	9,430	-	-	-	122,152
As at December 31, 2008	(3,583,800)	(257,228)	(18,771)	(177,942)	(76,744)	(84,937)	-	(4,199,422)
Charge for the period	(3,186,348)	(55,208)	(31,774)	(268,330)	(397,923)	(77,129)	-	(4,016,712)
Eliminated on disposals	456,988	34,156	3,664	-	-	-	-	494,808
Impairment (Note 7)	-	-	-	-	(1,791,284)	(2,965,948)	(2,482,457)	(7,239,689)
As at September 30, 2009	$ (6,313,160)	$ (278,280)	$ (46,881)	$ (446,272)	$ (2,265,951)	$ (3,128,014)	$ (2,482,457)	$(14,961,015)
Net book value								
As at December 31, 2007	181,880	236,654	115,844	204,367	-	-	384,635	1,123,380
As at December 31, 2008	34,961,185	269,334	73,512	2,032,448	355,747	3,336,866	11,410,819	52,439,911
As at September 30, 2009	$ 46,238,704	$ 274,343	$ 349,725	$ 2,045,914	$ 12,833,978	$ 3,344,200	$ 704,701	$ 65,791,565

16. AMOUNTS DUE UNDER LINE OF CREDIT FACILITIES

16.1 First funding agreement

In April 2006, the Company entered into a line of credit facility (the "First Funding Agreement") with Ivanhoe, whereby Ivanhoe agreed to make available to the Company an unsecured line of credit facility of up to $10 million which was extended to a maximum of $15 million, excluding interest and the interim coal expenditures. All amounts outstanding under the line of credit bore interest at the three month London Interbank Offered Rate ("LIBOR") plus 200 basis points. In May 2007, the Company completed the purchase of the Ivanhoe coal division (Note 22) in consideration for the issuance to Ivanhoe of 57,000,000 common shares and 25,576,383 preferred shares of the Company. The First Funding Agreement became convertible into common shares at the election of either the Company or Ivanhoe. Until May 29, 2008, the Company had the right to require Ivanhoe to convert the outstanding amounts under the First Funding Agreement into common shares at a conversion price of Canadian dollar ("Cdn$") $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. Under IAS 32 *'Financial Instruments: Presentation'* the conversion feature was considered an embedded derivative and this feature has been discussed further in Note 16.4.

16.2 Second funding agreement

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. All amounts outstanding under the line of credit bore interest at LIBOR plus 330 basis points.

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.

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

16.3 Credit facility

On December 30, 2008, the Company established a credit facility (the "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 term of one year 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, non-convertible and carries an interest rate equal to LIBOR plus 750 basis points.

In July, 2009, the Company and Ivanhoe agreed to increase the Credit Facility from $30 million to $60 million. The amended credit facility (the "Credit Facility") will mature on December 31, 2010, is unsecured and bears interest at LIBOR plus 750 basis points. The amended facility also requires repayment in the event that the Company acquires additional financing from a third party source and provides for an extension fee of $1.5 million payable in the event any portion of the facility is outstanding past March 31, 2010.

The effective interest rate on the Credit Facility at September 30, 2009 was 7.8%. At September 30, 2009, the Company had received advances of $36 million against the Credit Facility and has accrued interest expense of $1,030,151 for the nine months ended September 30, 2009 ($632,456 for the three months ended September 30, 2009).

16.4 Embedded derivative

The Company accounted for any amounts drawn on the First Funding Agreement (Note 16.1) from April 26, 2006 to May 1, 2007 as a liability recorded at amortized cost. On May 29, 2007, the entire indebtedness became convertible into ordinary shares of the Company at the election of either Ivanhoe or the Company. Until May 29, 2008, the Company had the right to require Ivanhoe to convert the outstanding loan 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 loan into common shares at a conversion price of Cdn$2.35 per share.

On January 23, 2008 at the Company's request, Ivanhoe converted $29,963,354 of debt into 14,709,071 common shares of the Company. As a result of this conversion the amount due under the convertible line of credit facility was eliminated.

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

16.4 Embedded derivative (continued)

At the date of conversion the fair value of the embedded derivative and the debt outstanding was $107,551,903 which was converted and recorded as common share capital. All preferred shares were also converted to common shares on that date.

The Company identified that the conversion feature was an embedded derivative to be presented as a liability in accordance with IAS 32 *'Financial Instruments: Presentation'* due to the variable number of shares that would be issued on conversion. This resulted from the debt being denominated in U.S. dollar but being convertible at a fixed conversion rate into Canadian dollar denominated shares.

The debt that was recorded prior to May 1, 2007 was recorded at face value as a liability at amortized cost. On May 1, 2007 the conversion feature was considered to have a value and was recorded at fair value in addition to the value of the previously recorded debt. All subsequent advances on the line of credit were valued at fair value and the value of the debt host was deemed to be nil on account of the beneficial feature which exceeded the fair value of the debt. The difference between the host debt component of $nil and the principal amount of the loan outstanding was accreted to income over the remaining term of the debt. At each reporting period the embedded derivative was fair valued, with the movements recorded in income.

The embedded derivative was valued upon initial measurement and at each drawing date using the Black-Scholes option valuation model. The following variables were used to calculate the impact of the call and put option elements of the embedded derivative. Some amounts below have been stated in Cdn$, all other amounts are in U.S. dollar.

	Drawn down date					Cumulative at	
	May 10, 2007	**May 29, 2007**	**July 4, 2007**	**August 21, 2007**	**October 1, 2007**	**December 31, 2007**	**January 23, 2008**
Principal and interest borrowed	$ 1,000,000	$ 13,212,395	$ 2,000,000	$ 2,500,000	$ 2,000,000	$ 29,855,178	$ 29,963,354
Stock price	Cdn$4.81	Cdn$5.00	Cdn$8.00	Cdn$6.20	Cdn$6.68	Cdn$8.90	Cdn$9.45
Dividend yield	0%	0%	0%	0%	0%	0%	0%
Call option							
Interest rate	4.60%	4.60%	4.68%	4.05%	4.21%	3.93%	3.41%
Volatility	76.19%	76.19%	77.15%	76.62%	70.49%	58.66%	59.89%
Exercise price	Cdn$2.35	Cdn$2.35	Cdn$2.35	Cdn$2.35	Cdn$2.35	Cdn$2.35	Cdn$2.35
Expected life (years)	0.91	0.91	1.16	1.02	0.91	0.66	0.60
Put option							
Interest rate	4.61%	4.61%	4.68%	4.05%	4.21%	3.91%	3.41%
Volatility	76.19%	76.19%	77.15%	75.09%	75.76%	50.58%	55.06%
Exercise price	Cdn$2.09	Cdn$2.09	Cdn$2.09	Cdn$2.09	Cdn$2.09	Cdn$2.09	Cdn$2.09
Expected life (years)	0.91	0.91	0.81	0.77	0.66	0.41	0.35
Net embedded derivative	$ 1,185,033	$ 15,657,121	$ 4,893,436	$ 4,279,665	$ 3,787,946	$ 83,998,434	$ 91,221,833

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

16.4 Embedded derivative (continued)

As at December 31, 2007, $63,266,762 had been recorded as a charge against income within finance costs relating to the movement in fair value of the embedded derivative. At the elimination of the debt on January 23, 2008, the fair value of the embedded derivative was $91,202,557 and $7,223,399 had been recorded as a charge against income within finance costs in the three month period ended March 31, 2008. The debt cost was recorded at fair value, with the difference between the cost and the principal amount being accreted as interest charges over the term of the debt. The total accretion expense recorded as interest cost to January 23, 2008 was $6,480,703.

17. ASSET RETIREMENT OBLIGATION

Reclamation and closure costs have been estimated based on the Company's interpretation of current regulatory requirements and have been measured at fair value. Fair value is determined based on the net present value of future cash expenditures upon reclamation and closure. Reclamation and closure costs are capitalized into PPE dependant on the nature of the asset related to the obligation and amortized over the life of the related asset.

The asset retirement obligations relate to reclamation and closure costs of the Company's Ovoot Tolgoi project in Mongolia and Mamahak project in Indonesia.

The asset retirement obligations at Ovoot Tolgoi are calculated as the net present value of estimated future net cash flows of the reclamation and closure costs, which at September 30, 2009 total US$2,141,405 and are required to satisfy the obligations, discounted at 10.55% per annum. The settlement of the obligations will occur through to 2025.

The asset retirement obligations at Mamahak are calculated as the net present value of estimated future net cash flows of the reclamation and closure costs, which at September 30, 2009 total US$1,568,838 and are required to satisfy the obligations, discounted at 10.55% per annum. The settlement of the obligations will occur through to 2019.

(Stated in U.S. dollars)

17. ASSET RETIREMENT OBLIGATION (Continued)

The following is an analysis of the asset retirement obligation:

Balance, As at January 1, 2007	$	-
Additions		-
Accretion		-
Balance, As at December 31, 2007		-
Additions		308,731
Accretion		19,498
Balance, As at December 31, 2008		328,229
Additions		625,603
Accretion		30,990
Balance, As at September 30, 2009	**$**	**984,822**

18. SHARE CAPITAL

18.1 Common and preferred shares

Authorized	Unlimited common shares with no par value Unlimited preferred shares with no par value
Issued and outstanding	133,543,049 (2008 – 132,839,582) common shares Nil (2008 - nil) preferred shares

Refer to Consolidated Statement of Changes in Equity for movement in share capital for the nine months ended September 30, 2009.

18. SHARE CAPITAL (Continued)

18.2 Preferred shares

On May 29, 2007, upon completion of the coal transaction (Note 22), the Company issued 25,576,383 preferred shares to Ivanhoe. Each preferred share issued to Ivanhoe was convertible into one common share but only if, upon any such conversion, the total number of common shares held by Ivanhoe and all other insiders of the Company or any of their respective associates or affiliates did not exceed 90% of the total number of common shares then issued and outstanding. The preferred shares were non-voting and had a preference over the common shares with respect to the payment of dividends and distribution of assets in the event of a liquidation, dissolution or winding up of the Company.

On January 23, 2008, Ivanhoe converted 25,576,383 preferred shares into common shares of the Company on a one to one basis. The Company has no outstanding preferred shares at September 30, 2009.

19. SHARE-BASED PAYMENTS

19.1 Stock option plan

The Company has a stock option plan which permits the Board of Directors of the Company to grant options to acquire common shares of the Company at the greater of the 15% discounted closing trading price on the date of the grant or the volume weighted average closing price for the five days preceding the date of grant. 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 Compensation and Benefits Committee determines and makes recommendations to the Board of Directors as to the recipients of, and nature and size of, share-based compensation awards in compliance with applicable securities law, stock exchange and other regulatory requirements. 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.

(Stated in U.S. dollars)

19. SHARE-BASED PAYMENTS (Continued)

19.1 Stock option plan (continued)

The stock option plan permits the Board of Directors of the company to set the terms for each stock option grant, however, 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. The options granted in the nine months ended September 30, 2009 were granted with a weighted average maximum exercise period of 5.47 years and a weighted average vesting period of 1.82 years.

During the nine months ended September 30, 2009, the Company granted 2,656,000 (2008 – 2,034,000) stock options to officers, employees and directors at exercise prices ranging from Cdn$7.94 to Cdn$12.99 and expiry dates ranging from May 6, 2014 to February 6, 2016 (2008 – exercise prices ranging from Cdn$7.16 to Cdn$18.86 and expiry dates ranging from January 7, 2013 to August 27, 2013). The weighted average fair value of the options issued the nine months ended September 30, 2009 was estimated at $5.95 (Cdn$6.56) per option at the grant date using the Black-Scholes option pricing model. The weighted average assumptions used for the calculation were:

	Nine months ended September 30, 2009	**Year ended December 31, 2008**
Risk free interest rate	**2.17%**	2.81%
Expected life	**3.6 years**	3.5 years
Expected volatility [(i)]	**79.57%**	75.52%
Expected dividend per share	**$nil**	$nil

(i) Expected volatility has been based on historical volatility of the Company's publicly trade shares.

A share-based compensation cost of $14,771,051 for the options granted in the nine months ended September 30, 2009 (2008 - $14,529,821) will be amortized over the vesting period, of which $2,902,547 was recognized in the nine months ended September 30, 2009 (2008 - $2,632,689).

(Stated in U.S. dollars)

19. SHARE-BASED PAYMENTS (Continued)

19.1 Stock option plan (continued)

The total share-based compensation calculated for the nine months ended September 30, 2009 was $9,741,174 (2008 - $3,625,580). Share-based compensation of $8,078,621 (2008 - $2,293,753) has been allocated to Salaries and benefits, $1,293,621 (2008 - $nil) has been allocated to Operating expenses and $368,932 (2008 - $1,331,827) has been allocated to Evaluation and exploration expenses.

19.2 Outstanding stock options

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

	Nine months ended September 30, 2009			Year ended December 31, 2008		
	Number of options		Weighted average exercise price (Cdn$)	Number of options		Weighted average exercise price (Cdn$)
Balance, beginning of period	**6,586,055**	**$**	**7.18**	4,994,632	$	3.55
Options granted	**2,656,000**		**11.11**	3,184,000		11.27
Options exercised	**(349,767)**		**3.25**	(1,442,244)		2.80
Options forfeited	**(418,669)**		**8.46**	(150,333)		15.25
Balance, end of period	**8,473,619**	**$**	**8.51**	6,586,055	$	7.18

The following table summarizes information about stock options outstanding and exercisable at September 30, 2009:

	Options Outstanding				Options Exercisable			
Exercise price (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 - $2.85	1,571,166	$	1.98	1.51	1,571,166	$	1.98	1.51
$3.70 - $6.00	2,440,453		5.60	3.31	1,440,453		5.94	2.72
$7.16 - $13.80	3,496,000		11.20	4.74	541,917		10.99	4.33
$15.07 - $18.86	966,000		16.79	3.83	366,000		16.59	3.84
	8,473,619	$	8.51	3.63	3,919,536	$	6.04	2.56

(Stated in U.S. dollars)

20. ACCUMULATED DEFICIT AND DIVIDENDS

The Company has incurred losses since inception and at September 30, 2009 the Company has accumulated a deficit of $252,357,812 (at December 31, 2008 - $213,322,459).

No dividends have been paid or declared by the Company since inception.

21. RELATED PARTY TRANSACTIONS

The financial statements include the financial statements of SouthGobi Energy Resources Ltd. and its subsidiaries listed in the following table:

		% equity interest		
		As at		
	Country of	September 30,	As at December 31,	
Name	incorporation	2009	2008	2007
Asia Gold International Holding Company Ltd.	British Virgin Islands	100%	100%	100%
Dayarbulag LLC	Mongolia	100%	100%	100%
SouthGobi Sands LLC	Mongolia	100%	100%	100%
Transbaikal Gold	Russia	100%	100%	100%
SGQ Coal Investment Pte. Ltd.	Singapore	100%	100%	100%
SGQ Dayarcoal Mongolia Pte. Ltd.	Singapore	100%	100%	100%
SGQ Singapore Investment Company Pte. Ltd.	Singapore	100%	100%	100%
SouthGobi Energy Resources (Hong Kong) Ltd.	Hong Kong	100%	-	-
PT Multi Mamahak Batubara	Indonesia	85%	85%	-
SGQ Batubara (A) Pte. Ltd.	Singapore	85%	85%	-
PT Karsa Optima Jaya	Indonesia	84%	-	-
PT Mamahak Coal Mining	Indonesia	84%	-	-
PT Bara Karsa Lestari	Indonesia	84%	-	-
PT Mahakam Energi Lestari	Indonesia	84%	-	-
PT Mahakam Bara Energi	Indonesia	84%	-	-
Bacan Holding Company Ltd.	British Virgin Islands	-	100%	100%
Ivanhoe Coal Holding Company Ltd.	British Virgin Islands	-	-	100%
Mongolia Holding Company Ltd.	British Virgin Islands	-	100%	100%
Arkadia Indonesia Holding Company Ltd.	British Virgin Islands	-	100%	100%
Ivanhoe Resources Ltd.	Canada	-	-	100%
PT AGC Indonesia	Indonesia	-	100%	100%
PT ASG Harita Mining Services	Indonesia	-	85%	85%
Asia Gold Mongolia LLC	Mongolia	-	100%	100%
Bacan Indonesia Holding Company Pte. Ltd.	Singapore	-	100%	100%
SGQ Indonesia Holding Company Pte. Ltd.	Singapore	-	100%	100%
SGQ Mongolia Holding Ltd.	Singapore	-	100%	100%
SGQ Singapore Projects Holding Company Pte. Ltd.	Singapore	-	100%	100%

(Stated in U.S. dollars)

21. RELATED PARTY TRANSACTIONS (Continued)

21.1 Related party expenses

The Company incurred the following expenses with Ivanhoe, I2MS.NET PTE LTD ("I2MS") and Global Mining Management ("GMM"), companies related by way of directors or shareholders in common. As at September 30, 2009, Ivanhoe owned approximately 79% of the outstanding common shares of the Company.

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
Corporate administration	**$ 247,585**	$ 292,689	**$ 773,140**	$ 1,494,120
Salaries and benefits	**331,274**	362,465	**970,036**	1,505,726
Interest (Note 16)	**632,456**	-	**1,030,151**	134,186
Total related party expenses	**$ 1,211,315**	$ 655,154	**$ 2,773,327**	$ 3,134,032

The corporate administration and salaries and benefits have been recorded on a cost recovery basis and the interest expense has been recorded on the contractual amount basis.

The breakdown of the expenses between the different related parties is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
GMM	**$ 476,010**	$ 525,944	**$ 1,358,756**	$ 1,987,307
Ivanhoe	**632,456**	-	**1,030,151**	134,186
I2MS	**102,849**	129,210	**384,420**	1,012,539
Total related party expenses	**$ 1,211,315**	$ 655,154	**$ 2,773,327**	$ 3,134,032

21.2 Related party assets

The assets of the Company include the following amounts due from related parties:

	As at September 30,	As at December 31,	
	2009	**2008**	**2007**
Amounts due from GMM	**$ 108,333**	$ -	$ -

(Stated in U.S. dollars)

21. RELATED PARTY TRANSACTIONS (Continued)

21.3 Related party liabilities

The liabilities of the Company include the following amounts due to related parties:

	As at September 30, 2009	As at December 31, 2008	As at December 31, 2007
Amounts due to GMM	**$ 204,592**	$ 230,712	$ 211,045
Accounts payable to Ivanhoe	**58,900**	60,682	52,045
Accounts payable to I2MS	**109,070**	285,372	-
Deposit received for sale of metals division	**-**	3,000,000	-
Amounts due under line of credit facilities	**37,030,151**	-	105,673,380
Total liabilities due to related parties	**$37,402,713**	$ 3,576,766	$ 105,936,470

22. COAL TRANSACTION

In July 2006, the Company and Ivanhoe signed a definitive agreement, effective April 26, 2006, whereby the Company agreed to acquire Ivanhoe's coal division (the "Coal Transaction") in exchange for 57,000, 000 common shares and 25,576,383 preferred shares of the Company.

On August 8, 2006, the Coal Transaction and the equity conversion rights under the line of credit facility (Note 16) were approved by the Company's minority shareholders at a special meeting convened for that purpose.

The Coal Transaction, which was a related party transaction, received final approval from the TSX Venture Exchange on May 28, 2007.

On May 29, 2007, the Company completed the purchase of the Ivanhoe coal division. The common shares issued to Ivanhoe, when aggregated with Ivanhoe's existing holding of common shares, represented approximately 86% of the total number of common shares currently issued and outstanding. The coal rights and licenses acquired by the Company have been recorded at $nil as the underlying assets had no carrying amount within the coal division.

With the completion of the Coal Transaction, certain coal division expenditures made by Ivanhoe between April 26, 2006 and May 29, 2007 were added to the indebtedness outstanding under the line of credit and will be repayable by the Company as if they were advances. The total coal expenditures funded by Ivanhoe from April 26, 2006 to May 28, 2007, and accepted by SouthGobi, are approximately $13.2 million of which $13 million are related to exploration expenses and $200,000 are for plant and equipment.

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 Coal Transaction using the principles of merger accounting and the prior periods were restated as if the Company and the coal division had always been combined. The coal division consists of certain coal related assets and expenditures made by Ivanhoe from its inception in 2004 to May 29, 2007. Note 3(i) to the financial statements provides detailed disclosure of the impact of the principles of merger accounting.

(Stated in U.S. dollars)

23. SUPPLEMENTAL CASH FLOW INFORMATION

23.1 Non-cash financing and investing activities

In the three and nine months ended September 30, 2009 the Company incurred the following non-cash investing and financing transactions:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
Conversion of line of credit facility (first funding agreement) (Note 16.4)	**$ -**	$ -	**$ -**	$ 107,551,903
Conversion of preferred shares to common shares	**-**	-	**-**	4,189,154
Acquisition of mineral properties through the issue of common shares	**-**	30,000	**-**	30,000
Transfer of share option reserve upon exercise of options	**519,361**	420,630	**802,935**	1,925,691
Total non-cash financing and investing activities	**$ 519,361**	$ 450,630	**$ 802,935**	$ 113,696,748

23.2 Cash payments for interest and taxes

In the three and nine months ended September 30, 2009 the Company made the following cash payments for interest and income taxes:

	Three months ended September 30,		Nine months ended September 30,	
	2009	**2008**	**2009**	**2008**
Interest paid	**$ -**	$ -	**$ -**	$ 77,470
Taxes paid	**-**	-	**-**	-
Total cash payments	**$ -**	$ -	**$ -**	$ 77,470

24. COMMITMENTS FOR EXPENDITURE

At September 30, 2009, the Company had outstanding commitments of $28.7 million for coal mining equipment and buildings. Included in the $28.7 million is $24.1 million for the purchase of a second and third fleet of coal mining equipment for the development of its Ovoot Tolgoi Project in Mongolia. Delivery and commissioning of the second fleet of equipment is scheduled for the fourth quarter of 2009 and of the third fleet of equipment is scheduled for mid-2010. 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.

25. SUBSEQUENT EVENTS

On October 26th, 2009, the Company announced that it had entered into a financing agreement with a wholly owned subsidiary of China Investment Corporation ("CIC") for $500 million in the form of a secured, convertible debenture bearing interest at 8.0% with a maximum term of 30 years. The financing is required primarily to support the accelerated investment program in Mongolia and up to $120 million of the financing may also be used for working capital, repayment of debt due on funding, general and administrative expense and other general corporate purposes. The proposed financing has received conditional approval from Canada's TSX Venture Exchange.

The key commercial terms of the financing include:

- Interest - 8% per annum (6.4% payable in cash and 1.6% payable in the Company's shares, where the number of shares to be issued is calculated based on the 50-day volume-weighted average price ("VWAP").
- Term - Maximum of 30 years.
- Security - First charge over the Company's assets, including shares of its material subsidiaries.
- Conversion price - The conversion price is set as the lower of Cdn$11.88 or the 50-day VWAP at the date of conversion, with a floor price of Cdn$8.88 per share. Assuming full conversion at the base price of Cdn$11.88 and that any conversion occurs following the Company achieving a 25% public float (on an as converted for the debenture loan basis), CIC's overall shareholding interest in the Company would be approximately 22%.

25. SUBSEQUENT EVENTS (Continued)

- Conversion timing - The Company and CIC each have various rights to call conversion of the debenture into common shares. CIC has the right to convert the debenture, in whole or in part, into common shares 12 months after the date of issue. The Company has the right to call for the conversion of up to $250 million of the debenture on the earlier of 24 months after the issue date, if the market price of its common shares is greater than Cdn$10.66, or upon the Company achieving a public float of 25% of its common shares under certain agreed circumstances. If the Company fully exercises its conversion right immediately following its achieving a 25% public float (on an as converted for the debenture loan basis) and assuming conversion at the Cdn$11.88 base price, CIC's initial shareholding interest in the Company would be approximately 11%.
- Company's normal conversion right – After 60 months from the issuance date, at any time that the VWAP of the Company's shares for the 50 business days is 20% higher than the floor price, the Company will be entitled to require conversion of all outstanding convertible debentures into common shares at the conversion price.
- Representation on the Company's Board - While the debenture loan is outstanding, or while CIC has a minimum 15% direct or indirect stake in the Company, CIC has the right to nominate one director to the Company's Board. the Company currently has eight Board members.
- Voting restriction - CIC has agreed that it will not have any voting rights in the Company beyond 29.9% if CIC ever acquires ownership of such a shareholder stake through exercising the debenture.
- Pre-emption rights - While the debenture loan is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has certain pre-emption rights on a pro-rata basis to subscribe for any new shares to be allotted and issued by the Company for the period which the debenture is outstanding. The pre-emption rights will not apply to new shares issued pursuant to pro-rata public equity offerings made to all shareholders, exercise of stock options and shares issued to achieve a 25% public float.
- Right of first offer - While a portion of the debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has the right of first offer for any direct and indirect sale of Ivanhoe's ownership stake in the Company. Ivanhoe currently owns directly and indirectly approximately 105.8 million the Company shares, or approximately 79% of the Company's current issued and outstanding shares.
- Registration Rights - CIC has registration rights under applicable Canadian provincial securities laws in connection with the common shares issuable upon conversion of the debenture.

25. SUBSEQUENT EVENTS (Continued)

In conjunction with the financing, the Company will also enter into a mutual co-operation agreement with a subsidiary of CIC. Under the terms of the agreement, CIC's subsidiary will provide advice and services to the Company on matters that include sales to China, procurement and logistics, and will receive a customary commercial payment for such services based on product sales from Mongolia to China.

The Company is currently determining the accounting treatment for the convertible debenture and an estimate of the financial impact cannot be made at this time. The Company expects this transaction to close in the fourth quarter of 2009.

26. APPROVAL OF THE FINANCIAL STATEMENTS

The Consolidated Interim Financial Statements of SouthGobi Energy Resources Ltd. for the nine months ended September 30, 2009 were approved and authorized for issue by the Audit Committee on November 3, 2009.

SouthGobi Energy Resources Ltd.

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

September 30, 2009

(Stated in U.S. dollars)

SOUTHGOBI ENERGY RESOURCES LTD

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
September 30, 2009
(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 mining, development and exploration 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 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 to Ivanhoe as of December 30, 2008, the Company's principal focus is on mining, developing and exploring of coking and thermal coals in Mongolia's South Gobi Province.

The Company owns the following significant coal projects in Mongolia: the Ovoot Tolgoi open pit producing mine ("Ovoot Tolgoi Mine"), and two development projects, the Soumber Deposit, and the Ovoot Tolgoi Underground Deposit. The Ovoot Tolgoi Complex comprises the Ovoot Tolgoi Mine together with the Ovoot Tolgoi Underground Deposit.

In addition, the Company owns the Tsagaan Tolgoi Deposit in Mongolia and holds and 85% interest in the Mamahak Deposit in Indonesia.

Recent Developments

Ovoot Tolgoi Complex

Coal shipments from the Ovoot Tolgoi Mine commenced in late September 2008 and continued throughout the fourth quarter of 2008. In January and February 2009, the Company experienced difficulty expediting the movement of its coal shipments through the Mongolia-China border crossing check point at Ceke due to erratic and unpredictable opening hours and sporadic closures. As a result, the Company initiated a production curtailment program in January 2009, decreasing production to preserve cash and to manage stockpiles.

The Company continued coordinating efforts with the Mongolian Government and various agencies to improve border crossing access for coal shipments. On February 24, 2009, in a further effort to minimize costs, the Company shut down production at the Ovoot Tolgoi Mine operation. All production equipment was demobilized, except for coal loading of customer trucks from the coal stockpile.

As discussions continued with the Mongolian Government, border access improved towards the end of the first quarter of 2009. In March 2009, the border crossing check point started operating on a more formal basis, with a schedule of eight hours per day, seven days per week. This resulted in increased shipments for the month of March, with sales of over 115,000 tonnes of coal. In April and May 2009, shipments totaled approximately 152,000 tonnes. In June, the border crossing check point started operating 11 hours per day, six days per week. Total shipments in June were approximately 232,000 tonnes, a new record for the Company. In July 2009, Mongolian and Chinese officials met at the Mongolian-Chinese border and allocated designated gates for coal export to create an expedited coal border crossing corridor.

With increasing sales and a reduction in its coal inventory, the Company resumed full mining operations effective July 1, 2009 on a 24 hour per day, seven day per week basis. For the third quarter of 2009 total shipments were 457,000 tonnes. Total shipments since the mine commenced production have now exceeded one million tonnes.

Construction of the permanent mancamp and permanent maintenance workshop facility were completed during the third quarter of 2009. The Company moved into the workshop/warehouse complex in August 2009 and into the permanent camp in September 2009. The mine airstrip surfacing has been completed and final permitting was received for the concrete airstrip.

On October 12, 2009, the Company announced that it completed a prefeasibility study for the Ovoot Tolgoi Mine resulting in the identification of Proven and Probable Mineral Reserves. The independent estimate prepared by Norwest Corporation ("Norwest") calculated 114.1 million tonnes of Proven and Probable surface coal reserves at July 1, 2009.

Surface Mineable Reserves as of July 1, 2009

Reserve Area	ASTM Coal Rank	Proven (million tonnes)	Probable (million tonnes)	Total (million tonnes)
Ovoot Tolgoi Mine	hvB to hvA*	105.0	9.1	114.1

* hvB to hvA - high-volatile bituminous coal B to A rank based on ASTM D388 standards

Total Surface and Underground Coal Resource Summary as of June 1, 2009

The Company also announced that it had received an updated independent NI 43-101 compliant resource estimate for the Ovoot Tolgoi Complex, prepared by Norwest.

The Ovoot Tolgoi surface and underground resources contain measured plus indicated coal resources of 249.8 million tonnes, with an additional inferred coal resource of 33.5 million tonnes as at June 1, 2009.

Area	Type	Resource Limits Depth (metres)	ASTM Group	In-Place Resources (million tonnes)		
				Measured	**Indicated**	**Inferred**
Sunrise Field	Surface	Surface to 250m	hvB to hvA*	53.8	15.7	4.9
Sunset Field	Surface	Surface to 250m	hvB to hvA	82.1	19.4	8.1
Sub-Total				**135.9**	**35.1**	**13.0**
Sunrise Field	Underground	250m to 600m	hvB to hvA	11.2	5.2	11.2
Sunset Field	Underground	250m to 600m	mhB to hvA	34.6	27.8	9.3
Sub-Total				**45.8**	**33.0**	**20.5**
Total				**181.7**	**68.1**	**33.5**

* hvB to hvA - high-volatile bituminous coal B to A rank based on ASTM D388 standards

Ovoot Tolgoi resources are found in two different resource areas, referred to as the Sunrise and Sunset Fields (formerly the South-East and West Fields, respectively). The Mineral Resources are inclusive of the Mineral Reserves.

Soumber Deposit

On October 12, 2009, the Company reported that it had received an initial independent NI 43-101 compliant resource estimate for the Soumber coal project, prepared by Norwest.

The Soumber coal project and resource area is estimated to contain initial measured plus indicated coal resources of 21.4 million tonnes, with an additional inferred coal resource of 55.5 million tonnes as at August 11, 2009.

Resource Area	ASTM Coal Rank	Measured (million tonnes)	Indicated (million tonnes)	Inferred (million tonnes)
Soumber	Medium volatile bituminous*	13.1	8.3	55.5
Total		21.4		55.5

*medium-volatile bituminous coal based on ASTM D388 standards

Mamahak Deposit

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 ("Mamahak").

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

In October 2009, SMG Consultants ("SMG") updated a resource estimate as at September 11, 2009 for the E and SW resource blocks. SMG has estimated that the resource blocks on the Mamahak Deposit contain 6.9 million tonnes of measured resources, 3.2 million tonnes of indicated resources and 161,000 tonnes of inferred resources. The resource estimates have been calculated to Joint Ore Reserves Committee ("JORC") standards. The JORC resource quantities are equivalent to the resource quantities that would have been estimated using the CIM Definition Standards on Mineral Resources and Reserves mandated by National Instrument 43-101. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are set out in the Resource Report entitled, "Mamahak Coal Project" dated October 12, 2009 and available at www.sedar.com.

As the Company progressed with efforts to prepare for the mining and shipment of the targeted 30,000 tonne trial cargo from Mamahak, the Company became aware of the requirement for additional capital expenditure beyond what was originally budgeted to develop the project. After the initial review of the project expenditures and related budgets, the Company suspended further development works at Mamahak pending a detailed operational review and analysis.

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 transaction, the Company obtained a $30 million working capital credit facility from Ivanhoe.

On March 20, 2009, the Company announced two new appointments to its Management and Resource Development team: Jess Harding and Stephen Torr.

Jess Harding has been appointed the Company's Vice-President, Evaluations and Project Development. Mr. Harding has more than 15 years' experience in the mining industry and assumes the same role that he presently holds at Ivanhoe Mines Ltd. Mr. Harding has a Bachelor of Chemical Engineering from the University of Leeds, UK.

Stephen Torr, (P.Geo.), has been appointed the Company's Resource Manager. Mr. Torr has 19 years of experience in the mining industry and currently is the Resource Manager for Ivanhoe Mines Ltd. Mr. Torr has a B.Sc. (Hons) Degree in Geology from the University of Southampton and a M.Sc. in Applied Geoscience from the University of Leicester. Mr Torr has previous experience in estimation of open pit and underground coal resources and will be assuming the role of Qualified Person to oversee future independent resource estimates for SouthGobi.

In June 2009, Jay Gow was appointed the Company's Vice-President, Coal Marketing. Mr. Gow has extensive experience in international and domestic resource marketing, which will be important as the Company develops its international customer base in Asia, Europe and the Americas.

In July 2009, the Right Honourable Jean Chretien, the 20th Prime Minister of Canada, was appointed as a senior international adviser to the Company as part of a broader engagement of Mr. Chretien's services by Ivanhoe and certain other companies with which the Company shares access to corporate administrative facilities, employees and service providers. See "Related Party Transactions". Mr Chretien is expected to advise the Company with respect to international business opportunities in the energy and mineral resource sectors.

In July 2009, the Company announced the resignation of Gene Wusaty as the Company's Chief Operating Officer.

In July 2009, the Company and Ivanhoe agreed to increase an existing working capital credit facility from $30 million to $60 million. The amended credit facility will mature on December 31, 2010, is unsecured and bears interest at LIBOR plus 750 basis points. The amended facility also requires repayment in the event that the Company acquires additional financing from a third party source and provides for an extension fee of $1.5 million payable in the event any portion of the facility is outstanding past March 31, 2010. This additional $30 million working capital facility allowed the Company to continue to fund its expansion plans and current operations in Mongolia and its operations in Indonesia.

Effective September 1, 2009, Denis Lehoux, SouthGobi Sands LLC's ("SGS"), in country Operations Director in Mongolia retired. David Bartel, who has been with SGS since January 2007, has been appointed Operations and Executive Director and Vice President. Mr. Bartel has over 30 years of experience in the coal industry and will be the key representative for the Company in Mongolia.

On September 8, 2009, the Company announced the appointment of Gavin May as the Company's new Chief Operating Officer. Mr. May has more than 25 years of experience in the coal industry and is uniquely qualified to plan for the next stage of development and build out of the Company's significant projects in Mongolia. He was formerly Chief Executive Officer and Managing Director of Gloucester Coal Ltd., a company listed on the Australian Stock Exchange.

On February 10, 2009, the Company announced the appointment of Alexander Molyneux as its new President, effective April 27, 2009. Effective October 12, 2009 Mr. Molyneux assumed the dual role of President and Chief Executive Officer. Based in Hong Kong, he was most recently Managing Director, Head of Metals & Mining Investment Banking, Asia Pacific, Citigroup.

On October 26th, 2009, the Company announced financing had been secured from a wholly-owned subsidiary of China Investment Corporation ("CIC"), which will provide $500 million in the form of a secured, convertible debenture bearing interest at 8.0% (Please see the Liquidity, Financing and Working Capital Resources section for more details).

Ivanhoe, directly and indirectly, currently owns 105,782,155 common shares representing approximately 79% of the issued and outstanding common shares of SouthGobi.

FORWARD LOOKING STATEMENTS

Except for statements of fact relating to the Company, certain information contained herein constitutes forward-looking statements. Forward-looking statements are frequently characterized by words such as "plan", "expect", "project", "intend", "believe", "anticipate" and other similar words, or statements that certain events or conditions "may" or "will" occur. Forward-looking statements are based on the opinions and estimates of management at the dates the statements are made, and are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ materially from those projected in the forward-looking statements. These factors include the inherent risks involved in the exploration and development of mineral properties, the uncertainties involved in interpreting drilling results and other geological data, fluctuating commodity 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.

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, 2009 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 by Canadian securities regulatory authorities 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 has adopted 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 was comprehensive and addressed 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 was understood and managed reasonably, the Company retained an external third party accounting firm and hired an IFRS conversion project manager. The accounting staff 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 implemented 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 reconciliations between Canadian GAAP and IFRS for the total assets, total liabilities, shareholders equity and net earnings in

Note 3 to the Consolidated Interim Financial Statements. The adoption of IFRS has had no significant impact on the net cash flows of the Company. The changes made to the statements of financial position and comprehensive income 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.

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.

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 date of the statement of financial position 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.

Comparative Information

The Company has restated all prior period figures in accordance with IFRS.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with IFRS requires the Company to establish accounting policies 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 4 to the Consolidated Interim Financial Statements for the three and nine months ended September 30, 2009. Note 3 to the Consolidated Interim Financial Statements for the three and nine months ended September 30, 2009 provides a review of the significant changes to the reported financial position and results of operations of the Company under Canadian GAAP and IFRS.

The following is an outline of the estimates that the Company considers as critical in the preparation of its consolidated financial statements.

Mineral Property and Exploration Costs

All direct costs related to the acquisition of mineral property interests are capitalized into intangible assets 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 into property, plant and equipment ("PPE"). 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 will be provided on a unit-of-production basis using estimated resources as the depletion base.

At the end of each reporting period, the Company reviews the carrying values of its mineral property interests to determine whether there is an indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Recoverable amount is the higher of fair value less costs to sell and value in use. If the recoverable amount is estimated to be less than its carrying amount, the carrying amount is reduced to its recoverable amount.

Decommissioning, restoration and similar liabilities (Asset retirement obligation or "ARO")

The Company recognizes provision for statutory, contractual, constructive or legal obligations, including those associated with the reclamation of mineral properties and mineral assets under PPE, when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, a provision for an asset retirement obligation is recognized as its present value in the period in which it is incurred. Upon initial recognition of the liability, the corresponding asset retirement obligation 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 current market-based discount rate, amount or timing of the underlying cash flows needed to settle the obligation.

Inventory valuation

Coal inventories are stated at lower of production cost and net realizable value. Production costs include direct and indirect labour, operating materials and supplies, transportation costs and an appropriate portion of fixed and variable overhead expenses, including depreciation and depletion. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.

Materials and supplies inventory consists of consumable parts and supplies which are valued at lower of weighted average cost and net realizable value. Supplies used in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. Net realizable value is defined as the selling price of the finished product less any provisions for obsolescence and costs of completion.

Stripping costs

Stripping costs incurred during the development of a mine are capitalized into PPE. 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 give rise to future benefits from the mineral property, in which case the stripping costs would be capitalized into PPE. Future benefits arise when stripping activity increases the future output of the mine by providing access to a new ore body. Capitalized stripping costs are depleted on a unit-of production basis, using estimated resources as the depletion base.

Income taxes

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the date of the statement of financial position.

Deferred income tax is provided using the liability method on temporary differences, at the end of each reporting period, between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Stock-based compensation

Employees (including directors and senior executives) of the Company receive a portion of their remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments. The Company accounts for stock options using the Black-Scholes option pricing model. 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 thereafter.

In situations where equity instruments are issued and some or all of the goods or services received by the entity as consideration cannot be specifically identified, they are measured at fair value of the share-based payment. Otherwise, share-based payments are measured at the fair value of goods or services received.

Revenue recognition

Revenue represents the fair value of consideration received and receivable that is derived from the sales of coal. 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. The revenue from sales of coal in the ordinary course of business is recognized when coal is either loaded onto a truck or when it is unloaded at the final destination, depending on the terms of the 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 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, 2009, the Company adopted IFRS. The provisions of new and revised standards and interpretations are applicable and effective for the Company's financial year beginning on or after January 1, 2009.

A summary of the new and revised standards and interpretations are outlined in Note 2.3 of the Consolidated Interim Financial Statements for the nine months ended September 30, 2009.

NON-IFRS FINANCIAL MEASURES

($ in thousands, unless otherwise stated)

This Management Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") refers to certain financial measures, such as "cash costs", which are not standardized measures recognized under IFRS and do not have a standardized meaning prescribed by IFRS. 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 mining 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.

Prior year comparatives are not provided as the Company did not have sales in the nine months ended September 30, 2008.

	Three Months Ended		Nine Months Ended
	September 30, 2009	June 30, 2009	**September 30, 2009**
Cash costs, continuing operations			
Cost of sales per financial statements	**$ 8,637**	$ 9,139	**$ 20,989**
Less non-cash adjustments	**(2,510)**	(2,171)	**(5,536)**
Total cash costs	**6,127**	6,968	**15,453**
Coal sales *(tonnes)*	**456,819**	384,305	**968,490**
Total cash costs of product sold *(per tonne)*	**$ 13.41**	$ 18.13	**$ 15.96**

	Three Months Ended		Nine Months Ended
	September 30, 2009	June 30 2009	**September 30, 2009**
Cash costs, continuing operations			
Direct cash costs of product sold *(per tonne)*	**$ 11.16**	$ 16.64	**$ 13.75**
Mine administration cash costs of product sold *(per tonne)*	**2.25**	1.49	**2.21**
Total cash costs of product sold *(per tonne)*	**$ 13.41**	$ 18.13	**$ 15.96**

MINERAL PROPERTIES

Qualified Persons

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 Stephen Torr (P.Geo.) and Resource Manager. Mr. Torr is a "qualified person" for the purposes of National Instrument 43-101 of the Canadian Administrators ("NI 43-101").

Mr. Torr was appointed the Company's Resource Manager on March 20, 2009. Prior to March 20, 2009 Gene Wusaty, P.Eng, and Chief Operating Officer was the Company's "qualified person" for the purposes of the 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 Complex (formerly Nariin Sukhait), the Tsagaan Tolgoi Deposit 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 hectares ("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 October 23, 2009 the Company held 23 licenses, including the two mining licenses, which in total cover an area of approximately 859,000 ha.

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

Properties in Mongolia

Ovoot Tolgoi Mine

The Ovoot Tolgoi mine 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.

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.

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. Mining operations at the Ovoot Tolgoi property are found in two distinct areas, referred to as the Sunset Pit to the west and the Sunrise Pit to the east.

In 2009, the Company engaged Norwest to complete a new technical report for the Ovoot Tolgoi area incorporating outstanding data obtained from drilling to the end of 2008, reflecting a redesign of the surface mine, updating the resource models and delineating reserves based on a pre-feasibility level of engineering.

The following tables summarize the estimated reserves and resources at the Ovoot Tolgoi Mine. The estimates are based on exploration activities undertaken up to the end of 2008. The Mineral Resources are inclusive of the Mineral Reserves.

Summary of Coal Reserves at the Ovoot Tolgoi Mine as of July 1, 2009

Reserve Area	Proven	Probable	Total
	(million tonnes)		
Ovoot Tolgoi Mine	105.0	9.1	114.1

Summary of Coal Resources at Ovoot Tolgoi Mine as of June 1, 2009

Resource Area	Measured	Indicated	Total Measured and Indicated	Inferred
	(million tonnes)			
Ovoot Tolgoi Mine				
Sunset Pit	82.1	19.4	101.5	8.1
Sunrise Pit	53.8	15.7	69.5	4.9
Total Ovoot Tolgoi Mine	135.9	35.1	171.0	13.0

The coal rank at the Ovoot Tolgoi Mine is high volatile B to A bituminous. High volatile B produces between 7,212 to 7,785 kcal/kg and high volatile A produces greater than 7,785 kcal/kg heat output.

Three coal products are presently being mined or are expected to be produced at the Ovoot Tolgoi Mine; a hard coking (or metallurgical) coal, a premium coal with applications for PCI coking coal or a high-quality thermal coal, and a thermal coal product for use in the power generation.

After obtaining its Permit to Mine on March 31, 2008, the Company started operations at Ovoot Tolgoi in April 2008. Coal shipments began in September 2008.

Due to erratic and unpredictable Mongolia-China border access, coal shipments in January and February 2009 were lower than expected. Consequently, and in order to preserve cash and manage stockpiles, a production curtailment program was initiated in January 2009 decreasing production to a dayshift basis. This was followed by a full mine shutdown in late February 2009, except for coal loading of customer trucks from coal stockpiles.

For the three month period ending June 30, 2009, the mine ceased coal production in order to reduce costs and coal inventory. Coal sales to December 31 2008 were approximately 113,000 tonnes. In 2009, coal shipments in the first quarter were approximately 127,000 tonnes; in the second quarter approximately 384,000 tonnes; and in the third quarter approximately 457,000 tonnes. Total shipments since the mine commenced production have now exceeded one million tonnes.

In order to increase the amount of coal traffic across the border, in July 2009 Chinese and Mongolian authorities agreed to create a designated coal transportation corridor at the Shivee Khuren — Ceke border crossing. This facility is currently under construction and is expected to be operational by late 2009. When completed, it will permit coal to be transported across the border through three corridors that are separate from other, non-coal, border traffic. The Company believes that these improvements in the border crossing capacity will allow the Company to continue to substantially increase the amount of coal we ship into China.

The Ovoot Tolgoi Mine's proximity to the Shivee Khuren — Ceke border crossing allows our customers to transport coal by truck on an unpaved road from our mine site to China. The Company is currently studying the feasibility of building additional road infrastructure from the Ovoot Tolgoi Complex to the Mongolia-China border.

A north-south railway line currently connects Ceke with Jiayuguan City in Gansu Province and with the interior of China. Another east-west railway line from Ceke to Linhe, an industrial city in eastern Inner Mongolia, is expected to be operational in 2010. This line is anticipated to have an initial transportation capacity of approximately 15 million tonnes per year, later increasing to 25 million tonnes per year. Using this route coal can be shipped to Baotou and further east to ports on China's Bohai Gulf.

Since December 2008, we have engaged in various levels of discussions with railway contractors regarding the feasibility of developing a coal railway from the Ovoot Tolgoi Mine to the Mongolia-China border.

The Company employed 278 employees as at September 30, 2009. Of the 278 employees, 39, including expatriates, are employed in the Ulaanbaatar office, 7 in outlying smaller offices including the Ceke border point and 232 at the mine site. Of the total 278 employees based in Mongolia, 270 (97%) are Mongolian nationals and 81 (29%) are residents of the local Gurvantes Soum.

In April 2008, the Company purchased a second fleet of coal mining equipment for the open pit mine, which is scheduled to be commissioned in the fourth quarter of 2009. The new shovel / truck mining fleet consists of a Liebherr 996 hydraulic excavator (34 cubic m) and four Terex MT4400 (218-tonne capacity) trucks. The new fleet will supplement the existing mine fleet consisting of a Liebherr 994 hydraulic excavator (13.5-cubic m capacity) and 7 Terex TR100 (91-tonne capacity) trucks.

Additional equipment will be required as production at the mine expands, including larger hydraulic shovels, larger end dump trucks and larger dozers and graders. The Company has entered into an agreement with a Mongolian supplier for a third fleet including a larger Liebherr 996 34m^3 shovel, four 218-tonne Terex haul trucks and various auxiliary equipment. The third fleet is expected to be delivered in mid-2010, with an additional fleet of equipment likely to be ordered for 2011. The larger equipment will increase productivity. However, we will continue to employ the smaller initial fleet in areas of thinner seams and to supplement the larger equipment.

The airstrip surfacing project was completed at year end 2008 and was certified in early 2009. The mancamp and maintenance workshop building complexes were completed during the third quarter of 2009. Both complexes are now occupied.

The Company is currently completing construction of the Ovoot Tolgoi customs bonded yard situated to the east of the Sunset Pit boundary. This is a customs controlled impound area which will allow mine operations to safely and efficiently load coal trucks destined for China from the stockpiles under the direct supervision of Mongolian customs officers.

Ovoot Tolgoi Underground Deposit

The Ovoot Tolgoi Underground Deposit is contiguous to, and located directly, below the surface mine development. The entire extension of the coal at depth from 250 to 600 m that is designated for potential underground development is located inside the existing Ovoot Tolgoi mining license.

In March 2008, The America's Group (TAG) prepared a resource estimate for underground resources in the Sunset Pit (formerly the West Field). Estimated underground resources for the Sunset Pit were 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 located in the Sunset Pit. This drilling was conducted to obtain additional information respecting the structure and quality of the deep underground coal mineralization. The drilling conducted in 2006 and 2007 identified coking and semi-soft coal at depths of between 250 m and 600 m beneath the lower boundaries of the planned open pits at Sunrise and Sunset. The No. 5 coal seam continues to be open at depth and along strike.

On October 12, 2009, the Company announced an independent resource estimate prepared by Norwest under the requirements of NI 43-101. Norwest estimated that the Ovoot Tolgoi Underground Deposit contained approximately 45.8 million tonnes of measured resources, 33 million tonnes of indicated resources and 20.5 million tonnes of inferred resources.

Summary of Underground Resources at Ovoot Tolgoi Mine as of June 1, 2009

Resource Area	Measured	Indicated	Total Measured and Indicated	Inferred
	(million tonnes)			
Ovoot Tolgoi Underground Deposit				
Sunset Field	34.6	27.8	62.4	9.3
Sunrise Field	11.2	5.2	16.4	11.2
Total Ovoot Tolgoi Underground Deposit	45.8	33.0	78.8	20.5

Having identified underground resources at the Ovoot Tolgoi Underground Deposit, the Company is investigating the possibility of mining these resources using underground mining methods.

Soumber Deposit

The Soumber Deposit is located approximately 20 km east of the Ovoot Tolgoi Mine. It lies within the administrative unit of Gurvantes Soum in the Omnigovi Aimag (South Gobi Province), approximately 50 km northeast of the Shivee Khuren-Ceke border crossing.

Exploration and drilling programs at Soumber first started in 2005 in the western field. Sixty-two holes were drilled during 2005 and 2006 that confirmed the potential for a significant coal deposit in the area. Between 2007 and 2008, over 121 drill holes, totaling 24,512 m of drilling were completed. In 2009, the Company conducted geotechnical and hydrological programs in the Soumber central field. The exploration geology fieldwork included reconnaissance mapping, trenching, geologic descriptions of drilling returns, geotechnical data, field logs and database development.

Based on the drill hole data distribution, the Soumber coal field can be divided into three prospective areas: central, east and west. The majority of exploration activity has focused on the central Soumber field. The coal occurrence on the Soumber central field can be divided into seven separate seams, or benches of a seam separated by rock interburden. The seams themselves are composed of coal intercalated with numerous rock partings. The coal seams in the Soumber field may not be directly correlative to the Ovoot Tolgoi and Nariin Sukhait coal seams.

On October 12, 2009, the Company announced that it had received an initial independent resource estimate for the Soumber Deposit. The coal resources estimated at the Soumber central field are comprised of measured coal resources of 13.1 million tonnes, indicated coal resources of 8.3 million tonnes and inferred coal resources of 55.5 million tonnes. Laboratory data demonstrated that some of coal benches exhibit potential coking coal characteristics. The coal rank ranges between high to medium volatile bituminous coal, having an average calorific value range of 5,172 to 6,728 kcal/kg. The Soumber Deposit has potential to increase coal resources to the east and to the west as well as at depth. The resource estimate incorporates exploration data up to August 11, 2009 down to a depth of 250 m below surface.

Due to the proximity to the Ovoot Tolgoi Mine, any future mining operation at the Soumber Deposit would likely be able to share common infrastructure with the Ovoot Tolgoi Mine. The Company has initiated mine planning and an application for a mining license, which will be submitted for development of this project. Environmental baseline studies have been completed and General Environmental Impact Assessments have begun. The Company is also studying the feasibility of building a coal preparation plant for the Soumber coal to remove rock partings and improve quality.

Tsagaan Tolgoi Deposit

The Tsagaan Tolgoi coal field is located in south-central Mongolia. The property is located in the Omnigovi 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. In February 2008, Norwest 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.

Effective August 12, 2009, the Mongolian government issued a mining license for the Tsagaan Tolgoi coal field. The Technical and Economic Study has been completed, and is currently under government review. Detailed Environmental Impact Assessment is underway and will be submitted following the approval of the Technical and Economic Study.

The nearest in-country rail line is the Trans-Mongolia Railway that runs northwest to southeast and connects Ulaanbaatar to Beijing. The nearest point on this line to the Tsagaan Tolgoi Deposit is approximately 400 km the east at the Chinese border. Limited infrastructure exists at Tsagaan Tolgoi and will need to be developed prior to any mining operations.

The Tsagaan Tolgoi Deposit is located close to Ivanhoe's Oyu Tolgoi copper and gold project and has the potential to supply coal to any power project that may, in the future, be there.

Tavan Tolgoi Extension Area

The Tavan Tolgoi Extension Area is composed of seven exploration licenses located east of Dalanzadgad, the provincial capital in the Omnogovi Aimag. These exploration licenses surround the third party-owned Tavan Tolgoi coal project. The Tavan Tolgoi coal field was discovered in the 1950's 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 and 2009 and is currently being updated.

Exploration Program

A number of the exploration licenses are associated with the broader Ovoot Tolgoi Complex and the Soumber Deposit. The Company considers many of these to be prospective exploration properties, which have yet to be fully explored.

The exploration program in 2010 includes drilling, trenching and geological reconnaissance on a number of license areas which are identified as having good potential for coking and thermal coal deposits.

Properties in Indonesia

Mamahak Deposit

The Company holds its 85% interest in the Mamahak Coal project through a joint venture. In September 2008, the Company increased its working interest in the original 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 terms of the JVA allow the Company to increase its working interest to 100% in the project.

In October 2009, SMG updated a resource estimate as at September 11, 2009 for the E and SW resource blocks. SMG has estimated that the resource blocks on the Mamahak Deposit contain 6.9 million tonnes of measured resources, 3.2 million tonnes of indicated resources and 161,000 tonnes of inferred resources. The resource estimates have been calculated to Joint Ore Reserves Committee ("JORC") standards. The JORC resource quantities are equivalent to the resource quantities that would have been estimated using the CIM Definition Standards on Mineral Resources and Reserves mandated by National Instrument 43-101. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are set out in the Resource Report entitled, "Mamahak Coal Project" dated October 12, 2009 and available at www.sedar.com.

As the Company progressed with efforts to prepare for the mining and shipment of the targeted 30,000 tonne trial cargo from Mamahak, the Company became aware of the requirement for additional capital expenditure beyond what was originally budgeted to develop the project. After the initial review of the project expenditures and related budgets, the Company suspended further development works at Mamahak pending a detailed operational review and analysis.

Metals Division Profile and Discontinued Operations

On December 31, 2008, the Company announced the sale of its Metals Division to Ivanhoe for $3 million and other non-cash consideration. The Metals Division consisted 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, providing for loan advances from Ivanhoe up to $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 750 basis points.

The transaction was completed on February 2, 2009 following receipt of regulatory approval.

SELECTED QUARTERLY DATA

($ in thousands, except per share information)

	2009			2008				2007
QUARTER ENDED	**30-Sep**	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec
Revenue	**$ 11,871**	$ 10,667	$ 3,540	$ 3,126	$ -	$ -	$ -	$ -
Impairments	**23,029**	-	-	-	-	-	-	-
Exploration expenses	**5,011**	4,641	4,130	8,104	11,356	10,358	6,375	5,992
Loss from continuing operations	**23,782**	7,910	9,960	14,457	21,110	11,189	14,909	42,500
Loss from discontinued operations	**-**	-	-	2,549	1,667	2,392	1,302	-
Net loss	**23,782**	7,910	9,960	17,006	22,777	13,581	16,211	42,500
Net loss per share	**(0.18)**	(0.06)	(0.07)	(0.13)	(0.17)	(0.11)	(0.19)	(0.57)

<u>Selected Quarterly Information</u>

The changes in comparative results of operations on a quarter over quarter basis are due primarily to significant fluctuations in the following areas: revenue, exploration expenses, stock-based compensation charges, foreign exchange gains and losses, interest expense, interest accretion on line of credit facility and fair value of embedded derivative on debt. These latter two items are described in Note 3 and 16 to the Consolidated Interim Financial Statements.

Coal shipments began at the end of September 2008, and increased during the quarter ended December 31, 2008. For the three months ended September 30, 2009, revenue increased compared to the three months ended June 30, 2009. Major factors contributing to the increase in sales volumes through 2009 were the mobilization by customers of larger truck fleets and enhancements at the border crossing. 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 and Indonesia. Expenditures on the Indonesian Coal Division began in the first quarter of 2008. The net loss in the third quarter of 2009 includes an impairment of Mamahak for $23.0 million offset by a future income tax recovery of $8.6 million related to the Mongolian operations.

RESULTS OF OPERATIONS

	Three Months Ended			Nine Months Ended	
	September 30, 2009	June 30, 2009	September 30, 2008	**September 30, 2009**	September 30, 2008
Volumes, Prices and Costs					
Coal production *(millions of tonnes)*	**0.36**	-	-	**0.51**	-
Coal sales *(millions of tonnes)*	**0.46**	0.38	-	**0.97**	-
Average sales price *(per tonne)*	**$ 27.82**	$ 29.71	-	**$ 28.76**	-
Total cash costs of product sold *(per tonne)*	**$ 13.41**	$ 18.13	-	**$ 15.96**	-
Direct cash costs of product sold *(per tonne)*	**$ 11.16**	$ 16.64	-	**$ 13.75**	-
Operating Statistics					
Total waste material moved *(millions of bank cubic metres)*	**1.06**	-	-	**1.41**	-
Strip ratio *(bank cubic metres of waste rock per tonne of clean coal produced)*	**2.98**	-	-	**2.74**	-
Operating Results *(thousands of dollars)*					
Revenue	**$ 11,871**	$ 10,667	$ -	**$ 26,078**	$ -
Cost of Sales	**(8,637)**	(9,139)	-	**(20,989)**	-
Income from mine operations	**3,234**	1,528	-	**5,089**	-
Adminstration expenses	**(6,234)**	(4,444)	(10,339)	**(16,783)**	(12,851)
Evaluation and exploration expenses	**(5,011)**	(4,641)	(11,356)	**(13,781)**	(28,088)
Impairment charge on Mamahak Coal project	**(23,029)**	-	-	**(23,029)**	-
Operating loss from continuing operations	**$ (31,040)**	$ (7,557)	$ (21,695)	**$ (48,504)**	$ (40,939)

Three Months Ended September 30, 2009 and 2008

The Company incurred an operating loss from continuing operations for the three months ended September 30, 2009 of $31.0 million compared to $21.7 million for the same period in 2008. The variance is due to the factors discussed below.

Revenue, net of royalty expense and cost of sales relate to the Company's operations in Mongolia. Through early 2009, shipments across the border were limited and as a result the Company initiated a production curtailment program in January 2009. This was followed by a full mine shut down on February 24, 2009, except for coal loading of customer trucks from coal stockpiles.

With increasing sales and a reduction in its coal inventory, the Company has resumed full mining operations effective July 1, 2009 on a 24 hour per day, seven day per week basis.

In the third quarter of 2009, the Company shipped approximately 457,000 tonnes of coal at an average realized selling price of approximately $28 per tonne. This compares to 384,000 tonnes of coal shipped in the second quarter of 2009 at an average realized selling price of $30 per tonne. Variability in the realized selling price relates to a change in sales mix in terms of coal quality.

Cost of sales was $8.6 million in the current quarter, which comprise the cost of the product sold, mine administration costs, equipment depreciation, and depletion of stripping costs. There were no cost of sales in the third quarter of 2008. Total cash costs per tonne of product sold in the third quarter of 2009 were $13.41 compared to $18.13 for the second quarter of 2009. The decrease is due to the Company resuming full mining operations on July 1, 2009 and higher sales volumes during the third quarter of 2009. In the second quarter of 2009, operational costs were expensed due to the full mine shutdown at the end of February 2009 and therefore resulted in higher total cash costs in the second quarter of 2009.

Exploration expenses for the three months ended September 30, 2009 were lower than the quarter ended September 30, 2008. In the three months ended September 30, 2009, there were decreased drilling expenditures as non-prospective licenses in Mongolia were relinquished and no further exploration work was conducted on these licenses. As well, prior to the commencement of sales in late September 2008, certain operational costs were classified as exploration expense.

Administration expenses for the quarter ended September 30, 2009 were $6.2 million compared to $10.3 million for the quarter ended September 30, 2008. The decrease predominately relates to the listing fees and the movement in the foreign exchange. Administration expenses for the quarter ended September 30, 2009 also include approximately $2.2 million of stock based compensation compared to approximately $1.0 million for the same period last year.

The administration expenses consist of the following major categories broken down for comparative purposes (see Note 9 of the Consolidated Interim Financial Statements).

Legal fees for the quarter ended September 30, 2009 were higher than the quarter ended September 30, 2008. Legal fees include costs associated with the Company's regulatory affairs including expenses associated with corporate governance, contract negotiations, filing, registration and disclosure.

Corporate administration fees increased in the three months ended September 30, 2009 compared to the same period in 2008. The increase relates to additional administration costs incurred in the Hong Kong office. Certain of the Company's administrative staff and office facilities are provided by Global Mining Management Ltd. (see 'Related Party Transactions') on a cost recovery 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 September 30, 2009 as compared to the same period in 2008. Quarterly charges include the cost of quarterly reviews, internal computer systems training and planning, and accruals for the year-end audit of the Company's financial statements. The increase in the current quarter relates predominantly to costs related to the various technical reports for the Mongolia project.

Salaries and benefits, excluding stock based compensation costs, increased in the three months ended September 30, 2009 to $650,000 as compared to $475,000 for the three months ended September 30, 2008. The increase mainly relates to the additional staff in the Hong Kong office.

The foreign exchange losses are primarily the result of changes of the U.S. to Canadian dollar ("Cdn$") and the U.S. to Mongolian Tugrik exchange rates during the period. The higher foreign exchange loss of $2.0 million in the third quarter of 2008 compared to $273,000 in the current quarter relates to the higher Canadian cash balances.

Listing fees consist of legal, accounting and professional fees incurred for a secondary listing on an Asian stock exchange. Normally the Company would treat the charges as share issue costs upon a successful equity fundraising and had capitalized the listing fees to June 30, 2008. However, uncertainty in the timing of a possible equity financing led to a decision to expense $5.9 million in listing fees in the third quarter of 2008. The Company is continuing with the secondary listing application and has expensed $1.6 million in the current quarter.

In the third quarter of 2009, the Company recorded an impairment charge of $23.0 million related to Mamahak. The impairment includes the impairment of inventory, fixed assets and intangible assets. As the Company progressed with efforts to prepare for the mining and shipment of the targeted 30,000 tonne trial cargo from Mamahak, the Company became aware of the requirement for additional capital expenditure beyond what was originally budgeted to develop the project. After the initial review of the project expenditures and related budgets, the Company suspended further development works at Mamahak pending a detailed operational review and analysis. As a result of the suspension the Company recorded an impairment charge in the third quarter of 2009.

Nine Months Ended September 30, 2009 and 2008

The Company incurred an operating loss from continuing operations for the nine months ended September 30, 2009 of $48.5 million compared to $40.9 million for the same period in 2008. This variance is due to the factors discussed below.

In the nine month period ended September 30, 3009, the Company shipped approximately 968,000 tonnes of coal at an average realized selling price of approximately $29 per tonne.

Cost of sales was $21.0 million in the nine months ended September 30, 2009, which includes the cost of the product sold, mine administration costs, equipment depreciation, and depletion of stripping costs. There were no cost of sales in the nine months ended September 30, 2008. Total cash costs per tonne of product sold in the nine months ended September 30, 2009 were $15.96.

Exploration expenses for the nine months ended September 30, 2009 were $13.8 million as compared to $28.1 million for the same period in 2008. Exploration expenditures in Mongolia in 2008 were higher as the Coal Division acquired equipment, hired additional personnel and began pre-development activities at the Ovoot Tolgoi mine site. Throughout 2008, the Mongolia coal exploration program concentrated on drilling in the Sunset Field. The Coal Division continued its exploration activities in Indonesia throughout the nine months ended September 30, 2009.

Administration expenses were $16.8 million for the nine months ended September 30, 2009 as compared to $12.9 million for the nine months ended September 30, 2008. Stock based compensation expense allocated to administration expenses was $8.1 million for the nine months ended September 30, 2009 and $2.3 million for the same period in 2008. Other amounts that are included in the nine months ended September 30, 2009 that are not in the 2008 period are professional fees related to the various technical reports for the Mongolia project and a corporate consulting contract for the Mongolian operations.

The administration expenses consist of the following major categories broken down for comparative purposes (see Note 9 of the Consolidated Interim Financial Statements).

Legal fees for the nine months ended September 30, 2009 and September 30, 2008 were for costs associated with the Company's regulatory affairs including expenses associated with corporate governance, contract negotiations, filing, registration and disclosure.

Corporate administration fees increased in the nine months ended September 30, 2009 compared to the same period in 2008. The increase relates to higher insurance costs and filing fees.

Professional fees have increased for the nine months ended September 30, 2009 as compared to the same period in 2008. Included in professional fees are the cost of quarterly reviews, internal computer systems training and planning, and accruals for the year end audit of the Company's financial statements. The increase relates predominantly to increased audit fees, increased internal control costs, costs related to the various technical reports for the Mongolia project and a corporate consulting contract for the Mongolian operations.

Salaries and benefits, excluding stock based compensation costs in the nine months ended September 30, 2009 was $1.6 million which was slightly higher than the $1.5 million for the nine months ended September 30, 2008. Bonuses paid in 2008 are offset by higher director fees and the additional salary costs in the Hong Kong office in the nine months ended September 30, 2009.

A foreign exchange loss of $1.3 million was recorded for the nine months ended September 30, 2009 as compared to $808,000 for the nine months ended September 30, 2008. The foreign exchange losses are primarily the result of changes of the U.S. to Canadian dollar and the U.S. to Mongolian Tugrik exchange rates during the period.

Listing fees consist of legal, accounting and professional fees incurred for a secondary listing on an Asian stock exchange. Normally the Company would treat the charges as share issue costs upon a successful equity fundraising and had capitalized the listing fees to June 30, 2008. However, uncertainty in the timing of a possible equity financing led to a decision to expense $5.9 million in the third quarter of 2008. The Company is continuing with the secondary listing application and listing fees of $1.9 million have been expensed in 2009.

In the third quarter of 2009, the Company recorded an impairment charge of $23.0 million related to Mamahak. The impairment includes the impairment of inventory, fixed assets and intangible assets. As the Company progressed with efforts to prepare for the mining and shipment of the targeted 30,000 tonne trial cargo from Mamahak, the Company became aware of the requirement for additional capital expenditure beyond what was originally budgeted to develop the project. After the initial review of the project expenditures and related budgets, the Company suspended further development works at Mamahak pending a detailed operational review and analysis. As a result of the suspension the Company recorded an impairment charge in the third quarter of 2009.

EXPLORATION COSTS AND DISCONTINUED OPERATIONS BY DIVISION

($ in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	**2009**	2008
Mongolian Coal Division	**$ 2,149**	$ 8,468	**$ 4,660**	$ 21,485
Indonesian Coal Division	**2,862**	2,888	**9,121**	6,603
Total Exploration	**$ 5,011**	$ 11,356	**$ 13,781**	$ 28,088

Coal Division

The total coal exploration expenditures in the three months ended September 30, 2009 were $5.0 million compared to $11.4 million for the same period in 2008. For the nine months ended September 30, 2009 coal exploration expenditures were $13.8 million as compared to $28.1 million for the nine months ended September 30, 2008.

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.

The costs of pre-development, overburden removal and stripping activities, which are incurred in the pre-production stage are expensed as incurred. The Company commenced mining operations in Mongolia on April 2, 2008, and costs incurred for site development prior to the production phase were expensed.

The Mongolian Coal Division started exploration and development subsequent to the completion of the coal transaction at the end of May 2007. Expenditures in the first nine months of 2008 were incurred as the Coal Division acquired equipment, hired additional personnel and began pre-development activities at the Ovoot Tolgoi mine site. Pre-development of the Ovoot Tolgoi open pit mine site included road construction, site clearing, drainage control and topsoil removal. The exploration expenditures also included consulting-geological, drilling, license fees, office and salary and benefits.

Exploration expenditures in Mongolia were approximately $2.1 million for the three months ended September 30, 2009 compared to $8.5 million in 2008. Prior to the commencement of sales in late September 2008, certain operational costs were treated as exploration expense. For the three months ended September 30, 2009, the Mongolia exploration expenditures included consulting-geological, drilling, license fees, office and salary and benefits. Exploration expenditures will vary from quarter to quarter and are also related to the seasonality of the exploration programs.

In Indonesia, exploration expenditures were $2.9 million for the three months ended September 30, 2009 compared to $2.9 million in 2008. The Company began its exploration activities in Indonesia in early 2008. The 2008 drilling program identified quantities of coking coal that appeared to be amenable to surface mining. Exploration expenditures increased in 2009 as the company prepared for production.

As the Company progressed with efforts to prepare for the mining and shipment of the targeted 30,000 tonne trial cargo from Mamahak, the Company became aware of the requirement for additional capital expenditure beyond what was originally budgeted to develop the project. After the initial review of the project expenditures and related budgets, the Company suspended further development works at Mamahak pending a detailed operational review and analysis. As a result of the suspension, the Company has recorded an impairment charge of $23.0 million in the third quarter of 2009.

Metals Division – Discontinued Operations

The Company sold the Metals Division to Ivanhoe in December 2008. The Metals Division consisted of a series of base and precious metal exploration properties in Mongolia and Indonesia. In 2008, the proceeds of $3 million were classified as a deposit received for the sale of the division. The gain on sale of the Metals Division is $2.6 million and is classified in the consolidated statement of changes in equity.

In 2008, the sale of the Metals Division was disclosed as a discontinued operation and its financial results were presented as separate items in the consolidated statement of financial position and statements of comprehensive income and cash flows.

During the three and nine months ended September 30, 2008, exploration expenses were $1.7 million and $5.4 million respectively. The majority of the expenses incurred in Mongolia and Indonesia were related to ongoing license fees, drilling, and salaries.

The exploration expenditures of $1.7 million for the quarter ended September 30, 2008 and $5.4 million for the nine months ended September 30, 2008 have been classified as a loss from discontinued operations. The basic and diluted loss per share from discontinued operations is $0.01 for the quarter ended September 30, 2008 and $0.04 for the nine months ended September 30, 2008.

OTHER INCOME/EXPENSE

($ in thousands)

	Three Months Ended September 30		Nine Months Ended September 30,	
	2009	2008	**2009**	2008
Fair value change on embedded derivative	**$ -**	$ -	**$ -**	$ (7,223)
Interest accretion on line of credit facilities	**-**	-	**-**	(598)
Interest expense	**(632)**	-	**(1,030)**	(134)
Accretion expense	**(11)**	(5)	**(31)**	(10)
Interest income	**4**	589	**16**	1,698
	$ (639)	$ 584	**$ (1,045)**	$ (6,267)

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 $10 million which was extended to a maximum of $15 million on June 6, 2007. Attached to the First Funding Agreement was a conversion option which became effective upon the completion 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 $29,982,631 into 14,709,701 common shares of the Company. As a result of this conversion the amount due under the First Funding Agreement was eliminated.

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. (Please refer to Note 16.4 of the Consolidated Interim Financial Statements for further details).

Interest expense was higher in the quarter ended September 30, 2009 and the nine months ended September 30, 2009 compared to the same periods in 2008. This is related to advances on the line of credit to fund operations. In January 2008, with the completion of the additional equity private placements, the First Funding Agreement line of credit facility and the second interim funding agreement were terminated.

In 2009, as part of the sale of the Metals Division, the Company obtained a $30 million working capital 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 750 basis points. In July 2009, the Company and Ivanhoe agreed to increase the existing working capital credit facility from $30 million to $60 million. The amended credit facility will mature on December 31, 2010, is unsecured and bears interest at LIBOR plus 750 basis points. The amended facility also requires repayment in the event that the Company acquires additional financing from a third party source and provides for an extension fee of $1.5 million payable in the event any portion of the facility is outstanding past March 31, 2010. This additional $30 million working capital facility allowed the Company to continue to fund its expansion plans and current operations in Mongolia. The Company has received advances of $36 million against the line of credit facility in the first nine months of 2009.

On October 26, 2009, the Company announced it had secured financing from a wholly owned subsidiary of CIC for $500 million and this additional financing will be used to repay the credit facility with Ivanhoe (Please refer to the Liquidity, Financing and Working Capital Resources section for more details).

The Company recognizes asset retirement obligations in the period in which they are incurred. The liability component is measured at fair value and is adjusted to its present value as accretion expense is recorded.

Interest income was higher in 2008, due to higher cash balances which relate to the completion of the equity financings in early 2008. Lower interest income during 2009 reflects lower average cash balances during this period.

In the third quarter of 2009, the Company recorded current income tax expense $712,000 related to its Mongolian operations. The Company's believes profitable operations in Mongolia are probable and has therefore recorded a future income tax asset of $8.6 million related to deductible temporary differences and the carry forward of unused tax losses.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Highlights
($ in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	**2009**	2008
Cash used in operating activities	**$ (4,119)**	$ (17,470)	**$ (20,216)**	$ (44,181)
Cash used in investing activities	**(8,598)**	(13,040)	**(24,403)**	(51,782)
Cash generated by financing activities	**12,626**	629	**37,006**	134,227
Effect of foreign exchange rate changes on cash	**(4)**	(2,260)	**(16)**	(866)
(Decrease) increase in cash for the period	**(95)**	(32,141)	**(7,629)**	37,398
Cash balance, beginning of period	**2,806**	70,933	**10,340**	1,394
Cash balance, end of period	**$ 2,711**	**$ 38,792**	**$ 2,711**	**$ 38,792**

General market conditions

In 2008 and in early 2009, market events and conditions, including the disruptions in the international credit markets and other financial systems and deterioration of global economic conditions, caused significant volatility in commodity prices. General economic conditions are showing signs of improvement, and demand for coal in China and India is expected to grow through 2010 and into the foreseeable future. Management continues to monitor external conditions and their impact on the Company's business plans for the upcoming year.

Cash used in operating activities

At September 30, 2009, the Company had cash resources of $2.7 million compared to cash resources of $10.3 million at December 31, 2008.

Cash used in continuing operations was $4.1 million for the three months ended September 30, 2009 compared to $16.0 million for the same period in 2008. For the nine months ended September 30, 2009 cash used in continuing operations was $20.2 compared to $39.9 million for the nine months ended September 30, 2008. Cash used in discontinued operations for the three and nine month periods ended September 30, 2008 was $1.5 million and $4.2 million, respectively.

In the three and nine month period ended September 30, 2009, the Company incurred a net loss from continuing operations of $23.8 million and $41.7 million, respectively, compared to a net loss from continuing operations for the three and nine months ended September 30, 2008 of $21.1 million and $47.2 million respectively. The impairment of Mamahak in the third quarter of 2009 resulted in higher losses in the third quarter of 2009 compared to 2008. Continuation of the Company's build out of the Ovoot Tolgoi mining operation, higher finance costs and evaluation and exploration costs contributed to the losses in 2008. In 2009, the Company recorded revenue of $11.9 million for the three months ended September 30, 2009 and $26.1 million for the nine months ended September 30, 2009. With the increased activities at the Ovoot Tolgoi site and the operations in Mongolia, accounts receivable, prepaid expenses, and accounts payable increased during nine months ended 2009.

The foreign exchange losses are primarily the result of changes of the U.S. to Canadian dollar and the U.S. to Mongolian Tugrik exchange rates during the period.

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 of 2008 and early 2009. Payment of accounts receivable due from government taxation authorities in Mongolia could be delayed throughout 2009, and is being used to offset future income taxes payable on account.

In July 2009, the Mongolian tax law has been amended to preclude producers and exporters of unfinished mineral products from claiming back VAT. The Mongolian government has yet to define what products will qualify as finished mineral products and any VAT amounts impacted will be prospective from the effective date of the law, August 16, 2009. The Company is monitoring the amendments to the tax law regarding current claims for Value Added Tax.

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

Prepaid balances and deposits have increased during 2009. The increase relates to the timing of prepayments for Mongolian exploration licenses, supplies, insurance and additional security deposits in Indonesia.

Coal and supplies inventory have decreased to $10.7 million at September 30, 2009 from $13.7 million at the year ended December 31, 2008. Coal and supplies inventory is valued at the lower of cost and net realizable value. Coal inventory cost of $9.9 million includes direct and indirect labour, operating materials and supplies, transportation costs and an appropriate portion of fixed and variable overhead expenses including depreciation and depletion. Supplies inventory consists of consumable parts and supplies.

The Company had a stockpile of approximately 578,000 tonnes of coal inventory at September 30, 2009 and 688,000 tonnes at June 30, 2009.

Accounts payable have increased in the nine months ended September 30, 2009 due to increased corporate activity.

Cash used for investing activities

Cash used for investing activities was $8.6 million for the three months ended September 30, 2009 compared to $13.0 million for the same period in 2008. For the nine months ended September 30, 2009, cash used for investing activities was $24.4 million compared to $51.8 million for the nine months ended September 30, 2008.

The Company's investment in property, plant and equipment was higher during 2008. Deposits for further mining equipment and maintenance facilities are included as plant and equipment. In the three months ended September 30, 2008, deferred stripping costs in Mongolia were also included. The Company incurred expenditures in 2009 for mobile and mining equipment in Mongolia and construction projects and deferred stripping in Indonesia.

Interest income will increase or decrease in a quarter depending on the cash position. Interest was higher in 2008 due to higher cash balances which related directly to the completion of the equity financings.

Cash provided by financing activities

During the nine months ended September 30, 2008, the Company completed a series of equity financing transactions and received proceeds from the exercise of stock options. The total proceeds net of issue costs were $629,000 and $140.3 million for the three and nine months ended September 30, 2008, compared to proceeds received for the exercise of stock options in the three and nine months ended September 30, 2009 of $626,000 and $1.0 million, respectively.

The proceeds from the equity financings in 2008 were 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. The proceeds were also used to repay amounts advanced under the line of credit facility obtained from Ivanhoe in October 2007.

On December 31, 2008, the Company announced the sale of its Metal Division to Ivanhoe for $3 million and other non-cash consideration. 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 750 basis points. In July 2009, the Company and Ivanhoe agreed to increase the existing working capital credit facility from $30 million to $60 million. The amended credit facility will mature on December 31, 2010, is unsecured and bears interest at LIBOR plus 750 basis points. The amended facility also requires repayment in the event that the Company acquires additional financing from a third party source and provides for an extension fee of $1.5 million payable in the event any portion of the facility is outstanding past March 31, 2010. For the nine months ended September 30, 2009, the Company received advances of $36 million against the line of credit facility.

Liquidity, Financing and Working Capital Resources

The Company is an integrated 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 2010 and is prioritizing its budgeted expenditures with a current emphasis on production and near term cash flow.

On October 12, 2009, the Company announced that it completed a prefeasibility study for the Ovoot Tolgoi Mine resulting in the identification of Proven and Probable Mineral Reserves. The independent estimate prepared by Norwest calculated 114.1 million tonnes of Proven and Probable surface coal reserves at July 1, 2009.

In July 2009, the Company and Ivanhoe agreed to increase the existing working capital credit facility from $30 million to $60 million. The amended credit facility will mature on December 31, 2010, is unsecured and bears interest at LIBOR plus 750 basis points. The amended facility also requires repayment in the event that the Company acquires additional financing from a third party source and provides for an extension fee of $1.5 million payable in the event any portion of the facility is outstanding past March 31, 2010. This additional $30 million working capital facility allowed the Company to continue to fund its expansion plans and current operations in Mongolia and its operations in Indonesia.

On October 26, 2009, the Company announced that it had entered into a financing agreement with a wholly owned subsidiary of CIC for $500 million in the form of a secured, convertible debenture bearing interest at 8.0% with a maximum term of 30 years. The financing is required primarily to support the accelerated investment program in Mongolia and up to $120 million of the financing may also be used for working capital, repayment of debt due on funding, general and administrative expense and other general corporate purposes. The proposed financing has received conditional approval from Canada's TSX Venture Exchange.

Key commercial terms of the financing include:

- Interest - 8% per annum (6.4% payable in cash and 1.6% payable in SouthGobi shares, where the number of shares to be issued is calculated based on the 50-day volume-weighted average price (VWAP);
- Term - Maximum of 30 years;
- Security - First charge over SouthGobi's assets, including shares of its material subsidiaries;
- Conversion price - The conversion price is set as the lower of Cdn$11.88 or the 50-day VWAP at the date of conversion, with a floor price of Cdn$8.88 per share. Assuming full conversion at the base price of Cdn$11.88 and that any conversion occurs following SouthGobi achieving a 25% public float (on an as converted for the debenture loan basis), CIC's overall shareholding interest in SouthGobi would be approximately 22%;
- Conversion timing - SouthGobi and CIC each have various rights to call conversion of the debenture into common shares. CIC has the right to convert the debenture, in whole or in part, into common shares 12 months after the date of issue. SouthGobi has the right to call for the conversion of up to $250 million of the debenture on the earlier of 24 months after the issue date, if the market price of its common shares is greater than Cdn$10.66, or upon SouthGobi achieving a public float of 25% of its common shares under certain agreed circumstances. If SouthGobi fully exercises its conversion right immediately following its achieving a 25% public float (on an as converted for the debenture loan basis) and assuming conversion at the Cdn$11.88 base price, CIC's initial shareholding interest in SouthGobi would be approximately 11%;
- Company's normal conversion right – After 60 months from the issuance date, at any time that the VWAP of the Company's shares for the 50 business days is 20% higher than the floor price, the Company will be entitled to require conversion of all outstanding convertible debentures into common shares at the conversion price;
- Representation on SouthGobi Board - While the debenture loan is outstanding, or while CIC has a minimum 15% direct or indirect stake in SouthGobi, CIC has the right to nominate one director to SouthGobi's Board. SouthGobi currently has eight Board members;
- Voting restriction - CIC has agreed that it will not have any voting rights in SouthGobi beyond 29.9% if CIC ever acquires ownership of such a shareholder stake through exercising the debenture;
- Pre-emption rights - While the debenture loan is outstanding, or while CIC has a 15% direct or indirect stake in SouthGobi, CIC has certain pre-emption rights on a pro-rata basis to subscribe for any new shares to be allotted and issued by SouthGobi for the period which the debenture is outstanding. The pre-emption rights will not apply to new shares issued pursuant to pro-rata public equity offerings made to all shareholders, exercise of stock options and shares issued to achieve a 25% public float;

- Right of first offer - While a portion of the debenture is outstanding, or while CIC has a 15% direct or indirect stake in SouthGobi, CIC has the right of first offer for any direct and indirect sale of Ivanhoe Mines' ownership stake in SouthGobi. Ivanhoe Mines currently owns directly and indirectly approximately 105.8 million SouthGobi shares, or approximately 79% of SouthGobi's current issued and outstanding shares; and
- Registration Rights - CIC has registration rights under applicable Canadian provincial securities laws in connection with the common shares issuable upon conversion of the debenture.

In conjunction with the financing, the Company will also enter into a mutual co-operation agreement with a subsidiary of CIC. Under the terms of the agreement, CIC's subsidiary will provide advice and services to the Company on matters that include sales to China, procurement and logistics, and will receive a customary commercial payment for such services based on product sales from Mongolia to China.

The Company expects this transaction to close in the fourth quarter of 2009.

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 Global Mining Management Ltd. ("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 and service providers are recovered from the Company proportionate to the time spent by the shared part-time employees and service providers 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 $1.4 million and $2.0 million for the nine months ended September 30, 2009 and 2008, 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 consisted 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 750 basis points.

In July 2009, the Company and Ivanhoe agreed to increase the existing working capital credit facility from $30 million to $60 million. The amended credit facility will mature on December 31, 2010, is unsecured and bears interest at LIBOR plus 750 basis points. The amended facility also requires repayment in the event that the Company acquires additional financing from a third party source and provides for an extension fee of $1.5 million payable in the event any portion of the facility is outstanding past March 31, 2010. This additional $30 million working capital facility allowed the Company to continue to fund its expansion plans and current operations in Mongolia and its operations in Indonesia.

OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value. As at November 3, 2009: 133,702,749 common shares were issued and outstanding. There are also incentive stock options outstanding that are exercisable to acquire 8,313,918 unissued common shares. On a diluted basis, 142,016,667 common shares were outstanding. There are no preferred shares outstanding.

Ivanhoe, directly and indirectly, currently owns 105,782,155 common shares representing approximately 79% of the issued and outstanding common shares of SouthGobi.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

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.

RISK FACTORS

Material risks and uncertainties affecting SouthGobi, their potential impact and the Company's principal risk management strategies are substantially unchanged from those disclosed in the Company's MD&A for the year ended December 31, 2008, which is available at www.sedar.com.

OUTLOOK

We believe that demand for commodities is increasing as the current economic crisis passes. General economic conditions are showing signs of improvement. It is still difficult to forecast commodity prices and customer demand for our products; however our sales and marketing efforts in the most recent quarter are providing positive results. The Company is continuing to pursue new customers, and maintain strong relations with its current customer base.

The Company's properties in Mongolia are well located in close proximity to China and other major industrializing economies in Asia. Furthermore, our near-term production is in high quality bituminous thermal and coking coals, which we anticipate will remain attractive premium products.

Our success to date and potential for future growth can be attributed to a combination of our competitive strengths, including the following:

- Projects are strategically located close to China, especially to the fast growing Gansu and Inner Mongolia regions;
- Substantial and growing resources and reserves;
- Produce premium quality coals;
- Low cost structure due to favorable geographic and geological conditions;
- Established production with strong growth potential through future expansion of our existing mine capacity and development of our priority assets; and

- Experienced management team with strong skills in mining, exploration and marketing and are able to leverage the expertise, experience and relationships of our principal shareholder, Ivanhoe.

Mongolia

Revenue was $11.9 million for the three months ended September 30, 2009 compared to $10.7 million for the three months ended June 30, 2009. The Company will continue to focus on generating higher sales volume throughout the remainder of 2009.

On October 12, 2009 the Company announced that independent 43-101 estimates prepared by Norwest that upgraded the reserves at the Ovoot Tolgoi Complex and the Soumber Deposit:

- Total surface mineable coal reserves as of July 1, 2009 at Ovoot Tolgoi were calculated and estimated to be 105 million tonnes of proven reserves and 9.1 million tonnes of probable reserves;

- Ovoot Tolgoi surface and underground resources as of June 1, 2009 were calculated and estimated to be 181.7 million tonnes of measured resources, 68.1 million tonnes of indicated resources and 33.5 million tonnes of inferred resources; and

- The Soumber resource area is estimated to contain 13.1 million tonnes of measured resources, 8.3 million tonnes of indicated resources and 55.5 million tonnes of inferred resources.

In March 2009, the border started opening more reliably for seven days per week on an eight hour per day basis. In April and May 2009, shipments totaled approximately 152,000 tonnes. In June, the border started operating at 11 hours per day, six days per week. Total shipments in June were approximately 232,000 tonnes, a new record for the Company. For the third quarter 2009 total shipments were 457,000 tonnes.

The Company is 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, 365 days per year. This should increase daily distribution of Ovoot Tolgoi coal to our customers in China.

As we move to ramping up our surface production, Norwest considers it possible that our total coal production from the Ovoot Tolgoi Mine could increase to approximately 4 million tonnes in 2010 and approximately 8 million tonnes in 2012.

We continue to develop markets for our premium quality coals. A China based research firm has conducted a complete market analysis of the coal markets in western Inner Mongolia and Gansu provinces, helping us to identify potential customers in these provinces. Our target customer base consists of a mixture of distributors and end users of coal, including steel mills, power plants and industrial consumers.

Indonesia

As the Company progressed with efforts to prepare for the mining and shipment of the targeted 30,000 tonne trial cargo from Mamahak, the Company became aware of the requirement for additional capital expenditure beyond what was originally budgeted to develop the project. After the initial review of the project expenditures and related budgets, the Company suspended further development works at Mamahak pending a detailed operational review and analysis.

Overview and Objectives

We continue to focus our efforts on mining, development and exploration of coking and thermal coal products in Mongolia for supply of quality products to our customers in China. As we look forward through the remainder of 2009, we are encouraged by the positive developments in Mongolia. We are making progress with our sales and marketing efforts, continuing to focus on efficiency and prudent financial management and intend to manage production levels to meet anticipated demand for our products.

Our objectives for the remainder of 2009 and as we look forward into 2010 are as follows:

- Expanding production at the Ovoot Tolgoi Mine;
- Developing integrated infrastructure for the area around the Ovoot Tolgoi Mine;
- Advancing the development of the Soumber Deposit;
- Enhancing the value of our products that are delivered to end customers;
- Continuing to develop attractive and value enhancing coal projects;
- Undertaking exploration initiatives to establish and expand reserves and resources; and
- Continuing to focus on production safety, environmental protection, operational excellence and community relations.

November 3, 2009