SouthGobi Energy Resources

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

June 30, 2007

(Stated in U.S. Dollars)

SOUTHGOBI ENERGY RESOURCES LTD
(formerly ASIA GOLD CORP)

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OVERVIEW

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

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

The Company is a mineral exploration company with a historical focus on precious and base metal exploration and development in Mongolia, Bulgaria and Indonesia. The Company's principal focus will now be on coal exploration and development in southern Mongolia.

Recent Developments

The Company and Ivanhoe Mines Ltd. ("Ivanhoe") reached a definitive agreement on July 7, 2006 for the Company to acquire Ivanhoe's coal division (the "coal transaction") in exchange for 82,576,383 common shares and preferred shares of the Company. The minority shareholders of the Company approved the coal transaction at a special meeting of the shareholders of the Company held on August 8, 2006.

On May 1, 2007, Ivanhoe and SouthGobi announced that the Government of Mongolia completed the transfer of all 35 coal exploration licenses held by Ivanhoe in the South Gobi area of Mongolia. All of the material conditions precedent to the closing of the Company's acquisition of Ivanhoe's coal division were satisfied. The coal transaction, which was a related party transaction, received final approval from the TSX Venture Exchange on May 28, 2007.

The Company completed the purchase of the Ivanhoe coal division in consideration for the issuance to Ivanhoe of 57,000,000 common shares and 25,576,383 preferred shares. The common shares issued to Ivanhoe, when aggregated with Ivanhoe's existing holding of common shares, represent approximately 87% of the total number of common shares currently issued and outstanding. Each preferred share issued to Ivanhoe is convertible into one (1) common share but only if, upon any such conversion, the total number of common shares held by Ivanhoe and all other insiders of the Company or any of their respective associates or affiliates does not exceed 90% of the total number of common shares then issued and outstanding. The preferred shares are non-voting and have a preference over the common shares with respect to the payment of dividends and distribution of assets in the event of a liquidation, dissolution or winding up of the Company.

When Ivanhoe and the Company reached their agreement in principle in April 2006 to effect the coal transaction, Ivanhoe also agreed to extend a line of credit to the Company of $10 million, which could be increased to $15 million by mutual agreement. On June 6, 2007 Ivanhoe and SouthGobi mutually agreed to extend the line of credit to $15 million.

With the completion of the coal transaction, certain interim coal division expenditures made by Ivanhoe after the agreement in principle was reached but prior to closing were added to the indebtedness outstanding under the line of credit and will be repayable by the Company as if they were advances. The total coal expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007, and accepted by SouthGobi, are approximately $13.2 million. Together with the line of credit advances the total amount payable to Ivanhoe as at June 30, 2007 is approximately $22.4 million.

The line of credit is governed by the terms of an interim funding agreement (the "Funding Agreement"). The outstanding loan is, under the terms of the Funding Agreement, convertible into common shares at the election of either the Company or Ivanhoe. Until May 29, 2008, the Company has the right to require Ivanhoe to convert the outstanding loans into common shares at a conversion price of Cdn$2.09 per share. Until August 29, 2008, Ivanhoe has the right to convert the outstanding loans into common shares at a conversion price of Cdn$2.35 per share.

On August 1, 2007 and subsequent to the quarter end, Ivanhoe and SouthGobi agreed to extend the maturity date of the line of credit from April 25, 2008 to June 30, 2009. All other terms and conditions of the Funding Agreement remain in full force and effect.

All amounts advanced under the line of credit and all interim coal expenditures bear interest at an annual rate equal to the three month London Interbank Offered Rate ("LIBOR") plus two (2%) per cent per annum, which is approximately 7.36% at June 30, 2007.

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

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

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

FORWARD LOOKING STATEMENTS

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

CRITICAL ACCOUNTING ESTIMATES

A detailed summary of all of the Company's significant accounting policies is included in Note 2 to the annual Consolidated Financial Statements for the year ended December 31, 2006.

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

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

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

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

CHANGE IN ACCOUNTING POLICIES

The Company adopted the provisions in the Canadian Institute of Chartered Accountants Handbook Sections 3251 – Equity, 3855 – Financial Instruments – Recognition and Measurement, 3861 – Financial Instruments – Disclosure and Presentation and 1530 – Comprehensive Income, on January 1, 2007, which addresses the classification, recognition and measurement of financial instruments in the financial statements and the inclusion of other comprehensive income. The Company's financial instruments' carrying value approximate fair values due primarily to their immediate or short term maturity. Section 1530 – Comprehensive Income, does not apply to the Company at this time.

COAL AND MINERAL PROPERTIES

Qualified Persons

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

Mongolia Exploration Licenses-Overview

Prior to June 30, 2006, exploration licenses in Mongolia were granted for a period of three years with rights to two two-year extensions (for a total of seven years) and required escalating annual rent payments. In early July 2006, the Government of Mongolia approved new mining legislation. The term for an exploration license has increased from a maximum of seven to nine years, with escalating rate structures varying from $.10 per hectare ("ha) to $1.50 per ha for licenses that are outstanding seven to nine years. Accordingly, the longer an exploration license is held the higher the annual cost becomes. As exploration licenses are identified as having limited mineral potential, they will be surrendered in order to minimize license fees. The number of licenses held will therefore fluctuate on a period to period basis as new properties are acquired and older ones surrendered. Under the new law, a mining license is now granted for a term of 30 years with rights to two 20 year extensions.

The new 2006 Minerals Law created requirements for making minimum exploration license expenditures. Beginning in 2007 an exploration license holder is required to undertake reconnaissance, exploration and related work at a per ha minimum of $.50 for each of the second and third years of the term of the exploration license; $1.00 for each of the fourth to sixth years and $ 1.50 for each of the seventh to ninth years .

Coal Group Profile

Mongolia Exploration Licenses

The purchase of the Ivanhoe coal division included Ivanhoe's entire interest in the Ovoot Tolgoi (formerly Nariin Sukhait) coal development project, the Tsagaan Tolgoi coal exploration project and various coal exploration projects in Mongolia. To complete the transaction, 35 coal exploration licenses held by Ivanhoe, along with other assets and personnel, were transferred to the Company.

The Company already owned a further 19 exploration licenses with coal potential, and with the additional 35 licenses, an aggregate of 54 licenses covering an area of approximately 2.2 million ha are available for coal exploration.

Properties in Mongolia

Ovoot Tolgoi Project (formerly Nariin Sukhait)

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

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

Ivanhoe initiated coal exploration in the Ovoot Tolgoi area in October 2004 followed up by extensive exploration programs in 2005 and 2006. The 2006 exploration program was designed to bring the level of knowledge for the identified resource area to a pre-feasibility level for mine planning. In addition to resource definition drilling, the program included investigation of hydrologic conditions, geotechnical engineering rock properties and coal quality analyses.

Resources at the Ovoot Tolgoi property are found in two different resource areas, referred to as the South-East and the West Fields. Estimated resources for these areas, categorized in accordance with National Instrument 43-101, are approximately 105 million tonnes of measured resources, 45 million tonnes of indicated resources and an additional 29 million tonnes of inferred resources. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are available in the Ivanhoe Mines 2007 Annual Information Form and the Ovoot Tolgoi Technical Report available at www.sedar.com.

In April 2007, Ivanhoe initiated the formal process for obtaining a Mining License for development of a surface open-pit coal mine at Ovoot Tolgoi. As required by the Minerals Law of Mongolia, the Company filed a Detailed Environmental Impact Assessment (DEIA) and a Geological Resource Report for the Ovoot Tolgoi property. In May 2007, the DEIA for the Ovoot Tolgoi coal project was approved by the Mongolian Government's Ministry of Environment. On August 6, 2007 the government approved the Geological Resource Report and the Company has filed a formal application for a Mining License to commence development and operation of an open pit coal mine at Ovoot Tolgoi.

The Company has commissioned Norwest Corporation (Norwest) to complete a pre-feasibility study on Ovoot Tolgoi and it is anticipated that it will be completed in the third quarter 2007. This study is expected to refine and enhance previous mining plans and scoping studies carried out to date. Equipment selection has been evaluated and is ready for order pending formal mining license approval. Site facilities have been designed and also are awaiting formal mining license approval.

Ovoot Tolgoi Underground Project

In June 2007 Norwest concluded a study of the potential for an underground mining operation at Ovoot Tolgoi. The objective was to identify mining methods applicable to the extension of the No. 5 seam coal structure at depths below 250 meters ("m") of the surface mine resource areas. The steep dip and unusual thickness of the No. 5 seam eliminates the possibility of using conventional underground mining methods. The decision to start planning for potential development of the underground resources at Ovoot Tolgoi is being driven by the increased coal demand in China and within the Ovoot Tolgoi market area.

Norwest identified two potential underground mining areas in conjunction with potential surface mining activities. Other potential underground areas may exist where drilling data is currently limited. Norwest's underground mine development study focused on areas adjacent to and below the surface resources delineated to date in the No.5 coal seam in Ovoot Tolgoi's South-East and West Fields.

Based on deep drilling conducted in 2006, coking and semi-soft coals have been identified at depths of between 250 m and 650 m below surface beneath the lower boundaries of the planned open pits at the South-East and West Fields. The No. 5 coal seam is open to depth and along strike. Additional drilling is planned for in 2007 to provide the basis for a resource estimate in the underground areas.

Tsagaan Tolgoi Project

The Tsagaan Tolgoi coal field is located in south-central Mongolia. The property is located in the Omnogovi Aimag approximately 570 km south of Ulaanbaatar and 113 km southeast of the provincial capital of Dalanzadgad, and approximately 115 km west of Oyu Tolgoi.

Norwest was commissioned by Ivanhoe in late 2003 to develop an exploration plan for coal resources in the area to delineate adequate fuel resources for supplying power to Ivanhoe's proposed Oyu Tolgoi copper and gold mining project.

A coal delineation program was first carried out in 2004, but no further work was conducted in 2005. A 2006 exploration program was carried out to define the potential resources to an assurance level that is compliant with the resource reporting standards prescribed by National Instrument 43-101. The program consisted of a combination of data acquisition methods that included field mapping, exploration trenching and rotary and core drilling. The resource estimate is expected to be completed in late 2007.

Tavan Tolgoi Extension Project

The Tavan Tolgoi Extension Project is composed of 8 exploration licenses located east of Dalanzadgad, the provincial capital in the Omnogovi Aimag. These exploration licenses surround the Tavan Tolgoi coal project on three sides. The Tavan Tolgoi coalfield was discovered in the 1950's by a joint Mongolian/Soviet team and is 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 composed of these 8 licenses has been flown 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 is being planned for this project starting in the third quarter of 2007.

Ovoot Tolgoi Extension

In 2005 coal occurrences were identified in the N and O fields (now called Ovoot Tolgoi Extension) approximately 16 and 23 km east-southeast of Ovoot Tolgoi. Further exploration drilling in 2006 has indicated that these coal occurrences may in fact be one coal field. Significant intersections were encountered and potential exists for expanding the resources along strike and down dip.

Coal Exploration Programs

SouthGobi has commenced a major exploration program on six separate coal projects in the Gobi area of southern Mongolia. Mobilization of drills, crews and camps was started in May 2007. For the remainder of the year the Company has budgeted approximately $9.5 million for the following programs;

- New greenfields exploration at Tavan Tolgoi Extension
- Determination of structure and quality on identified coal occurrences
- Infill drilling on defined projects (Ovoot Tolgoi and Tsagaan Tolgoi)
- Additional resource definition at Ovoot Tolgoi Extension and Ovoot Tolgoi Underground
- Greenfields exploration to determine license prospectivity
- Maintenance of minimum mineral license exploration expenditure requirements

The Ovoot Tolgoi Project requires some infill drilling in the West Field to better ascertain geological structuring for mine planning purposes. The mine shop facilities and waste dump locations need to be finalized on areas where there is no coal potential.

Further drilling in the Ovoot Tolgoi Extension will focus on gaining a better geological, structural and quality of understanding of the coal mineralization.

The Ovoot Tolgoi Underground project requires further drilling between the West and South-East Fields to better determine the No.5 seam dip south of the MAK / Qinhua southern border.

The Tsagaan Tolgoi exploration program includes some localized drilling and drilling on six other licenses in the immediate area.

The Tavan Tolgoi Extension licenses held by the Company are in close proximity to the known, third party-owned Tavan Tolgoi coal fields. This program is critical as it has the potential to identify metallurgical coal mineralization due to its proximity to the known, third party-owned Tavan Tolgoi coal fields.

Further greenfields exploration work will be performed on a number of the licenses in order to meet minimum expenditure requirements.

Metals Group Profile

Mongolia Exploration Licenses

As of July 31, 2007 the Company held 36 exploration licenses for copper and gold exploration in Mongolia covering an aggregate area of approximately 616,000 ha. Twenty-one of these licenses comprising an area of approximately 508,000 ha, the West Gobi Properties, are located in the west-central portion of the Omnogovi Aimag (province) approximately 510 km southwest of UlaanBaatar, Mongolia. Three of the remaining licenses are known as the Oyut Ovoo property and are located approximately 270 km southwest of UlaanBaatar. In addition, one license is held in Dornod Aimag which is located approximately 300 km northeast of UlaanBaatar, ten licenses are held in Khuvsgul Aimag in northern Mongolia and one license is held as part of a joint venture agreement.

The Company targeted and prioritized a number of licenses on the basis of potential, age, and cost. As a result of this review, a group of metals related licenses were relinquished during the quarter, and parts of 2 licenses have been sold subsequent to the quarter end.

Properties in Mongolia

West Gobi Property

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

Khongor Project

Exploration results from the Khongor porphyry copper-gold project in southern Mongolia confirm a mineralized strike length of 2 km. About half of this strike length (Khongor North) is located within the West Falcon Gobi Property, a joint-venture property with BHP Billiton World Exploration Inc. (“BHP Billiton”). The balance is located on the Tsakhir license, referred to as Khongor South, which was optioned by the Company from Solomon Resources Limited (“Solomon”) and Gallant Minerals Ltd. (“Gallant”).

The Company formerly held an option from Solomon to earn up to a 70% interest in Khongor South. Solomon, in turn, held an option on the same properties from Gallant. Following Solomon’s withdrawal from these arrangements in March 2007, the Company entered into a new Option Agreement directly with Gallant pursuant to which the Company can earn an 80% interest in the Tsakhir license.

In order to exercise the option to acquire an 80% interest in the Tsakhir license, SouthGobi is required over the next two years to make cash payments of $70,000, issue common shares of the Company valued at $50,000 and spend an aggregate of $ 600,000 on related work programs.

Subject to SouthGobi exercising its option to acquire an 80% interest in the Tsakhir license, Gallant has a one time option, exercisable within 30 days of SouthGobi completing the option, to retain its 20% interest as a fully participating joint venture partner, or to convert its 20% interest into a net smelter royalty of up to 3%. The Company retains the right to buy down the royalty pursuant to a payment scale based on the amount of the annual net smelter revenue.

The Tsakhir license hosts the southern extension of the Khongor porphyry copper-gold deposit discovered by the Company in 2005 (see News Releases dated October 18, 2005 and July 19, 2006). Mapping of the Tsakhir license has identified a cluster of nested porphyry bodies and significant areas of quartz stock work and breccia bodies. The property scale geology suggests that Tsakhir and Khongor may be part of a very large (>10 km diameter) multi-phase intrusive complex with significant prospectivity. Tsakhir and Khongor lie within the South Gobi arc terrain that hosts the Oyu Tolgoi copper-gold deposit, located 300 km to the east.

Further work on the Khongor Project, including drilling, is planned for in 2007.

BHP Billiton West Falcon Gobi Joint Venture

Pursuant to an Option Agreement with BHP Billiton dated June 30, 2005, BHP Billiton can earn a 50% interest in the West Falcon Gobi Property by spending $2 million on exploration prior to December 31, 2007, and an additional 20% interest by funding a feasibility study up to a maximum value of $45 million.

The Company and BHP Billiton signed an amended option agreement dated March 1, 2006 that expands the area and scope of the original option agreement. The area covered under this amended agreement (the ‘West Falcon Gobi Property’) has been increased by 4,019 square kilometres (‘km^2’) to 7,648 km^2 and the scope has been amended to include coal targets in addition to the copper-gold targets contemplated in the original option agreement. The amended agreement requires BHP Billiton to increase exploration expenditures to $3.5 million (from the original agreed amount of $2 million) during the earn-in period which terminates on December 31, 2007.

Under the terms of an amended option agreement, SouthGobi can continue the exploration of Khongor North at its own expense subject to a back-in right in favour of BHP Billiton. This back-in right allows BHP Billiton to include Khongor North in the joint venture company to be established after BHP Billiton has exercised the first option and acquired a 50% interest in the West Falcon Gobi Property. In addition, BHP Billiton must also pay SouthGobi an amount equal to the Khongor exploration costs incurred by SouthGobi.

The West Falcon Gobi Property includes an area of about 2,218 km^2, or about 30% of the total area, where the Company owns a 100% interest in the coal rights. The area includes parts of large, unexplored sedimentary basins that are prospective for Permian age coal. Tavan Tolgoi, a large metallurgical and thermal coal deposit, is 60 km northeast of the West Falcon Gobi Property’s eastern boundary. In addition to the area prospective for coal, the expanded West Falcon Gobi

Property also includes an area of 5,431 km^2, or about 70% of the property that is prospective for porphyry copper-gold deposits.

BHP Billiton conducted a Falcon™ airborne gravity gradiometer survey over the joint venture property in May 2006. Potential coal-bearing basins and prospective areas for porphyry copper systems were identified.

In March 2007 BHP Billiton commenced IP surveys for porphyry copper mineralization. This work continued through the quarter and has defined several targets for drilling. In June 2007 BHP Billiton mobilized a diamond drill rig to the area and by the end of the month had completed three holes.

Naran Bulag Project

The Company announced the discovery of 13 quartz veins containing visible gold at Naran Bulag on a 100% owned exploration license in southern Mongolia in 2005. The veins occur over a distance of 2.5 km and initial fire assay results indicate gold grades averaging between 30 g/t gold (0.96 ounces per ton) and 165 g/t gold (5.30 ounces per ton) in seven of the veins. A 7,000 m trenching program that commenced in October 2005 confirmed the high grade gold in five main veins and revealed two new veins which were found within 2 km of the main vein system.

An approximate 3,500 m combined diamond and reverse circulation (RC) drilling program commenced in April 2006. Three blocks were defined for RC grid drilling on the down-dip extensions of the B, A-C and D veins that host high grade gold mineralization (see News Releases dated January 23, 2006, and February 16, 2006).

The 84-hole RC drilling program included 20 holes on the B vein, 35 on the D vein and 29 on the AC vein system. The RC holes (diameter 13.1 cm) were collared on 10 m centers on drill hole fence-lines with a 25 m line separation for the B and D veins and a 50 m line separation for the AC veins. Drill fences were located both perpendicular to the general strike of the veins and down dip of the highest grade gold mineralization found in the trenches. The B and D veins were tested with short vertical holes due to the shallow dip of the veins. Holes on the AC veins were drilled at -55 to -60 degrees towards the veins. RC chip samples were collected at 1 m intervals.

The results of the first RC drilling program indicate that the best gold mineralization is in four shallow dipping, south plunging shoots within the quartz veins. The shoots are defined by a coherent envelope of combined anomalous gold and base metals which encloses all the better gold intersections. The estimated dimensions of the shoots are 30 to 60 m in width, 1 to 4 m in thickness and 90 to 130 m down plunge. All four shoots are open at depth. (See SouthGobi's website for a plan view of the interpreted shoots)

For 2007, the Company is considering its options for a proposed 1200 m RC drilling program.

East Energy Corp.

On March 22, 2007 East Energy Corp. terminated its earn-in agreement on the Gobi Gold prospect. The Company is currently considering its options for the mineral licenses in this prospect.

Other Properties

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

As of July 2007, the Company held 1 license in Dornod Aimag covering a total area of approximately 17,000 ha. In June 2007, a Letter of Intent was signed with Batu Mining Mongolia LLC to explore the license. Under the proposed agreement Batu can earn up to 80% of the joint venture by spending a minimum of $500,000 within three years. No further work is planned at this time and costs incurred in 2007 and 2006 relate to regulatory and filing fees.

For the Khuvsgul property, as of July 2007, 10 exploration licenses totaling approximately 67,000 ha were owned by the Company. In June 2007 a program of follow-up stream sediment and soil sampling was carried out over the main target area. Results are expected in the third quarter.

Properties in Bulgaria

The Company terminated its mineral exploration activities in Bulgaria and elected to withdraw from the Bulgarian Joint Venture effective March 2, 2007. This resulted in a loss of $35,000 in the first quarter of which $31,000 related to the write-down of plant and equipment.

Properties in Indonesia

Kaputusan Project

The Company signed a memorandum of understanding with PT Harita Multi Karya Mineral ("HMKM") on January 19, 2006 to form a joint venture to explore the Kaputusan prospect, a General Survey status exploration lease located on Bacan Island, Maluku in Indonesia. In March 2006, the exploration lease was converted to Exploration Status and split into 2 blocks respectively 13,641 ha and 13,770 ha. In January 2007, another adjacent exploration lease (10,250 ha) was included in the joint venture, bringing the total exploration area to 37,661 ha.

Effective September 7, 2006 a definitive Joint Venture Agreement and Cooperation Agreement was signed with HMKM, pursuant to which, the Company can earn up to an 85% interest in the Kaputusan prospect by spending $300,000 on exploration during the first year of the joint venture. The 85% interest was earned in 2006. A joint venture company, PT ASG Harita Mining Services was incorporated in December 2006. The 15% interest held by HMKM in the joint venture company is free carried to commercial mine production. The Company will be responsible for funding 100% of any project costs through to commercial mine production.

Company geologists visited the Kaputusan porphyry copper-gold deposit on the western side of Bacan Island in January 2005. The Kaputusan deposit was discovered upstream of placer gold deposits during a joint Indonesian-German (BGR) regional program carried out from 1977 to 1979. Subsequent exploration included 5,550 m of trenching and 1,575 m of NQ/BQ drilling in ten holes during 1983 to 1984.

The best drill intercepts recorded are 48 m at 0.37% Copper ('Cu') and 0.65 g/t gold ('Au') (hole 3; 6-54 m) and 153 m at 0.33% Cu and 0.28 g/t Au (hole 7; 51-204 m). The best trench interval is 80 m at 0.50% Cu and 0.39% Au including 44 m at 0.60% Cu and 0.50 g/t Au. However, the Company believes core analyses may underestimate the true grades as overall recovery in the ten holes was only 54% with an average 41% in mineralized intervals. Leaching and secondary enrichment has also occurred.

Camp construction, line cutting and logistical preparation has been established on the Kaputusan porphyry copper-gold project. A first-stage exploration program comprising geological mapping, an IP geophysical survey and trenching began in March 2006.

Detailed geological mapping by the Company has confirmed porphyry copper-gold mineralization is hosted by potassic-altered and magnetite-bearing tonalite porphyry stocks over an area measuring approximately 1,300 m by 500 m (see website). The best mineralization is associated with quartz vein stock works in two zones (North and South Zones) that are separated by an area of alluvial cover.

A total 110 line km of high resolution ground magnetics and 42 line km of dipole-dipole IP have been completed. The results of the IP survey show the North and South zones are surrounded by high PFE (Percent Frequency Effect) anomalies that are interpreted to be pyrite haloes surrounding mineralization. The IP results suggest the North and South zones are continuous beneath the alluvium.

SouthGobi reopened and sampled seventeen of the original BGR trenches. A total of about 1,150 m of the original 5,550 m of trenches were re-sampled. SouthGobi channel samples were two or three m in length while BGR channels were five or six m in length. In all cases the SouthGobi results compare well with the BGR results and provide confidence in the remaining BGR analytical results as being similarly accurate. A complete list of the results can be found on the Company website.

A follow up trenching program comprising 2,958 m in 15 trenches was completed in November 2006. These trenches expanded the initial program in the North and South Zones and resulted in the discovery of the new West Zone of porphyry style copper-gold mineralization.

In the North Zone, a 152 m section of mineralization that is open to the east and west, grades 0.20% copper and 0.18 g/t gold in potassic and propylitically altered tonalite host rock. This section includes a 60 m interval grading 0.31% copper and 0.36 g/t gold. In the South Zone, a 34-m section grades 0.14% copper and 0.15 g/t gold. The host rock is also a potassic altered tonalite. These results increase the north–south extent of copper-gold mineralization at Kaputusan to 1.8 km. The mineralization is still open to the north and south.

A 3,000 m diamond drilling program to test the North, South and West Zones began in February 2007. Six diamond drill holes totaling 1,000 m were completed by the end of May 2007. The drill proved insufficiently powerful to drill deeper than 200 m and was demobilized in June 2007. Interpretation of the results of the six holes is in progress. The drilling program is expected to resume in the third quarter using a new contractor and a more powerful Longyear 44 drill. Also, the company is negotiating a new equipment services and logistical support contract with a logging company active in the exploration permit. In July 2007 the company applied to the Department of Forestry for a new permit to conduct exploration within a production forest.

SELECTED QUARTERLY DATA

($ in thousands, except per share information)

	2007		2006				2005	
QUARTER ENDED	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Exploration expenses	$17,796	$ 867	$ 1,182	$ 1,865	$ 2,580	$ 546	$ 1,705	$ 1,457
Net loss	21,252	1,650	2,042	2,689	3,634	997	2,174	1,724
Net loss per share	(0.57)	(0.10)	(0.11)	(0.16)	(0.23)	(0.06)	(0.15)	(0.11)

Certain figures, the majority of which are related to stock based compensation expense, presented for comparative purposes for the period ended June 30, 2006 have been reclassified to conform to the presentation adopted for the current year.

The changes in comparative results of operations on a quarter over quarter basis through to and including March 31 2007 are due primarily to significant fluctuations in three areas: exploration expenses, stock-based compensation charges, and foreign exchange gains and losses. For the quarter ended June 30 2007, the significant fluctuation is due primarily to the addition of the interim coal expenditures and higher stock-based compensation charges.

Exploration expenses will vary from quarter to quarter depending on the number of projects and the related seasonality of the exploration programs. Most of the exploration expenditures recorded for seven quarters ended March 31 2007 were incurred on the metals projects in Mongolia, Bulgaria and Indonesia. The majority of the expenses for the quarter ended June 30, 2007 relate to the interim coal expenditures.

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

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

RESULTS OF OPERATIONS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	**2007**	2006
EXPENSES				
Depreciation	**$ 5,442**	$ 5,159	**$ 11,350**	$ 9,268
Exploration	**17,795,842**	2,733,661	**18,662,858**	3,280,120
Legal	**50,273**	12,661	**63,671**	32,484
Office and administration	**214,299**	181,402	**389,470**	320,013
Professional fees	**53,128**	23,337	**85,405**	31,928
Salaries and benefits	**2,550,769**	524,032	**2,889,426**	736,012
Travel	**71,587**	53,692	**133,524**	113,690
	20,741,340	3,533,944	**22,235,704**	4,523,515
OTHER EXPENSES/(INCOME)				
Coal transaction costs	**26,547**	104,000	**26,547**	104,000
Interest income	**(9,874)**	(16,328)	**(16,634)**	(31,285)
Interest expense	**233,074**	22,179	**354,839**	22,179
Interest accretion on line of credit facility	**297,534**	-	**297,534**	-
Foreign exchange (gain) loss	**(36,551)**	(9,332)	**(31,208)**	12,881
Write off of interest in joint venture	**-**	-	**35,009**	-
	510,730	100,519	**666,087**	107,775
NET LOSS	**$ 21,252,070**	3,634,463	**$ 22,901,791**	4,631,290

Three Months Ended June 30, 2007 and 2006

The Company incurred a net loss for the three months ended June 30, 2007 of $21.3 million as compared to a net loss of $3.6 million for the same period in 2006. This change is due primarily to higher exploration and stock based compensation expense for the three months ended June 30, 2007.

Exploration expenses for the three months ended June 30, 2007 are significantly higher due to the addition of the interim coal expenditures related to Mongolia. These are expenses, which were incurred by Ivanhoe after April 25, 2006, for the continuing exploration and development of the coal project. With the completion of the coal transaction, the aggregate amount of the expenses ($13.2 million) incurred by Ivanhoe from April 26, 2006 to May 28, 2007 are treated as advances and added to the outstanding balance under the line of credit facility.

Legal fees have increased for the three months ended June 2007 as compared to the same period in 2006. The majority of these charges were for costs associated with the Company's regulatory affairs including expenses associated with corporate governance, filing, registration, disclosure, the preparation of our annual information form, and joint venture documentation.

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

The Company has allocated stock based compensation expense of $2.4 million (2006 - $153,000) to exploration expense and $2.3 million (2006 – $359,000) to salaries and benefits. The total stock based compensation expense calculated for the three months ended June 30 2007 was $4.7 million as compared to $512,000 in the same period in 2006. The increase reflects additional option grants in the quarter and the related vesting and volatility pattern of the underlying stock options that gave rise to the compensation expense.

Salaries and benefits, excluding stock based compensation costs, increased in the three months ended June 30, 2007 ($259,000) as compared to the three months ended June 30, 2006 ($165,000). Office and administration fees increased in the three months ended June 30, 2007 as compared to the same period in 2006. The increases relate to the development of the exploration projects, added personnel and office and administration support costs. Certain of the Company's administrative staff and office facilities are employed/provided by Global Mining Management ("GMM")(see 'Related Party Transactions' below) whose costs are allocated on an as-used basis. Accordingly, quarterly fluctuations in the costs of administrative and personnel costs can be expected commensurate with increases or decreases in quarterly corporate activity and the level of personnel employed.

Travel costs were higher for the three months ended June 30, 2007 as compared to the same period in 2006. This is due primarily to the increased management activity at the Company's project locations in Mongolia and Indonesia.

Costs to effect the coal transaction are for legal and professional fees. The fees relate to the preparation of the documentation for closing the coal transaction in the current quarter.

Interest income has decreased, which relates directly to the Company's reduced cash position. Interest expense of $233,000 for the three months ended June 30, 2007 relates to the credit facility agreement with Ivanhoe and $298,000 on accretion of the liability component of the credit facility. The line of credit bears interest at an annual rate equal to the three month London Interbank Offered Rate (LIBOR) plus two percent per annum, which is approximately 7.36% at June 30, 2007.

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

Six Months Ended June 30, 2007 and 2006

The Company incurred a net loss for the six months ended June 30, 2007 of $22.9 million as compared to a net loss of $4.6 million for the same period in 2006. Exploration and stock compensation expense was higher for the six month period ended June 30, 2007. Stock option compensation expense increased due to additional option grants in the quarter.

Exploration expenditures for the six months ended June 30, 2007 were $18.7 million as compared to $3.3 million for the same period in the 2006. With the completion of the coal transaction, certain interim coal division expenditures made by Ivanhoe after the agreement in principle was reached but prior to closing were added to the indebtedness outstanding under the line of credit. The total coal expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007, and accepted by SouthGobi, are approximately $13.2 million including VAT.

Salary and benefits expense was $2.9 million for the six months ended June 30, 2007 as compared to $736,000 for the six months ended June 30, 2006. Stock based compensation expense allocated to salary and benefits expense was $2.4 for the six months ended June 30, 2007 and $394,000 for the same period in 2006. Salary and benefits expense, excluding stock option compensation costs, were $488,000 for the six months ended June 30, 2007 and $342,000 for the six months ended June 30 2006. The majority of the increase in salary and benefits expense relates to added personnel. The stock compensation expense reflects additional options grants, particularly in the June quarter, and the related vesting and volatility pattern of the underlying stock options that gave rise to the compensation expense.

Office and administration costs increased in the period ended 2007 compared to the same period in 2006. The increases relate to the development of the exploration projects and added personnel and related office and administration support costs.

Legal fees increased for the six month period ended June 30, 2007 compared to the same period ended June 30, 2006. The majority of these charges were for costs associated with the Company's regulatory affairs including expenses associated with corporate governance, filing, registration and disclosure. Included in professional fees are costs related to the quarterly reviews of the Company's financial statements, accrued year end audit and recruitment expenses.

Travel costs were $134,000 for the six months ended June 30, 2007 compared to $114,000 for the six months ended June 30, 2006. This is due primarily to the increased management activity at the Company's project locations.

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

Lower interest income during the 2007 period reflects lower average cash balances during this period. Interest expense has increased for the six month period ended June 30, 2007 compared to the same period in 2006. Interest expense has increased with further advances on the line of credit to fund continuing operations, including the accretion on the liability component of the loan. With the completion of the coal transaction, certain interim coal division expenditures made by Ivanhoe were added to the indebtedness outstanding under the line of credit.

A foreign exchange gain of $31,000 was recorded for the six months ended June 30, 2007 as compared to a loss of $13,000 for the six months ended June 30, 2006. These amounts are primarily reflective of the changes in the value of the Canadian dollar versus its U.S. counterpart during these periods and to a lesser extent the effect of the Mongolian Tugrik, and the Indonesian Rupiah.

EXPLORATION COSTS BY DIVISION

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	**2007**	2006
Metals Division	**$ 1,551,381**	$ 2,733,661	**$ 2,418,397**	$ 3,280,120
Coal Division	**16,244,461**	-	**16,244,461**	-
Total Exploration	**$ 17,795,842**	$ 2,733,661	**$ 18,662,858**	$ 3,280,120

Metals Division

The Company continues to explore on the Indonesian properties and further drilling is planned for the Mongolian properties in 2007. During the three month period ended June 30, 2007 exploration expenses were $1.6 million as compared to exploration expenses of $2.7 million in the same period in 2006. For the six months ended June 30, 2007, $2.4 million was spent on the Company's metal division exploration activities as compared to $3.3 million for the six months ended June 30, 2006. These expenditures relate to the metals division projects in Mongolia, Bulgaria and Indonesia.

Exploration expenditures in Mongolia were reduced from $2.5 million for the six months ended June 30, 2006 to $935,000 for the same period in 2007 while the Company continues its evaluation of the potential projects and further drilling activity in 2007. Of the $935,000, $470,000 was spent on license fees and $218,000 on salaries for the six months ended June 30, 2007. The two main projects in Mongolia for 2006 were Khongor and Naran Bulag.

For the six months ended June 30, 2007 Bulgarian expenditures decreased from $447,000 in 2006 to $96,000 in 2007 due to the withdrawal from the Bulgarian joint venture effective March 2, 2007.

Exploration activity increased in Indonesia for the six months ended June 30, 2007, with the exploration expenditures increasing to $1.4 million in 2007 from $363,000 in 2006 due to continued work on the Kaputusan prospect.

Coal Division

With the completion of the coal transaction, certain interim coal division expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007, and accepted by SouthGobi, were added to the outstanding balance under the line of credit facility with Ivanhoe. The total interim coal expenditures of $13.2 million that were added to the indebtedness outstanding under the line of credit include approximately $13.0 million of expenses and $200,000 of plant and equipment.

The total coal exploration expenditures for the three and six months ended June 30, 2007 was $16.2 million. Included in the total coal expenditures of $16.2 million are interim coal expenditures of $13.0 million, $1.0 million of coal exploration expenditures related to June 2007, and $2.2 million of allocated stock based compensation expense.

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

Drilling to date on Ovoot Tolgoi holdings from 2004 to 2006 includes a total of 502 exploration holes completed and 87,978 m drilled.

Of the $13.0 million of interim coal expenditures for the period from April 25, 2006 to May 28, 2007, reviewed and approved by SouthGobi and Ivanhoe, $3.0 million relates to geological consulting; $4.2 to drilling, assaying and camp costs, $2.5 million to license fees; $1.4 million to salaries and benefits; and $1.9 million to office, legal, and travel.

A new drilling program began on the Ovoot Tolgoi Project in June 2007. Mobilization of drills, crews and camps was started in May 2007. For the remainder of the year the Company has budgeted approximately $9.5 million for a combination of programs on Ovoot Tolgoi, Tavan Tolgoi Extension and the Company's other coal exploration properties.

After the coal transaction was completed, SouthGobi has spent approximately $1.0 million on coal exploration activities in June 2007. Of the $1.0 million of coal exploration costs; $375,000 relates to geological consulting; $295,000 to drilling, assaying and camp costs, $80,000 to license fees; $188,000 to salaries and benefits; and $92,000 to office, legal, and travel.

LIQUIDITY AND CAPITAL RESOURCES

		June 30, 2007		December 31, 2006
ASSETS				
CURRENT				
Cash	**$**	**1,443,481**	$	965,494
Accounts receivable		**206,592**		215,783
Prepaid expenses		**388,551**		235,013
		2,038,624		1,416,290
MINERAL PROPERTIES		**403,360**		403,360
PLANT AND EQUIPMENT		**584,226**		232,585
	$	**3,026,210**	$	2,052,235
LIABILITIES				
CURRENT				
Accounts payable and accrued liabilities	**$**	**1,275,050**	$	451,540
AMOUNT DUE UNDER LINE OF CREDIT FACILITY		**20,832,911**		5,835,501
		22,107,961		6,287,041
SHAREHOLDERS' EQUITY (DEFICIENCY)				
Share capital				
Common shares		**18,363,135**		16,518,231
Preferred shares		**75,419**		-
Equity portion of line of credit facility		**1,867,359**		-
Contributed surplus		**6,127,295**		1,860,131
Deficit		**(45,514,959)**		(22,613,168)
		(19,081,751)		(4,234,806)
	$	**3,026,210**	$	2,052,235

At June 30, 2007, the Company had cash resources of $1.4 million compared to $965,000 as at December 31, 2006. During the quarter, $1 million was drawn on the line of credit facility and $961,000 of stock options were exercised. These amounts provided financing for the Company’s operations during the three months ended June 30, 2007.

Accounts receivable includes funds due from government taxation authorities (GST or VAT). Prepaid balances have increased from $235,000 at December 31, 2006 to $389,000 at June 30, 2007. The increase relates to the timing of prepayments for Mongolian exploration licenses and additional lease deposits. Accounts payable have increased with the additional coal exploration activity and costs related to the coal transaction.

On April 25, 2006, in conjunction with the coal transaction, the Company entered into a line of credit facility with Ivanhoe whereby Ivanhoe agreed to make available to the Company an unsecured line of credit of up to $10 million. Under certain circumstances Ivanhoe may increase the amount to a maximum of $15 million. On June 6, 2007, Ivanhoe and SouthGobi mutually agreed to extend the line of credit to $15 million.

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

Coal expenditures incurred by Ivanhoe during the period from April 25, 2006 to May 28, 2007 are deemed advances under the line of credit facility. All amounts outstanding under the line of credit bear interest at three month LIBOR plus two percent. All advances pursuant to the line of credit will mature and be repayable in full on April 25, 2008. Ivanhoe has the ability to accelerate the Company's obligation to repay all advances pursuant to the line of credit and all accrued and unpaid interest thereon in the event of a default by the Company. The Company has the right to prepay the outstanding advances and accrued and unpaid interest, in whole or in part, at any time without penalty.

On August 1, 2007 and subsequent to the quarter end, Ivanhoe and SouthGobi agreed to extend the maturity date of the line of credit from April 25, 2008 to June 30, 2009. All other terms and conditions of the line of credit facility remain in full force and effect.

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

The Company is a development stage entity that has not achieved production on any of its mineral properties and, accordingly, does not have any revenues. The Company's ability to continue as a going concern, with a capital deficiency, is dependant upon the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing and permitting to develop properties and to establish future profitable production. The Company does not have sufficient cash to fund the exploration and development of its mineral properties to commercial production and, therefore, will require additional funding, which if not raised may result in the curtailment of operations. Management is of the opinion that additional financing is available to continue its planned activities in the normal course. At present, the Company relies on Ivanhoe for additional financing. There can, however, be no assurance the Company will be able to raise sufficient funds in the future.

RELATED PARTY TRANSACTIONS

The coal transaction between Ivanhoe and the Company is a related party transaction. (See 'Recent Developments').

The Company is a party to a shareholders' cost-sharing agreement with certain other public and private companies, including Ivanhoe (the "Other Companies") pursuant to which the Company and the Other Companies are equal shareholders in GMM and, through GMM, share office space, furnishings and equipment and communications facilities (on a cost recovery basis) and the employment, on a part-time basis, of various administrative, office and management personnel in Vancouver, British Columbia. Costs of the shared office facilities and the shared part-time employees are recovered from the Company proportionate to the time spent by the shared part-time employees on matters pertaining to the Company. Certain of the directors and officers of the Company are also officers and directors of GMM. The Company has utilized the services of the GMM staff and office since September 1, 2003 and has incurred costs of $1 million and $488,000 for the six months ended June 30, 2007 and 2006, respectively.

All amounts outstanding under the line of credit facility with Ivanhoe bear interest at three month LIBOR plus two percent. During the six months ended June 30, 2007, $355,000 of interest has been accrued on the line of credit facility with Ivanhoe.

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

OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value. As at August 15, 2007: 74,577,706 common shares were issued and outstanding; 25,576,383 preferred shares were issued and outstanding and 5,303,960 share purchase options were outstanding. On a fully diluted basis, 105,458,049 common and preferred shares were outstanding.

INTERNAL CONTROL OVER FINANCIAL REPORTING

There has been no change in the Company's internal control over financial reporting that occurred during the second quarter of 2007 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

RISK FACTORS

The business of mineral exploration and extraction involves a high degree of risk. Few properties that are explored are ultimately developed into production. At present, none of the Company's properties has a known body of commercial ore. Material risks and uncertainties affecting the

Company, their potential impact, and the Company’s principal risk management strategies, include the following:

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

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

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

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

Limited Markets - The coal industry is characterized by a relatively small number of customers worldwide. If and when the Company commences commercial production of coal, the loss of, or a significant reduction in, purchases by any of the Company's potential customers could adversely affect the Company's future revenue.

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

Infrastructure - The Ovoot Tolgoi Project and the Tsagaan Tolgoi Project are both located in extremely remote areas which lack basic infrastructure, including sources of power, water, housing, food and transport. The Company will need to hire personnel, establish facilities and otherwise establish its own exploration infrastructure before it can commence operations on its own. The Company will need to engage expatriate workers to come to Mongolia as there is a shortage of locally trained personnel. The Company will also need to establish the facilities and procure the materials necessary to support operations. The inability to make suitable arrangements may delay the conduct of the Company’s exploration and development program and prevent the Company from meeting its stated business objectives. The remoteness of these properties will also affect the potential viability of mining operations, as the Company will also need to establish substantially greater sources of power, water, physical plant and transport infrastructure in the area before it could conduct mining. The availability of such sources may adversely affect mining feasibility and will, in any event, require the Company to arrange significant financing, locate adequate supplies and obtain necessary approvals from national, provincial and regional governments, none of which can be assured.

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

Mining Risks - the Company's planned operations will be subject to all the hazards and risks normally encountered in the exploration, development and production of coal, including, without limitation, unusual and unexpected geologic formations, seismic activity, pit-wall failures, cave-ins, flooding and other conditions involved in the drilling and removal of material, any of which could result in damage to, or destruction of, mines and other producing facilities, damage to life or property, environmental damage and legal liability. Mining operations are subject to various hazards, including, without limitation, equipment failure, which may result in environmental pollution and legal liability. There are also physical risks to the exploration personnel working in the rugged terrain of Mongolia, often in poor climatic conditions. The parameters used in estimating mining and processing efficiency are based on testing and experience with previous operations. While the parameters used have a reasonable basis, various unforeseen conditions can occur that may materially affect the estimates.

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

Mining Experience and Personnel - The Company has no experience in placing mineral properties into production, and its ability to do so will be dependent upon using the services of appropriately experienced personnel or entering into agreements with other major resource companies that can provide such expertise. There can be no assurance that the Company will have available to it the necessary expertise if it places mineral deposit properties into production. Recruiting and retaining qualified personnel is critical to the Company's success. The number of persons skilled in the acquisition, exploration and development of mining properties is limited and competition within the mining industry for such persons is intense. The Company believes that it has been successful in recruiting excellent personnel to meet its corporate objectives but, as the Company's business activity grows, it will require additional key financial, administrative, mining, marketing and public relations personnel as well as additional staff on the operations side. Although the Company believes that it will be successful in attracting and retaining qualified personnel, there can be no assurance of such success.

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

Legal Risks - The Mongolian legal system shares several of the qualitative characteristics typically found in a developing country and a burgeoning democracy insofar as many of its laws, particularly with respect to matters of taxation, tend to be basic and have not evolved to a point where they contemplate or recognize more sophisticated transactions and business structures involving relatively well-established Western legal concepts such as joint ventures and beneficial, as opposed to legal, ownership of assets. Likewise, the Mongolian government bureaucrats and civil servants who administer these laws often lack any significant degree of experience in assessing these types of transactions such that a transaction or business structure that would likely be regarded under a Western legal system as appropriate and relatively straightforward is just as likely to be regarded by Mongolian government bureaucrats and civil servants as novel and without precedent and therefore outside the scope of Mongolian law. As a result, structuring business arrangements with third parties and engaging in tax planning within the limited ambit of settled Mongolian law carries significant risks, particularly when business objectives and practicalities dictate the use of arrangements and structures that, while not necessarily contrary to settled Mongolian law, are sufficiently novel within a Mongolian legal context, that it is impossible to determine with any degree of certainty that they will not be impugned after the fact by Mongolian government bureaucrats and civil servants who, because of their unfamiliarity with the arrangement or structure, may be inclined to "make" the law address the particular arrangement or structure in a manner that would be regarded, in a Western legal context, as arbitrary and unfair and that would be materially adverse to the parties to the arrangement or structure.

Political Risks - The Company's ability to conduct operations or exploration and development activities is subject to changes in legislation or government regulations or shifts in political attitudes beyond the Company's control.

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

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

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

Licenses and Permits - The Company's exploration licenses are subject to periodic renewal. While the Company anticipates that renewals will be given as and when sought, there is no assurance that such renewals will be given as a matter of course and there is no assurance that new conditions will not be imposed in connection therewith. The Company's business objectives may also be impeded by the costs of holding its exploration licenses. Fees in Mongolia for exploration licenses increase substantially upon renewal. The Company will need to continually assess the potential of each exploration license, particularly when it must be renewed, to determine if the costs of maintaining the exploration license are justified by the exploration results to date, and will likely need to let some of its exploration licenses lapse. A moratorium on transfers of exploration licenses was recently lifted and there is a risk that it could be re-imposed. The Company will require mining licenses in order to conduct mining operations at the Ovoot Tolgoi Project and the Tsagaan Tolgoi Project and there can be no assurance that such licenses will be obtained on terms favourable to the Company or at all.

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

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

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

Government approvals and permits are required in connection with the Company's operations. To the extent such approvals are required and not obtained; the Company may be delayed or prohibited from proceeding with planned exploration or development of its mineral properties.

Failure to comply with applicable laws, regulations and permitting requirements may result in enforcement actions there under, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in mining operations may be required to compensate those suffering loss or damage by reason of the mining activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

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

Additional Funding Requirements - The further development and exploration of the Ovoot Tolgoi Project, the Tsagaan Tolgoi Project and the various other mineral properties in which it holds interests depends upon the Company's ability to obtain financing through capital markets, or other means. To date, the Company has relied upon Ivanhoe to provide funding by way of a loan facility. Among the funding alternatives being considered is additional funding by Ivanhoe, although there is no assurance that the Company will be successful in obtaining financing as and when needed. Unfavorable market conditions may make it difficult or impossible for the Company to obtain debt financing or equity financing on acceptable terms or at all. The Company operates in a region of the world that is prone to economic and political upheaval and certain mineral properties held by the Company are located in politically and economically unstable countries, which may make it more difficult for the Company to obtain debt financing from project lenders. The Company must arrange additional financing for development of the Ovoot Tolgoi Project and the Tsagaan Tolgoi Project. Failure to obtain additional financing on a timely basis may cause the Company to postpone its development plans, forfeit rights in some or all of its properties or joint ventures or reduce or terminate some or all of its operations.

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

Concentration of Ownership - Ivanhoe holds approximately 87% of the Company's issued and outstanding common shares. Ivanhoe also holds preferred shares that are convertible into common shares but only if, following such conversion, the total number of common shares held by Ivanhoe and other insiders of the Company or their associates and affiliates does not exceed 90% of all common shares then issued and outstanding. Ivanhoe also has the right to convert all amounts owing pursuant to the terms of the Funding Agreement into common shares without regard to the 90% limit applicable to the conversion of the preferred shares. Therefore, a conversion by Ivanhoe of amounts outstanding under the Funding Agreement could increase Ivanhoe's ownership to more than 90% of the total number of common shares then issued and outstanding, which would put the Company in default of TSX Venture Exchange listing maintenance requirements respecting public distribution.

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

OUTLOOK

The purchase of the Ivanhoe coal division included the worldwide coal exploration rights, development activities and related coal interests. This included the entire interest in the Ovoot Tolgoi (formerly Nariin Sukhait), Tsagaan Tolgoi and Tavan Tolgoi Extension coal development projects and related licenses.

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

SouthGobi has commenced a major exploration program on six separate coal projects in the Gobi area of southern Mongolia. The results of the program, along with additional resource definition will be provided throughout the remainder of 2007. The Company will also continue its exploration efforts on identification and drilling of prospective copper-gold targets on its exploration licenses in Mongolia and Indonesia, and identification and acquisition of new mineral property exploration opportunities.

Norwest is assisting the Company in planning the mine development at Ovoot Tolgoi which is the Company's most advanced project. In the 2006 mine scoping studies the mine plan was expected to support an operation capable of producing four million tonnes of saleable coal per year. Ultimate capacity was planned to be reached in five years. This plan is being updated in a pre-feasibility mining study using the information from the 2006 exploration program and is expected to be completed in the fall of 2007. In April 2007 Ivanhoe initiated, on SouthGobi's behalf, the formal process for obtaining a Mining License for development of a surface open-pit coal mine at Ovoot Tolgoi by filing a Detailed Environmental Impact Assessment (DEIA) and a Geological Resource Report for the Ovoot Tolgoi Project. In May 2007, the Mongolian Government's Ministry of Environment approved the DEIA for the Ovoot Tolgoi Project. Receipt of Government approval of the Geological Resource Report was obtained on August 6, 2007, at which point SouthGobi filed the application for a Mining License to commence development and operation. The Minerals Law of Mongolia 2006 specifies that upon receiving and registering the license application the government shall make a decision within 20 business days to grant a Mining License.

Although the Company has been successful in the past in obtaining financing from Ivanhoe or through an outside independent party, there is no assurance that it will be able to obtain adequate financing in the future or that such financing will be on terms advantageous to the Company.

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

The Company plans to supply a wide range of coal products and electricity to markets in Mongolia and China and is studying the environmental benefits offered by emerging clean coal technology. The Company also is evaluating the future potential of Coal-to-Liquids (CTL) technology to convert coal into low-sulphur diesel, gasoline and naphtha.

August 15, 2007