SouthGobi
Energy Resources

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

September 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, and elsewhere. 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, which was a related party transaction, at a special meeting of the shareholders of the Company held on August 8, 2006. The closing of the coal transaction was subject to a number of conditions precedent that remained unsatisfied following approval by the Company's minority shareholders.

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

As consideration for the Ivanhoe coal division the Company issued 57,000,000 common shares and 25,576,383 preferred shares. The common shares issued to Ivanhoe, when aggregated with Ivanhoe's existing holding of common shares, represent approximately 86% 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 increase the line of credit to $15 million.

Pursuant to the agreements between the Company and Ivanhoe related to 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. These are in addition to the credit facility described above. 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 and interest the total amount payable to Ivanhoe as at September 30, 2007 is approximately $27.4 million.

The line of credit is governed by the terms of an interim funding agreement dated April 25, 2006 (the "First Funding Agreement"). The outstanding loan is, under the terms of the First Funding Agreement, convertible into common shares at the election of either the Company or Ivanhoe. Until May 29, 2008, the Company 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, Ivanhoe and SouthGobi agreed to amend the First Funding Agreement to extend the maturity date of the line of credit from April 25, 2008 to June 30, 2009. All other terms and conditions of the Funding Agreement remain in full force and effect.

All amounts advanced or deemed to be advanced under the First Funding Agreement 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 7.23% at September 30, 2007.

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

All amounts advanced under the Second Funding Agreement bear interest at an annual rate equal to the three month London Interbank Offered Rate ("LIBOR") plus 3.3% per cent per annum and mature on June 30, 2009.

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.

On September 28, 2007 the Company announced that David Owens had resigned his position as Executive Vice President, Metals Group to pursue corporate opportunities in the Asian metal mining industry. David developed a strong mineral exploration and development team at SouthGobi, throughout his tenure with the Company. Richard Gosse, Vice President Exploration, who joined SouthGobi in 2004, has taken over daily operational initiatives for the Metals Division.

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.

MINERAL PROPERTIES

Qualified Persons

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

Mongolia Exploration Licenses-Overview

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

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

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 2.1 million ha are available for coal exploration.

As of October 31, 2007, the Company held 54 licenses.

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 Company's Annual Information Form dated August 27, 2007 and available at www.sedar.com.

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

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

The Company expects to receive its Permit to Mine by the end of 2007. In the interim, all information is being gathered to apply for land use permits for the mining area and its associated infrastructure, such as roads, man camp and shop complex. Permanent site facilities have been designed and construction is scheduled to start in the second quarter of 2008 once weather permits. The exploration camp has been winterized and will service the project until the permanent facilities are ready.

The Company has commissioned Norwest Corporation of Salt Lake City, Utah (Norwest) to complete an updated mining study on Ovoot Tolgoi and it is anticipated that it will be completed in the fourth quarter 2007. Work continued on the study throughout the third quarter and this study is expected to refine and enhance previous mining plans and studies carried out to date.

A Letter of Intent to purchase approximately $16 million of mining equipment was issued during the quarter to a local mining equipment supplier in Ulaanbaatar. Finalization of the equipment order was completed in November 2007, with delivery scheduled for the first quarter 2008.

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 mineralization 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.

The assessment of underground mining alternatives continued during the third quarter. An underground coal mining consultant was engaged to review existing exploration data and to prepare a scoping level study for future underground mining. Drilling is being carried out under the 2007 exploration program. The Company, with the assistance of the coal mining consultant has designed an expanded exploration program for 2008 to further delineate deep coal resources and to advance the mine planning for development.

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 sources 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.

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

Tavan Tolgoi Extension Project

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

A field reconnaissance program was carried out on the Tavan Tolgoi Extension licenses in 2006. The exploration area has been surveyed for copper and gold exploration using BHP Falcon aerial geophysics. The Company has obtained the aeromagnetic and aero gravity survey data and is using the results of the upcoming analysis of the Falcon data to help delineate potential coal targets. A significant exploration program was started in the third 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. The 2007 exploration drilling is expected to provide additional structure and quality information.

Coal Exploration Programs

SouthGobi has commenced a major exploration program on six separate coal projects in the Gobi area of southern Mongolia. The 2007 exploration program has a budget of approximately $9.5 million, with work in the following areas:

1) Ovoot Tolgoi surface mine infill drilling,
2) Ovoot Tolgoi underground,
3) Ovoot Tolgoi extension,
4) Tavan Tolgoi extension,
5) Tsagaan Tolgoi extension, and
6) Greenfields exploration drilling. The program was designed to target high potential coal bearing formations while meeting the minimum legal exploration expenditure per lease.

Mobilization of drills, crews and camps was started in May 2007.

Initial drilling emphasis was concentrated at Ovoot Tolgoi. This was necessitated by the Company's need for additional in-fill drilling for pit planning purposes, an assessment of the deep coal occurrences for future underground mining development and drilling to assess the extent of the coal bearing formation along strike so that mine shop facilities and waste dump locations can be located in areas where there is no coal potential.

The coal bearing core from the Ovoot Tolgoi Underground project has been shipped to a laboratory in Tianjin, PRC for testing. Results are expected in November 2007. Once lab results are received and analyzed, further coring in the deeper coal formations will be considered in the fourth quarter 2007 to better determine the No.5 seam dip south of the southern border of the MAK / Qinhua (Nariin Sukhait) mining operation.

Further drilling in the Ovoot Tolgoi Extension will focus on gaining a better geological, structural and quality of understanding of the coal mineralization and extension of N field. Significant intersections were encountered and potential exists for expanding the resources along strike and down dip.

The Tsagaan Tolgoi exploration program includes some localized drilling and drilling and trenching on 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 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 October 31, 2007, the Company's Metals Group held 32 exploration licenses for copper and gold exploration in Mongolia covering an aggregate area of approximately 679,000 ha. Twenty-two of these licenses, comprising an area of approximately 606,000 ha, the West Gobi Properties, are located in the west-central portion of the Omnogovi Aimag (province) approximately 510 km southwest of Ulaanbaatar, Mongolia. Three of the remaining licenses are known as the Oyut Ovoo property and are located approximately 270 km southwest of Ulaanbaatar. In addition, one license is held in Dornod Aimag which is located approximately 300 km northeast of Ulaanbaatar, five licenses are held in Khuvsgul Aimag in northern Mongolia and one license is held as part of a joint venture agreement.

The Company regularly targets and prioritizes a number of copper and gold licenses on the basis of potential, age, and cost. As a result of this review, a group of metals related licenses were relinquished during the quarter.

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 about 2 km. About half of this strike length (Khongor North) is located within the West Falcon Gobi Property, a joint-venture property with BHP Minerals Asia Inc. ("BHP"). The balance is located on the Tsakhir license, referred to as Khongor South, which was optioned by the Company from Gallant Minerals Ltd. ("Gallant").

In order to exercise the option to acquire from Gallant 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 number of 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 2008.

BHP West Falcon Gobi Joint Venture

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

Under the terms of the Option Agreement, SouthGobi can continue the exploration of Khongor North at its own expense subject to a back-in right in favour of BHP. This back-in right allows BHP to include Khongor North in the joint venture to be established after BHP has acquired a 50% interest in the West Falcon Gobi Property. In order to exercise the back-in right, BHP must pay SouthGobi an amount equal to twice the Khongor exploration costs incurred by SouthGobi.

The West Falcon Gobi Property includes an area of about 2,218 km^2 where large sedimentary basins 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 that is prospective for porphyry copper-gold deposits.

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

In March 2007 BHP commenced IP surveys for porphyry copper mineralization. This work continued through the field season and has defined numerous targets for drilling. By the end of September 2007 BHP had completed 1831 km^2 of Vector Induced Polarization ("VIP"), 182.4 km of dipole-dipole IP and 11 drill holes totaling 2003.8 m.

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 occurred 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 2008, the Company is considering a 1200 m RC drilling program.

Gobi Gold Prospect

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 October 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 October 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 October 2007, 5 exploration licenses totaling approximately 33,000 ha were owned by the Company. In June 2007 a program of detailed stream sediment and soil sampling narrowed the 40 square km three drainage gold stream sediment anomaly defined in 2005 to a 6 by 2 km northeast trending zone. Several samples of outcropping pyritic carbonate-altered shale with anomalous gold and collected near the zone are considered encouraging and support the idea that the Proterozoic sediments in this region are good hosts for shale-hosted gold mineralization. Additional stream sediment and rock sampling of this target and three other targets were carried out in September with results pending.

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

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. All six holes encountered porphyry copper-gold mineralization however the drill proved insufficiently powerful to drill deeper than 200 m and was demobilized in June 2007.

The drilling program is expected to resume in the fourth quarter of 2007 or the first quarter of 2008 using a new contractor and a more powerful Longyear 44 drill. Also, the company has negotiated a new equipment services and logistical support contract with a logging company active in the area covered by 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.

Kerta Project

The Company entered into a joint venture with PT Suma Heksa Sinergi to explore for epithermal gold on a 9,982 ha exploration lease in west Java. A first pass prospecting and sampling program was carried out and follow-up mapping and soil sampling are planned in the next quarter.

Low level exploration for epithermal gold including mapping and rock and soil sampling will be carried out as soon as permissions are received from the state-owned palm plantation and logging companies that operate within the license area. Three steeply-dipping parallel epithermal veins with high level textures were exposed in 30 trenches during August and September 2007. The veins are sub-parallel, have a cumulative strike length of 230 m and are open and widening to the northwest. Detailed mapping, soil sampling and additional trenching are underway. A ground magnetic survey is planned for November 2007, with further results pending.

SELECTED QUARTERLY DATA

($ in thousands, except per share information)

	2007			2006				2005
QUARTER ENDED	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec
Exploration expenses	$ 5,204	$17,796	$ 867	$ 1,182	$ 1,865	$ 2,580	$ 546	$ 1,705
Net loss	7,840	21,252	1,650	2,042	2,689	3,634	997	2,174
Net loss per share	(0.11)	(0.57)	(0.10)	(0.11)	(0.16)	(0.23)	(0.06)	(0.15)

Certain figures, the majority of which are related to stock based compensation expense, presented for comparative purposes for the period ended September 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 are due primarily to significant fluctuations in the following areas: exploration expenses, stock-based compensation charges, foreign exchange gains and losses and interest expense. 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 six 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, and for the quarter ended September 30, 2007 the majority of the incurred costs relate to the operations of the Mongolia coal division.

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 in the Mongolian Tugrik, the Indonesian Rupiah, and in past quarters prior to 2007, the Bulgarian Lev and the Euro, which will affect the foreign exchange gains or losses recorded in the financial statements.

RESULTS OF OPERATIONS

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	**2007**	2006
EXPENSES				
Depreciation	**$ 15,373**	$ 5,085	**$ 26,724**	$ 14,353
Exploration	**5,204,594**	1,919,984	**23,867,452**	5,200,104
Legal	**91,434**	10,963	**155,106**	43,447
Office and administration	**287,979**	198,349	**677,448**	518,362
Professional fees	**63,620**	10,260	**149,024**	42,188
Salaries and benefits	**883,469**	310,240	**3,772,895**	1,046,252
Travel	**67,876**	56,630	**201,400**	170,320
	6,614,345	2,511,511	**28,850,049**	7,035,026
OTHER EXPENSES/(INCOME)				
Coal transaction costs	**-**	113,781	**26,547**	217,781
Interest income	**(16,246)**	(8,374)	**(32,881)**	(39,659)
Interest expense	**457,099**	63,645	**811,938**	85,824
Interest accretion on line of credit facility	**820,931**	-	**1,118,465**	-
Foreign exchange (gain) loss	**(36,214)**	7,996	**(67,422)**	20,877
Write off of interest in joint venture	**-**	-	**35,009**	-
	1,225,570	177,048	**1,891,656**	284,823
NET LOSS AND COMPREHENSIVE LOSS	**$ 7,839,915**	$2,688,559	**$ 30,741,705**	7,319,849

Three Months Ended September 30, 2007 and 2006

The Company incurred a net loss for the three months ended September 30, 2007 of $7.8 million as compared to a net loss of $2.7 million for the same period in 2006. This change is due primarily to higher exploration, stock based compensation, interest and line of credit interest accretion expense for the three months ended September 30, 2007.

Exploration expenses for the three months ended September 30, 2007 are significantly higher due to the completion of the coal transaction and the related costs incurred by the coal division. In 2006, the Company had operations in Mongolia, which were related to the metals division only.

Legal fees have increased for the three months ended September 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 September 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 year end audit accruals, and costs incurred for internal and external corporate tax planning and documentation.

For the three months ended September 30, 2007 the Company has allocated stock based compensation expense of $418,000 (2006 - $55,000) to exploration expense and $544,000 (2006 – $111,000) to salaries and benefits. Comparatively, 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 reflected additional option grants in the June 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 September 30, 2007 ($339,000) as compared to the three months ended September 30, 2006 ($199,000). Office and administration fees increased in the three months ended September 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 September 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.

Interest income will increase or decrease in a quarter depending on the cash position, draws on the line of credit and related spending in the metals and coal divisions. Interest income has increased, which relates directly to the Company's draws on the line of credit and increased cash position throughout the quarter. Interest expense of $457,000 for the three months ended September 30, 2007 relates to the credit facility agreement with Ivanhoe and $821,000 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 7.23% at September 30, 2007.

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

Nine Months Ended September 30, 2007 and 2006

The Company incurred a net loss for the nine months ended September 30, 2007 of $30.7 million as compared to a net loss of $7.3 million for the same period in 2006. Exploration, stock compensation, interest and line of credit interest accretion expense was higher for the nine month period ended September 30, 2007.

Exploration expenditures for the nine months ended September 30, 2007 were $23.9 million as compared to $5.2 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 $3.8 million for the nine months ended September 30, 2007 as compared to $1.0 million for the nine months ended September 30, 2006. Stock based compensation expense allocated to salary and benefits expense was $2.9 million for the nine months ended September 30, 2007 and $505,000 for the same period in 2006. Salary and benefits expense, excluding stock option compensation costs, were $833,000 for the nine months ended September 30, 2007 and $541,000 for the nine months ended September 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 second 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 nine month period ended September 30, 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 nine month period ended September 30, 2007 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 and disclosure. Included in professional fees are costs related to the quarterly reviews of the Company's financial statements, accrued year end audit, recruitment expenses and corporate tax planning.

Travel costs were $201,000 for the nine months ended September 30, 2007 compared to $170,000 for the nine months ended September 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 nine month period ended September 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 in the quarter ended June 30, 2007.

A foreign exchange gain of $67,000 was recorded for the nine months ended September 30, 2007 as compared to a loss of $21,000 for the nine months ended September 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 September 30,		Nine Months Ended September 30,	
	2007	2006	**2007**	2006
Metals Division	**$ 962,625**	$ 1,919,984	**$ 3,381,022**	$ 5,200,104
Coal Division	**4,241,969**	**-**	**20,486,430**	**-**
Total Exploration	**$ 5,204,594**	$ 1,919,984	**$ 23,867,452**	$ 5,200,104

Metals Division

During the three month period ended September 30, 2007 exploration expenses were $963,000 as compared to exploration expenses of $1.9 million in the same period in 2006. For the nine months ended September 30, 2007, $3.4 million was spent on the Company's metal division exploration activities as compared to $5.2 million for the nine months ended September 30, 2006. These latter expenditures in 2006 relate to the metals division projects in Mongolia, Bulgaria and Indonesia.

Exploration expenditures in Mongolia were reduced from $3.9 million for the nine months ended September 30, 2006 to $1.4 million for the same period in 2007 while the Company continues its evaluation of the potential projects and further drilling activity in 2007. For the nine months ended September 30, 2007 the majority of the expenses incurred in Mongolia were related to ongoing license fees and salaries. Included in the salary expense of $547,000 are $349,000 of allocated stock based compensation expense. The two main projects in Mongolia for 2006 were Khongor and Naran Bulag.

For the nine months ended September 30, 2007 Bulgarian expenditures decreased substantially as compared to the same period in 2006 due to the withdrawal from the Bulgarian joint venture effective March 2, 2007.

Exploration activity increased in Indonesia for the nine months ended September 30, 2007, with the exploration expenditures increasing to $1.8 million in 2007 from $605,000 in 2006 due to continued work on the Kaputusan prospect and some new smaller projects.

Coal Division

The total coal exploration expenditures for the three months ended September 30, 2007 were $4.2 million and for the nine months ended September 30, 2007 coal exploration expenditures were $20.5 million. Included in the total coal expenditures of $20.5 million are interim coal expenditures of $13.0 million, and $2.3 million of allocated stock based compensation expense and approximately $5.2 million of current exploration expenditures.

With the completion of the coal transaction in the second quarter of 2007, certain interim coal division expenditures funded by Ivanhoe from April 25, 2006 to May 28, 2007, 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.

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, $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 from June 2007 the Company 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 and $4.2 million for the three months ended September 30, 2007.

LIQUIDITY AND CAPITAL RESOURCES

	September 30, 2007	December 31, 2006
ASSETS		
CURRENT		
Cash	**$ 516,630**	$ 965,494
Accounts receivable	**404,287**	215,783
Prepaid expenses	**517,664**	235,013
	1,438,581	1,416,290
MINERAL PROPERTIES	**443,360**	403,360
PLANT AND EQUIPMENT	**901,736**	232,585
	$ 2,783,677	$ 2,052,235
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	**$ 1,674,272**	$ 451,540
AMOUNT DUE UNDER LINE OF CREDIT FACILITY	**25,836,880**	5,835,501
	27,511,152	6,287,041
SHAREHOLDERS' EQUITY (DEFICIENCY)		
Share capital		
Common shares	**18,954,778**	16,518,231
Preferred shares	**75,419**	-
Equity portion of line of credit facility	**2,660,696**	-
Contributed surplus	**6,936,505**	1,860,131
Deficit	**(53,354,873)**	(22,613,168)
	(24,727,475)	(4,234,806)
	$ 2,783,677	$ 2,052,235

At September 30, 2007, the Company had cash resources of $517,000 compared to $965,000 as at December 31, 2006. During the quarter, $4.5 million was drawn on the Ivanhoe line of credit facility and $419,000 of stock options was exercised. These amounts provided financing for the Company’s operations during the three months ended September 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 $518,000 at September 30, 2007. The increase relates to the timing of prepayments for Mongolian exploration licenses, and additional lease deposits. With increased activity, the coal division has prepaid expenditures on insurance, design and project costs. Accounts payable have increased with the additional coal exploration activity.

Plant and equipment expenditures increased in the quarter. The increase relates to mining software and equipment for project development, vehicles, and office furniture.

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. 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 First 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 June 30, 2009. 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.

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.

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

All amounts advanced under the Second Funding Agreement bear interest at an annual rate equal to the three month LIBOR plus 3.3% per cent per annum and matures on June 30, 2009.

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 was a related party transaction. (See 'Recent Developments').

The Company is a party to a shareholders' cost-sharing agreement with certain other public and private companies, including Ivanhoe (the "Other Companies") pursuant to which the Company and the Other Companies are equal shareholders in GMM and, through GMM, share office space, furnishings and equipment and communications facilities (on a cost recovery basis) and the employment, on a part-time basis, of various administrative, office and management personnel in Vancouver, British Columbia. Costs of the shared office facilities and the shared part-time employees are recovered from the Company proportionate to the time spent by the shared part-time employees on matters pertaining to the Company. Certain of the directors and officers of the Company are also officers and directors of GMM. The Company has utilized the services of the GMM staff and office since September 1, 2003 and has incurred costs of $1.6 million and $773,000 for the nine months ended September 30, 2007 and 2006, respectively.

All amounts outstanding under the line of credit facility, created pursuant to the First Funding Agreement with Ivanhoe bear interest at three month LIBOR plus two percent. During the nine months ended September 30, 2007, $812,000 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 November 15, 2007: 74,851,657 common shares were issued and outstanding; 25,576,383 preferred shares were issued and outstanding and 5,098,968 share purchase options were outstanding. On a fully diluted basis, 105,527,008 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 third 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.

Material risks and uncertainties affecting SouthGobi, their potential impact, and the Company's principal risk management strategies are substantially unchanged from those disclosed in its Annual Information Return dated August 27, 2007 and available at www.sedar.com.

OUTLOOK

The Company will focus its efforts on expanding and developing the coal assets.

SouthGobi is continuing its exploration program on six separate coal projects in the Gobi area of southern Mongolia. Along with the infill drilling at the Ovoot Tolgoi surface site, the exploration program continues at Ovoot Tolgoi underground, Ovoot Tolgoi extension, Tavan Tolgoi extension, Tsagaan Tolgoi extension and Greenfields sites. 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.

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

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

The Company expects to receive its Permit to Mine by the end of 2007. In the interim, all information is being gathered to apply for land use permits for the mining area and its associated infrastructure, such as roads, man camp and shop complex. Mining equipment has been ordered and permanent site facilities have been designed and construction will start in 2008 once weather permits. The exploration camp has been winterized and will service the project until the permanent facilities are ready.

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 new mining study using the information from the 2006 exploration program and is expected to be completed in late 2007.

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 once the open pit mining permit, production and mine plan processes are finalized. In the longer term, the Company is planning to supply 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.

November 15, 2007