MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
June 30, 2008

(Stated in U.S. Dollars)

SOUTHGOBI ENERGY RESOURCES LTD

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OVERVIEW

SouthGobi Energy Resources Ltd., (which, together with its subsidiaries, is collectively referred to as the “Company” or “SouthGobi”) is an integrated coal and energy development company. Since acquiring significant coal assets in Mongolia in a series of transactions (the “coal transaction”) with Ivanhoe Mines Ltd (“Ivanhoe”), the Company’s strategic focus has been developing and operating coal mining projects, principally in southern Mongolia.

The Company’s common shares trade on the TSX Venture Exchange (“TSX-V”) under the symbol SGQ.

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

Recent Developments

Ovoot Tolgoi Project Development

On September 11, 2007, the Company received official notification from the Government of Mongolia that it had been granted a mining license for its open-pit coal mine at its Ovoot Tolgoi Project. A 30-year Mining License Certificate, dated September 20, 2007 was received on October 1, 2007. In April 2008 the Company received its Permit to Mine for the Ovoot Tolgoi open pit operations.

SouthGobi announced, on November 5, 2007 that it had committed to purchase a fleet of coal-mining equipment for the Ovoot Tolgoi Project. Delivery of the equipment, valued at approximately $16 million, commenced in March 2008. Auxiliary equipment and a temporary maintenance facility were delivered to the mine site in December 2007 to begin pre-stripping activities.

Pre-development of the Ovoot Tolgoi open pit mine began during the first quarter of 2008. Road construction, site clearing, drainage control and topsoil removal, from the planned coal stockpile area, continued throughout the second quarter. The initial workforce for the Ovoot Tolgoi open-pit mine has been selected, along with senior mine management staff.

During the current quarter waste removal continued and coal was stockpiled for scheduled initial shipments in the third quarter of 2008. The mancamp and permanent shop facility plans were approved and construction detail layouts have commenced.

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

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

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

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

New Project

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

Financing Activities

On January 24, 2008 the Company announced the closing of an equity private placement of 10 million common shares at C$8.00 per share and a second equity private placement of 3.5 million common shares at C$9.00 per share to institutional investors, for total gross proceeds of C$111,500,000 ($108,372,995).

Concurrent with the closing of these equity private placements, Ivanhoe converted certain preferred shares and convertible debt into common shares of the Company. Subsequently, the Company repaid all non-convertible indebtedness owing to Ivanhoe.

The preferred shares were issued to Ivanhoe pursuant to the coal transaction. Each preferred share issued to Ivanhoe was convertible into one (1) common share but only if, upon any such conversion, the total number of common shares held by Ivanhoe and all other insiders of the Company or any of their respective associates or affiliates did not exceed 90% of the total number of common shares then issued and outstanding.

Ivanhoe currently owns 104,796,155 common shares representing approximately 79% of the issued and outstanding common shares of SouthGobi.

Under the terms of a funding agreement dated April 25, 2006 (the "First Funding Agreement"), the loans outstanding there under were convertible into common shares at the election of either the Company or Ivanhoe. Until May 29, 2008, the Company had the right to require Ivanhoe to convert the outstanding loans into common shares at a conversion price of C$2.09 per share. Until August 29, 2008, Ivanhoe had the right to convert the outstanding loans into common shares at a conversion price of C$2.35 per share. In connection with the equity private placements announced in January, 2008 the Company elected the conversion of the outstanding loans under the terms of the First Funding Agreement into common shares, at C$2.09 per common share.

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

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

The Company subsequently entered into a subscription agreement with the Mongolian equipment distributor for a private placement of 2 million shares at C$12.45 per share representing an aggregate offering amount of C$24,900,000($24,785,076). The non-brokered private placement closed on May 30, 2008.

It is expected that the bulk of the proceeds of these equity private placements will be used to further develop the Ovoot Tolgoi open-pit and underground projects, along with other development projects, exploration activities and for general corporate and administrative purposes.

FORWARD LOOKING STATEMENTS

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

CRITICAL ACCOUNTING ESTIMATES

A detailed summary of all of the Company's significant accounting policies is included in Note 2 to the annual Consolidated Financial Statements for the year ended December 31, 2007.

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

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

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

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

The Company has adopted the guidance of CICA Emerging Issues Committee EIC-160, Stripping Costs Incurred in the Production Phase of a Mining Operation. The guidance was effective for years commencing on or after July 1, 2006. The abstract requires the cost of the stripping activities during the production phase of the mine to be accounted for according to the benefit received. Generally, such costs are expensed as variable production costs; however, the costs are capitalized if they can be shown to represent a betterment to the mineral property. A betterment occurs when the stripping activity provides access to sources of reserves that will be produced in future periods that would not have otherwise been accessible in absence of the stripping activity. Any capitalized stripping costs are described as investing activities in the cash flow statement and are depleted on a unit-of-production basis over the life of the reserves that directly benefit from the specific stripping activity.

Effective April 2, 2008, on commencement of mining operations, the Company has capitalized its stripping costs as at June 30, 2008.

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

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

CHANGE IN ACCOUNTING POLICIES

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

a) Section 3862 – Financial Instruments – Disclosures, which replaces Section 3861 and provides expanded disclosure requirements that provide additional detail by financial asset and liability categories.

b) Section 3863 – Financial Instruments – Presentation, to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows.

c) Section 3031 – Inventories, which establishes standards for the measurement and disclosure of inventories. It provides the Canadian equivalent to International Accounting Standard IAS 2 – Inventories. The company's current practice for valuing inventory is substantially in accordance with the new standard.

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

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

d) Section 1535 – Capital Disclosures, which establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard, the Company is required to disclose the following, based on the information provided internally to the Company's key management personnel:

   - qualitative information about its objectives, policies and processes for managing capital;
   - summary quantitative data about what it manages as capital;
   - whether during the period it complied with any externally imposed capital requirement to which it is subject; and
   - when the Company has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

e) Section 1400 – General Standards of Financial Statement Presentation, to include requirements for management to assess and disclose an entity's ability to continue as a going concern.

MINERAL PROPERTIES

Qualified Persons

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

Mongolia Exploration Licenses-Overview

The term for an exploration license in Mongolia is 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. A mining license is granted for a term of 30 years with rights to two 20 year extensions.

An exploration license holder is required to undertake reconnaissance, exploration and related work at a per ha minimum of $0.50 for each of the second and third years of the term of the exploration license; $1.00 for each of the fourth to sixth years and $1.50 for each of the seventh to ninth years. The Company is targeting its 2008 exploration program to meet the minimum expenditures.

Unless stated otherwise the Company has a 100% interest in the coal and metals projects.

Coal Group Profile

Mongolia Exploration Licenses

In May 2007 the coal transaction completed, pursuant to which the Company acquired Ivanhoe’s coal division, included Ivanhoe’s entire interest in the Ovoot Tolgoi (formerly Nariin Sukhait) coal development project, the Tsagaan Tolgoi coal exploration project and various coal exploration projects in Mongolia. To complete the transaction, 35 coal exploration licenses held by Ivanhoe, along with other assets and personnel, were transferred to the Company. The Company already owned a further 19 exploration licenses with coal potential, and with the additional 35 licenses, a total of 54 licenses covering an area of approximately 2.1 million ha were then available for coal exploration.

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

As at August 7, 2008 the Company held 42 licenses, covering an area of approximately 1.8 million ha.

Properties in Mongolia

Ovoot Tolgoi Project (formerly Nariin Sukhait)

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

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

Ivanhoe first initiated coal exploration in the Ovoot Tolgoi area in October 2004 and extensive exploration programs were also carried out in 2005, 2006 and 2007. The Company's 2008 exploration program is concentrating on drilling in the West Field. The exploration program continues to expand the extent of the known mineralization in both the underground and surface coal deposits as well as increase the knowledge level of the quality and structure of both deposits.

Resources at the Ovoot Tolgoi property are found in two different areas, referred to as the South-East and the West Fields. Previously estimated resources for these areas, categorized in accordance with NI 43-101, were approximately 105 million tonnes of measured resources, 45 million tonnes of indicated resources and an additional 29 million tonnes of inferred resources, with a coal rank of volatile B to A bituminous based on the ASTM D388 standards. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are available in the Technical Report entitled "Ovoot Tolgoi Property – Omnogovi Aimag, Mongolia" dated March 27, 2008 and available at www.sedar.com.

In July 2008, the Company announced a significantly higher estimate of resources. Ovoot Tolgoi's West Field is now estimated to contain measured coal resources of approximately 79.6 million tonnes (55.1 million tonnes as at December 31, 2006), indicated coal resources of approximately 113.6 million tonnes (28.7 million tonnes as at December 31, 2006) and inferred resources of approximately 138.8 million tonnes (22.6 million tonnes as at December 31, 2006). Together with the previously identified resources in the South-East field, the estimated resources for these areas are approximately, 129.3 million tonnes of measured resources, 129.6 million tonnes of indicated resources and an additional 145.3 million tonnes of inferred resources. The resource estimates incorporate exploration data up to December 2007 for the West Field surface area down to a depth of 250 m. A technical report supporting the new coal resource estimate is in preparation and is scheduled to be filed in September 2008. A similar exploration and development program will be applied to the South-East Field surface and underground areas at Ovoot Tolgoi in the 2009 exploration program.

In April 2007, Ivanhoe initiated the formal process for obtaining a Mining License for development of a surface open-pit coal mine at Ovoot Tolgoi. As required by the Minerals Law of Mongolia, the Company filed a Detailed Environmental Impact Assessment (DEIA) and a Geological Resource

Report for the Ovoot Tolgoi property. In May 2007, the DEIA for the Ovoot Tolgoi coal project was approved by the Mongolian Government's Ministry of Environment. On August 6, 2007 the government approved the Geological Resource Report. The 30 year Mining License dated September 20, 2007, was received on October 1, 2007.

As a final step, and in order to commence mining operations at Ovoot Tolgoi, SouthGobi obtained a Permit to Mine on March 31, 2008 with an effective date of April 2, 2008. In order to obtain the Permit to Mine, the Company submitted for review by governmental authorities in Mongolia a Technical and Economical Report (comparable to a scoping level study) and a first year mine plan. Initial pre-development work was started in January with stockpiling of topsoil, ditching and roadwork. Approximately $16 million of mining equipment was purchased from a local mining equipment supplier in Ulaanbaatar. The Company received the mining equipment in March 2008 and training programs were initiated. Land use permits for the mining area and its associated infrastructure, such as roads, personnel facilities and shop complex were obtained in January 2008. Permanent site facilities have been approved and construction started in the second quarter of 2008. The exploration camp was winterized in 2007 and commissioned in early 2008 and will service the project until the permanent facilities are ready. A temporary maintenance shop has also been purchased and erected. Semi-weekly flights to the Ovoot Tolgoi airport began at the end of 2007.

Upon receiving the Permit to Mine, SouthGobi Energy officially began mining and stockpiling coal at its Ovoot Tolgoi Project in Mongolia's South Gobi region in April 2008. The official start of mining culminated after months of development and preparation, including the delivery of a fleet of surface-mining equipment during the first quarter 2008. As of June 30, 2008, the total waste mined was 559,632 BCM (Banked Cubic Meters) and the total coal mined was 254,190 tonnes at a strip ratio of 2.2 BCM waste per tonne of saleable coal. Approximately 80,000 tonnes of the mined coal was highly oxidized as it was outcropping. Coal deliveries to customers in China are scheduled to start in the third quarter 2008.

On June 4, 2008 the Company held an official opening ceremony for its Ovoot Tolgoi coal mine. Over 100 guests, including political and community leaders, key supporters, shareholders and employees attended the opening ceremony at the Ovoot Tolgoi mine site.

Recruiting activities were initiated during the fourth quarter of 2007 in preparation for hiring the workforce and commissioning of the mining equipment. All senior mine operation staff have now been hired. At the beginning of June 2008 the mine started operating on a full time 24 hr basis. Regular manpower rotation at the site is in effect. At June 30, 2008, SouthGobi employed 187 employees in Mongolia of which eight are expats and 179 are nationals. Of the 187 employees, 26 are in the Ulaanbaatar office. Of the 161 employees at the Ovoot Tolgoi mine site, 107 employees are from Ulaanbaatar, 3 from Dalanzadgad and 46 from the local Soum near the mine site.

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

The Ovoot Tolgoi mine is 45 km north of Mongolia's border with China. A Chinese steel mill has built a railway line to the Ceke border point, where a major automated railcar loading facility opened last year. The Mongolian Government is formally transforming the Ceke border point into a full-time border crossing that will allow daily distribution of Ovoot Tolgoi coal to customers in China. SouthGobi has purchased an automated 150 tonne scale which is being set up at the border to expedite coal traffic crossing the border into China from Ovoot Tolgoi.

Ovoot Tolgoi Underground Project

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

In June 2007, Norwest Corporation ("Norwest") identified two potential underground mining areas in conjunction with potential surface mining activities, the West Field and the South Field. In March 2008, The Americas Group prepared a resource estimate for underground resources in the West Field. Estimated resources for the West Field are approximately 3.9 million tonnes of measured resources, 12.6 million tonnes of indicated resources and 36.7 million tonnes of inferred resources. The coal rank is volatile B to A bituminous based on ASTM D388 standards. Holes drilled in the 2007 exploration program were not included in the resource estimation. A new resource report will be completed in late 2008 to include this data. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are available in the Technical Report entitled "Underground Resources at Ovoot Tolgoi – West Field" dated March 28, 2008 and available at www.sedar.com.

In 2007, seven deep holes were drilled into the No. 5 seam below 250 m designated for underground mining. The 2008 exploration program is concentrating on the underground West Field. This drilling is being conducted to obtain additional information respecting the structure and quality of the deep underground coal mineralization and is extending it to 700 meters. This same type of program will be carried out in 2009 on the South East Field at Ovoot Tolgoi. The drilling conducted in 2006 and 2007 has identified coking and semi-soft coal at depths of between 250 m and 600 m below surface beneath the lower boundaries of the planned open pits at the South-East and West Fields. The No. 5 coal seam is open to depth and along strike.

The assessment of underground mining alternatives continued during the fourth quarter of 2007. In the 2008 exploration program drilling is continuing to a depth of approximately 800 meters. The Company has engaged an underground coal mining consultant and is preparing a new scoping level study, which the Company plans to file by the year end 2008.

Tsagaan Tolgoi Project

Tsagaan Tolgoi contains a coal resource which has the potential to supply coal for Ivanhoe's proposed Oyu Tolgoi copper and gold mining project. The Tsagaan Tolgoi coal field is located in south-central Mongolia. The property is located in the Omnogovi Aimag approximately 570 km south of Ulaanbaatar and 113 km southeast of the provincial capital of Dalanzadgad, and approximately 115 km west of Oyu Tolgoi.

A coal delineation program was first carried out in 2004, but no further work was conducted in 2005. Exploration programs were carried out during 2006 and 2007 to provide for the basis of a resource estimate. A resource estimate prepared by Norwest and issued on February 25, 2008 quantified 36.4 million tonnes of measured (23.4 million tonnes) and indicated (13.0 million tonnes) and 9.0 million tonnes of inferred resources. The coal is of volatile bituminous B to C in rank based on ASTM D 388 standards and is suitable for use as a thermal coal. The resources are suitable for surface extraction down to a planned depth of 150 m. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are available in the Technical Report entitled "Coal Geology and Resources – Tsagaan Tolgoi Property" dated March 25, 2008 and available at www.sedar.com.

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

Tavan Tolgoi Extension Project

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

A field reconnaissance program was carried out on the Tavan Tolgoi Extension licenses in 2006. The exploration area has been surveyed for copper and gold exploration using BHP Falcon aerial geophysics. The Company has obtained the aeromagnetic and aero gravity survey data and is using the results of the upcoming analysis of the Falcon data to help delineate potential coal targets. A significant exploration program was started in the third and fourth quarters of 2007, and the results are being used to delineate further potential coal targets. Further exploration work on the extension will commence in the third quarter of 2008.

Sumber Project

In 2005, coal occurrences were identified in the N and O fields (previously called Ovoot Tolgoi Extension but now referred to as part of the Sumber Project). Further exploration drilling in 2006 suggests that these coal occurrences may in fact be one coal field. The 2007 exploration drilling provided additional structure and quality information, where significant intersections were encountered and potential exists for expanding known mineralization along strike and down dip.

In June 2008, the company announced that it has intersected significant thicknesses in near-surface seams of high-quality coking and thermal coal, including one intercept of 51.5 m, at the new Sumber Coal Project. The Sumber Project is comprised of N, O and E Fields. This coal field starts 16 km east of Ovoot Tolgoi and stretches for approximately 18 km to the east. Eleven coal seams have been identified.

The N, O and E fields are located in Mineral Exploration License #9443, which also encompasses part of the Ovoot Tolgoi Mining License. N field is located approximately 16 km east of the Ovoot Tolgoi South-East pit and 8 km west of O Field. E Field is located approximately 10 km west of O Field. N Field coal occurrences have been identified approximately two km north of the east-west trending Nariin Sukhait thrust fault, the major structural feature of the Ovoot Tolgoi region.

The intention of the 2008 drilling program, which is expected to be completed in the fourth quarter of 2008, is to delineate resources to NI 43-101 standards. Once completed, mine planning will be initiated and an application for a mining license will be submitted for development of this project.

Mamahak Coal Project – Indonesia

In November 2007 the Company signed a Memorandum of Agreement with an Indonesian company to carry out exploration on coal exploration concessions in East Kalimantan, Indonesia. The initial direct interest of the Company in the project will be 56%, which will require the Company to expend approximately $14.5 million on the development of the project. To date the Company has advanced funds to carry out geological reconnaissance and mapping, initial drilling, and a documentation program. A Joint Venture Agreement (JVA) that supersedes and replaces the Memorandum of Agreement has been completed and cooperation agreements are being finalized. The terms of the JVA allow for the Company to acquire an interest of up to 100% in the project.

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

Gordon Gormley has been appointed SouthGobi's Director of Indonesian Coal Operations. Mr. Gormley, based in Jakarta, will head up the on-going exploration and development of the Mamahak Project and other Indonesian coal opportunities. Mr. Gormley has more than 30 years of coal related experience in senior production, development and exploration capacities. SouthGobi is establishing an Indonesian subsidiary - PT Multi Mamahak Batubara (MMB) – which, under Mr. Gormley's direction, will be responsible for all coal initiatives in the country.

SouthGobi has commenced the development of greenfields surface coal deposits in four concessions covering 26,065 ha in East Kalimantan, Indonesia, through its participation in the Mamahak project. The 2008 drilling program has identified direct shipping, semi-soft coking coal amenable to surface mining. While further drilling is ongoing; work to date on the initial Mamahak concession (4,996 ha) supports the company's objective to develop an open-pit mining operation. The intent of the drilling program is to determine down-dip continuity, thickness variations, coal quality and structure. The close proximity of the Mahakam River to the Mamahak concession (26 km) has established this area as the priority location for initial project development. Future exploration is still required on the remaining three concession areas to fully assess the ultimate potential for the entire project.

The drilling results received to date support the quality data from the initial field outcrop quality results. This quality data supports the plan to market the coal as a semi-soft metallurgical coal, which commands a premium market price. The Company has contracted the Jakarta office of Australian based SMG Consultants to assist in the field programs. All drill holes are being geophysically logged with detailed intersection data provided to the SMG Consultants office in Jakarta for the preparation of a geological model to be used for mine planning. SMG Consultants will also review the practicality, design and cost of both wet season and dry season barge loading terminals on the Mahakam River and coal haul roads to these sites. Initial site infrastructure studies have identified an existing 26 kilometer logging road and log pond barging area on the Mahakam River, which, with upgrading will facilitate coal haulage and barge loading activities during wet season periods. Required permit applications for mining, coal transportation and a barge load-out facility for the area have been filed and are in various stages of progress. A site office, accommodation camp and a satellite communication system are being mobilized for the project. An administrative project office has been established at the port village of Melak on the Mahakam River approximately 90 km from the site. More than 200 workers are at the project site.

Metals Group Profile

Mongolia Exploration Licenses

As of August 7, 2008, the Company's Metals Group held 28 exploration licenses for copper and gold exploration in Mongolia covering an aggregate area of approximately 372,000 ha. Fifteen of these licenses, comprising an area of approximately 308,000 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, five licenses are held in Khuvsgul Aimag in northern Mongolia and one license is held as part of a joint venture agreement with Gallant in the West Gobi and four are located in the Tsagaan Tolgoi region.

The Company regularly targets and prioritizes a number of copper and gold licenses on the basis of potential, age, and cost. As a result of this review, metals related licenses are relinquished or sold once the reviews are finalized.

Properties in Mongolia

West Gobi Properties

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

Khongor Project

The Khongor porphyry copper-gold prospect in southern Mongolia has a mineralized strike length of about 2 km. About half of this strike length (Khongor North) is located within the West Falcon Gobi Property. The balance referred to as Khongor South is located on the Tsakhir license, which has been optioned by the Company from Gallant Minerals Ltd. ("Gallant").

In order to exercise the option from Gallant to acquire an 80% interest in the Tsakhir license, SouthGobi is required over the next two years to make cash payments of $70,000, issue common shares of the Company valued at $50,000 and spend an aggregate of $600,000 on related work programs. Subject to SouthGobi exercising its option to acquire an 80% interest in the Tsakhir license, Gallant has a one time option, exercisable within 30 days of SouthGobi completing the option, to retain its 20% interest as a fully participating joint venture partner, or to convert its 20% interest into a net smelter royalty of up to 3%. The Company retains the right to buy down the royalty pursuant to a payment scale based on the amount of the annual net smelter revenue.

The Company carried out a first stage diamond drilling program comprising 935 m in five holes in December 2005. All five holes intersected copper mineralization. Hole KPDH-3 intersected stock work style mineralization from surface to a down-hole depth of 70.3 m grading 0.67% Cu and 0.16 g/t Au. A second stage diamond drilling program comprising 3,167 m in 18 holes was completed in July 2006. Six holes intersected strong sheeted quartz stock work with associated high grade copper mineralization. Hole KPDH-9 reported 1.0% Cu and 0.3 g/t Au over a 50 m interval from 64.0 m to 114.0 m. A third stage drill that began in March 2008 focused on three nearby targets defined by geology and geophysics. Five diamond drill holes totaling 2048 m were drilled but did not intersect better grades or thicknesses at Khongor or new mineralization on the Tsakhir license. Although drilling results were not encouraging the overall potential at Khongor is still considered to be good. Expenditure commitments have been met for 2008 and no further work is planned this year.

Naran Bulag Project

In 2005, the Company discovered 13 quartz veins containing visible gold at Naran Bulag on a 100% owned exploration license about 50 km south of the Khongor prospect. The veins occurred over a distance of 2.5 km. A 7,000 m trenching program commenced that year confirmed high grade gold in five main veins and revealed two new veins which were found within 2 km of the main vein system.

A 3,500 m combined diamond and reverse circulation (RC) drill program was carried out in April 2006. Three blocks were defined for RC grid drilling on the down-dip extensions of three veins that host high grade gold mineralization 84 RC drill holes (diameter 13.1 cm), including 20 holes on the B vein, 35 on the D vein and 29 on the AC vein system were collared on 10 m centers on drill hole fence-lines with a 25 m line separation for the B and D veins and a 50 m line separation for the AC veins.

The holes identified four possible shallow dipping; south plunging mineralized shoots within the quartz veins that are defined by an envelope of anomalous base metals which encloses the better gold intersections. Grades of up to 12 g/t gold over 2 m in the AC vein, 10 g/t gold over 2 m in the B vein and 13 g/t gold over 1 m in the B vein were intersected. The estimated dimensions of the shoots are 30 to 60 m in width, 1 to 4 m in thickness and 90 to 130 m down plunge. All four shoots are open at depth. The Company has been evaluating joint venture proposals while conducting environmental studies to prepare the license to convert to a mining license.

Other West Gobi Properties

At Tsagaan Temmee a dipole-dipole IP survey identified a 500 m diameter chargeability anomaly between 300-500 m in depth that corresponds in plan to an area of intense leaching and alteration. Further interpretation is required to define the drill target.

Exploration on other licenses was minimal but sufficient to meet the minimum expenditures required to keep the licenses in good standing.

An agreement to sell and transfer a single license was signed on January 21, 2008. The purchaser paid $100,000 for the license and agreed to pay a 5% net production royalty and an additional $50,000 payment on the first anniversary. An agreement to sell and transfer another ten licences was signed on May 19, 2008. The purchaser paid $100,000 for the licenses and agreed to pay a 2% net production royalty.

Other Properties in Mongolia

In Khuvsgul Aimag the Company holds 5 exploration licenses totaling approximately 33,000 ha. These areas are considered to be prospective for Proterozoic shale-hosted gold mineralization similar to deposits in Irkutsk Oblast. Reconnaissance level exploration consisting of regional stream sediment sampling and prospecting was conducted in 2005 and the results were used to prioritize target areas. In June 2007 a follow up program of detailed stream sediment led to outcropping pyritic carbonate-altered shale with anomalous gold in one area. In September additional stream sediment sampling in three other target areas resulted in numerous geochemical anomalies including a cluster of nine contiguous catchments (about 70 square km) that is anomalous in gold and pathfinder elements. A follow up reconnaissance prospecting and mapping program is planned to start in June 2008.

The Company holds a single license in Dornod Aimag covering a total area of approximately 17,500 ha. In June 2007, a Letter of Intent was signed with Batu Mining Mongolia LLC to explore the license. In 2007 Batu carried out a wide spaced soil survey over the entire licence and identified several weak lead and zinc anomalies. Batu withdrew from the joint venture in January 2008.

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

<u>Properties in Indonesia</u>

Kaputusan Project

The Company signed a Joint Venture Agreement and Cooperation Agreement with PT Harita Multi Karya Mineral (“HMKM”) on September 7, 2006 to explore the Kaputusan copper gold porphyry prospect located on Bacan Island, Maluku in Indonesia. The joint venture consists of two Exploration KP’s of 13,641 ha and 13,770 ha and a General Survey KP of 10,250 ha for a total exploration area to 37,661 ha. The Company earned an 85% interest in the project by spending $300,000 on exploration during the first year of the joint venture. A joint venture company, PT ASG Harita Mining Services was incorporated in 2006. The 15% interest held by HMKM in the joint venture company is free carried to commercial mine production while the Company is responsible for funding 100% of any project costs through to commercial mine production.

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

Results of SouthGobi’s re-sampling of seventeen of the original BGR trenches compare well with BGR results and provide confidence in all BGR analytical results. An additional 15 trenches totaling

2,958 m resulted in the discovery of porphyry copper-gold mineralization, the new West Zone, and new areas of mineralization in the north and south. In the North Zone, a 152 m section of mineralization that is open to the east and west, grades 0.20% copper and 0.18 g/t gold and includes a 60 m interval grading 0.31% copper and 0.36 g/t gold. The north–south extent of copper-gold mineralization at Kaputusan was increased to 1,800 m and is still open to the north and south.

A 3,000 m diamond drilling program to test the North, South and West Zones began in February 2007. Six diamond drill holes totaling 1,000 m were completed by the end of May 2007. All six holes encountered porphyry copper-gold mineralization; however the drill was not sufficiently powerful and was demobilized in June 2007. Drilling is expected to resume in 2008 using a new contractor and a more powerful drill once the Company obtains an Exploration Permit from the Department of Forestry.

Other Indonesia Projects

The Company has signed Letters of Intent with two Indonesian companies for a 90% fully participating interest in a number of copper and gold projects through its 100% owned Indonesian subsidiary, PT AGC Indonesia. Nine General Survey and Exploration licenses totaling 47,178 ha and covering copper and gold projects in Sumatra, Java and Sulawesi have been granted to the two Indonesian companies.

On one of the projects in Java the Company signed a Joint Venture Agreement and Cooperation Agreement on May 29, 2008. The joint venture consists of a single Exploration license of 9,982 ha. The Company has a 90% interest in the project while the 10% interest held by the partner is free carried to the completion of a feasibility study.

At the joint venture located in Java, the Company has discovered a low sulphidation epithermal gold and silver system within an 8 km by 2-3 km structural corridor where occurrences of sinter, silica caps, high level epithermal veins and anomalous levels of gold and silver have been identified. An initial program of more than 70 trenches has identified numerous high-level epithermal veins in an area of 520 m wide and 200 m long. Diamond drilling began in March 2008 and by the end of June 2008 eight drill holes were completed totaling 2,370 m. The best result from the drill program to date is 5.6 m averaging 9.6 g/t gold and 23 g/t silver between 119.0 to 124.60 m in hole KL-3. A further 2,000 m drilling is planned.

Elsewhere in Indonesia the Company discovered new porphyry copper gold mineralization consisting of chalcopyrite, bornite and pyrite disseminated in a potassic altered diorite porphyry with quartz veinlet stock work on a joint venture license. The mineralization is exposed in outcrop for 380 m while outcrops of similarly mineralized rock found 500 m northwest indicate the presence of a second zone. Geological mapping, soil sampling and ground geophysics indicate the main porphyry extends over an area of 700 m by 500 m. Trenching and test pitting are in progress and drilling is planned to begin in the third quarter 2008.

On the same property an area of 150 m by 150 m of sericite altered andesite contains quartz sulphide breccia veins with 2-3 g/t gold. Soil sampling has been carried out and results are expected shortly.

On a neighboring joint venture license additional porphyry copper mineralization has been found along two streams over an area of 150 m by 150 m. Detailed mapping, sampling and soil geochemistry is planned. Also on this license an epithermal vein system has been discovered. Three vein zones that are 3 to 15 m wide is found over a strike length of 1.5 km. Individual veins are up to 5 m wide. More than 200 samples, including 174 one meter channels, were collected. Results are expected shortly.

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

SELECTED QUARTERLY DATA

($ in thousands, except per share information)

	2008		2007				2006	
QUARTER ENDED	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Exploration expenses	$ 12,703	$ 7,609	$ 5,958	$ 5,205	$ 4,784	$ 867	$ 1,237	$ 1,920
Net loss	13,488	8,539	9,000	7,840	8,240	1,650	2,042	2,689
Net loss per share	(0.10)	(0.10)	(0.12)	(0.11)	(0.22)	(0.10)	(0.11)	(0.16)

Selected Quarterly Information

Certain figures, the majority of which are related to stock based compensation expense, presented for comparative purposes for the periods ended in 2006, have been reclassified to conform to the presentation adopted for the current year, whereby stock based compensation expense is allocated directly to salaries and benefits and exploration expense .

The changes in comparative results of operations on a quarter over quarter basis are due primarily to significant fluctuations in the following areas: exploration expenses, stock-based compensation charges, foreign exchange gains and losses and interest expense.

Exploration expenses will vary from quarter to quarter depending on the number of projects and the related seasonality of the exploration programs. Most of the exploration expenditures recorded for three quarters ended March 31, 2007 were incurred on the metals exploration projects in Mongolia, Bulgaria and Indonesia. Coal expenditures were initially incurred during the quarter ended June 30, 2007. The majority of the expenses for the remainder of 2007 and 2008 relate to the coal expenditures that were incurred after the completion of the coal transaction, which were direct incurred costs related to the operations of the Mongolia coal division.

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

Foreign exchange gains and losses arise primarily from significant cash balances which are maintained in Canadian funds whereas the reporting currency of the Company is U.S. dollars. Accordingly, fluctuations in the Canada-U.S. exchange rate results in the recording of gains or losses on a quarterly basis. The Company also has transactions in the Mongolian Tugrik, the Indonesian Rupiah, and in quarters prior to 2008, the Bulgarian Lev and the Euro, which will affect the foreign exchange gains or losses recorded in the financial statements.

Interest income has increased with the higher cash balances, which are related to the private equity placements in 2008. Interest expense relates to the two funding agreements with Ivanhoe. The interest accretion of the liability component of the debt component of the First Funding Agreement is charged to earnings for the period. Both funding agreements have now been terminated.

RESULTS OF OPERATIONS

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
EXPENSES				
Depreciation	**$ 34,351**	$ 5,442	**$ 70,249**	$ 11,350
Exploration	**12,703,202**	4,784,218	**20,312,000**	5,651,235
Legal	**63,852**	50,273	**264,882**	63,671
Office and administration	**453,878**	214,299	**713,124**	389,470
Professional fees	**98,828**	53,128	**223,764**	85,405
Salaries and benefits	**1,331,818**	2,550,769	**2,146,399**	2,889,426
Travel	**116,476**	71,587	**187,107**	133,524
	14,802,405	7,729,716	**23,917,525**	9,224,081
OTHER EXPENSES/(INCOME)				
Coal transaction costs	**-**	26,547	**-**	26,547
Interest income	**(580,055)**	(9,874)	**(1,108,312)**	(16,634)
Interest expense	**-**	233,074	**148,187**	354,839
Interest accretion on line of credit facility	**-**	297,534	**279,048**	297,534
Foreign exchange gain	**(734,061)**	(36,551)	**(1,209,575)**	(31,208)
Write off of interest in joint venture	**-**	-	**-**	35,009
	(1,314,116)	510,730	**(1,890,652)**	666,087
NET LOSS AND COMPREHENSIVE LOSS	**$ 13,488,289**	$ 8,240,446	**$ 22,026,873**	$ 9,890,168

Three Months Ended June 30, 2008 and 2007

The Company incurred a net loss for the three months ended June 30, 2008 of $13.5 million as compared to a net loss of $8.2 million for the same period in 2007. This change is due primarily to higher exploration, stock based compensation, salaries, bonuses, office, legal and professional fees for the three months ended June 30, 2008.

Exploration expenses for the three months ended June 30, 2008 are significantly higher due to the related direct costs incurred by the coal division in Mongolia and Indonesia. In 2007, the Company had operations in Mongolia, Bulgaria and Indonesia, which were related to the metals division only, and had begun incurring coal expenditures in June 2007.

Legal fees have increased for the three months ended June 30, 2008 as compared to the same period in 2007. The majority of these charges were for costs associated with the Company's compliance with regulatory requirements including expenses associated with corporate governance, statutory filings, registration, and disclosure.

Professional fees for both the June 2008 and 2007 quarters include the cost of quarterly reviews and accruals for the year end audit of the Company's financial statements. The current quarter fees also relate to administrative support, and costs incurred for internal corporate tax planning, and documentation.

For the three months ended June 30, 2008 the Company has allocated stock-based compensation expense of $938,167 (2007 - $2.4 million) to exploration expense and $647,506 (2007 – $2.3 million) to salaries and benefits. The total stock based compensation expense calculated for the three months ended June 30, 2008 was $1.6 million as compared to $4.7 million in the same period in 2007.

Salaries and benefits, excluding stock based compensation costs, increased in the three months ended June 30, 2008 to $684,000 as compared to $259,000 for the three months ended June 30, 2007. Salary and benefits compared to the same period in 2007 have increased due to the increased corporate activities related to the coal division, and bonuses paid in the period ended June 30, 2008.

Office and administration fees increased in the three months ended June 30, 2008 as compared to the same period in 2007. The increases relate to the development of the exploration projects, added personnel and office and administration support costs, insurance and public relation costs. Certain of the Company's administrative staff and office facilities are provided by Global Mining Management ("GMM") (see 'Related Party Transactions' below) whose costs are allocated on an as-used basis. Accordingly, quarterly fluctuations in the costs of administrative and personnel costs can be expected commensurate with increases or decreases in quarterly corporate activity and the level of personnel employed.

Travel costs were higher for the three months ended June 30, 2008 as compared to the same period in 2007. 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, and related spending in the metals and coal divisions. Interest income has increased, which relates directly to the completion of the financings in the current quarter and the resulting increased cash position throughout the quarter. Interest expense is $nil for the three months ended June 30, 2008 as compared to $233,000 in the same period in 2007 and relates to the lines of credit from Ivanhoe. Interest accretion on line of credit expense was $nil in the current period and relates to the accretion of the liability component of the First Funding Agreement credit facility. The First Funding Agreement line of credit facility and the Second Funding Agreement were terminated in January 2008.

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

Six Months Ended June 30, 2008 and 2007

The Company incurred a net loss for the six months ended June 30, 2008 of $22.0 million as compared to a net loss of $9.9 million for the same period in 2007. Exploration, stock compensation expense, legal, office, and professional fees were higher for the six month period ended June 30, 2008.

Exploration expenditures for the six months ended June 30, 2008 were $20.3 million as compared to $5.7 million for the same period in the 2007. For the second quarter ended June 30, 2007, the Company had only incurred approximately one month of expenditures subsequent to the completion of the coal transaction at the end of May 2007.

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

Salary and benefits expense was $2.1 million for the six months ended June 30, 2008 as compared to $2.9 million for the six months ended June 30, 2007. Stock based compensation expense allocated to salary and benefits expense was $1.2 million for the six months ended June 30, 2008 and $2.4 million for the same period in 2007. Salary and benefits expense, excluding stock option compensation costs, were $977,000 for the six months ended June 30, 2008 and $488,000 for the six months ended June 30 2007. The majority of the increase in salary and benefits expense relates to bonuses paid in the quarter ended June 30, 2008 and additional personnel. The stock compensation expense reflects additional options grants, particularly in the June 2007 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 2008 compared to the same period in 2007. 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, 2008 compared to the same period ended June 30, 2007. The majority of these charges were for costs associated with the Company's regulatory affairs including expenses associated with corporate governance, filing, registration and disclosure.

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 cost increases are 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.

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

Interest expense was higher for the six month period ended June 30, 2007 compared to the same period in 2008. This related to advances on the line of credit to fund continuing operations in 2007, including the accretion on the liability component of the loan. In 2008 with the completion of the additional equity private placements, the First Funding Agreement line of credit facility and the Second Funding Agreement were terminated in January 2008.

A foreign exchange gain of $1.2 million was recorded for the six months ended June 30, 2008 as compared to a gain of $31,000 for the six months ended June 30, 2007. These amounts are primarily reflective of the larger US and Canadian cash balances due to the completion of the private equity placements in 2008 and the related changes in the value of the Canadian dollar versus its US counterpart during these periods and to a lesser extent the effect of the Mongolian Tugrik, and the Indonesian Rupiah.

EXPLORATION COSTS BY DIVISION

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	**2008**	2007
Metals Division	**$ 2,392,568**	$ 1,551,381	**$ 3,695,230**	$ 2,418,397
Coal Division	**10,310,634**	3,232,837	**16,616,770**	3,232,838
Total Exploration	**$ 12,703,202**	**$ 4,784,218**	**$ 20,312,000**	**$ 5,651,235**

Metals Division

The Company continues to explore on the Indonesian and Mongolian properties, and further work is planned for in 2008. During the three month period ended June 30, 2008 exploration expenses were $2.4 million as compared to exploration expenses of $1.6 million in the same period in 2007. For the six months ended June 30, 2008, $3.7 million was spent on the Company's metal division exploration activities as compared to $2.4 million for the six months ended June 30, 2007. These expenditures relate to the metals division projects in Mongolia and Indonesia.

Exploration expenditures in Mongolia increased to $1.7 million for 2008 from $935,000 in 2007 while the Company continued its evaluation of potential projects and further drilling activity. During 2008 the majority of the expenses incurred in Mongolia were related to ongoing license fees, drilling, and salaries.

The Company regularly targets and prioritizes a number of copper and gold licenses on the basis of potential, age, and cost. As a result of this review, metals related licenses are relinquished or sold once the reviews are finalized. During six months ended licenses were sold to unrelated third parties for approximately $187,000.

In Indonesia, exploration expenditures increased to $2.0 million in 2008 from $1.4 million in 2007 due to continued exploration on a number of new prospects.

Included in the salary expense of $1.3 million for the six months ended June 30, 2008 is $824,000 of stock based compensation expense.

The Company terminated its mineral exploration activities in Bulgaria in March 2007 and costs related to the Company's Bulgarian activities are in other expenses for 2007.

Coal Division

The total coal exploration expenditures in the three months ended June 30, 2008 were $10.3 million compared to $3.2 million for the same period in 2007. For the six months ended June 30, 2008 coal exploration expenditures were $16.6 million as compared to $3.2 million for June 30, 2007.

The coal division started mine operations subsequent to the completion of the coal transaction at the end of May 2007. For the three and six months ended June 30, 2007, $1 million relates to coal exploration expenditures and $2.2 million is allocated stock based compensation expense.

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

Exploration expenditures in Mongolia were $13 million for the six months ended June 30, 2008 and included consulting-geological, drilling, license fees, office and salary and benefits. Expenditures in 2008 were incurred as the coal division assembled equipment, hired additional personnel and began pre-development activities at the Ovoot Tolgoi mine site.

In Indonesia, exploration expenditures were $3.7 million for the six months ended June 30, 2008. To date the Company has advanced funds to carry out geological reconnaissance, licensing, mapping, initial drilling, and a documentation program on the new concessions in East Kalimantan.

Included in the salary expense of $2.0 million for the six months ended 2008 is $407,000 of allocated stock based compensation expense.

LIQUIDITY AND CAPITAL RESOURCES

		June 30, 2008		December 31, 2007
ASSETS				
CURRENT				
Cash and cash equivalents	**$**	**70,932,884**	$	1,393,632
Accounts receivable		**3,671,597**		759,528
Inventories		**3,148,755**		-
Prepaid expenses		**2,590,365**		1,890,177
		80,343,601		4,043,337
DEFERRED CHARGES		**3,236,318**		-
MINERAL PROPERTIES		**2,837,275**		443,360
PLANT AND EQUIPMENT		**38,241,266**		1,123,379
	$	**124,658,460**	$	5,610,076
LIABILITIES				
CURRENT				
Accounts payable and accrued liabilities	**$**	**5,885,013**	$	1,767,784
ASSET RETIREMENT OBLIGATIONS		**261,111**		-
AMOUNT DUE UNDER LINE OF CREDIT FACILITY		**-**		35,107,804
		6,146,124		36,875,588
SHAREHOLDERS' EQUITY (DEFICIENCY)				
Share capital				
Common shares		**194,235,647**		20,625,287
Preferred shares		**-**		75,419
Equity portion of line of credit facility		**-**		3,055,359
Contributed surplus		**8,658,285**		7,333,146
Deficit		**(84,381,596)**		(62,354,723)
		118,512,336		(31,265,512)
	$	**124,658,460**	$	5,610,076

At June 30, 2008, the Company had cash resources of $70.9 million compared to $1.4 million as at December 31, 2007.

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

On January 24, 2008 the Company completed an equity private placement of 10 million common shares at C$8.00 per share and a second equity private placement of 3.5 million common shares at C$9.00 per share to institutional investors, for total gross proceeds of C$111,500,000 ($108,372,995).

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

In the current quarter, the Company entered into a subscription agreement with a Mongolian equipment distributor for a private equity placement of 2 million shares at C$12.45 per share representing an aggregate offering amount of C$24,900,000($24,785,076). The non-brokered private placement closed on May 30, 2008.

These amounts plus $3.3 million received from the exercise of stock options provided financing for the Company's operations for the six months ended June 30, 2008.

The proceeds from these financings will be used for the initial development of the open-pit coal mine at the Company's Ovoot Tolgoi project, and for additional drilling and engineering focused on developing of the underground coal mine at the Ovoot Tolgoi site. Proceeds will also be used for investigating new projects and for general corporate and administrative purposes.

Accounts receivable includes funds due from government taxation authorities (Goods and Services Tax or Value Added Tax). Prepaid balances have increased from $1.9 million at December 31, 2007 to $2.6 million at June 30, 2008. The increase relates to the timing of prepayments for Mongolian exploration licenses, insurance, additional lease deposits, design and building costs and supplies for the Ovoot Tolgoi open-pit project.

Coal and parts inventories have increased to $3.1 million in the current quarter. Coal and parts inventory is valued at the lower of cost and net realizable value. Coal inventory cost of $2.1 million includes direct and indirect expenses associated with extracting and processing, including labor, operating materials, supplies, transportation costs and a relevant allocation of overhead including depreciation and depletion. Parts inventory includes items related to mining equipment and some supplies.

The Company has adopted the guidance of CICA Emerging Issues Committee EIC-160, Stripping Costs Incurred in the Production Phase of a Mining Operation. The guidance was effective for years commencing on or after July 1, 2006. The abstract requires the cost of the stripping activities during the production phase of the mine to be accounted for according to the benefit received. Generally, such costs are expensed as variable production costs; however, the costs are capitalized if they can be shown to represent a betterment to the mineral property. A betterment occurs when the stripping activity provides access to sources of reserves that will be produced in future periods that would not have otherwise been accessible in absence of the stripping activity. Any capitalized stripping costs are described as investing activities in the cash flow statement and are depleted on a unit-of-production basis over the life of the reserves that directly benefit from the specific stripping activity.

Mineral properties have increased with the addition of future asset retirement obligation costs in the first quarter and $2.1 million of deferred stripping costs capitalized in the current quarter.

Deferred charges relate to initial listing application costs for a secondary listing on an Asian stock exchange. The Company has appointed a sponsor and is well along in the process. Deferred charges include costs for legal, accounting and related professional fees.

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

The Company's investment in plant and equipment increased substantially during the quarter ended June 30, 2008. The purchase of coal mining equipment that was announced in November 2007 was commissioned for use at Ovoot Tolgoi in March 2008. Deposits for further mining equipment and maintenance facilities are included as plant and equipment.

In April 2006, in conjunction with the coal transaction, the First Funding Agreement pursuant to which the Company obtained from Ivanhoe an unsecured line of credit of up to $10 million, which was subsequently increased to $15 million.

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

Coal expenditures incurred by Ivanhoe during the period from April 25, 2006 to May 28, 2007 were deemed to be advances under the First Funding Agreement line of credit facility. All amounts outstanding under the line of credit bore interest at the three month LIBOR plus two percent per annum.

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

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

All amounts advanced under the Second Funding Agreement bore interest at an annual rate equal to the three month LIBOR plus 3.30% per cent per annum. The $8,077,470 balance due under the Second Funding Agreement included accrued interest and was repaid on January, 18 2008 from proceeds of the equity financings.

Concurrent with the closing of the equity private placements on January 24, 2008, Ivanhoe converted its preferred shares and convertible debt under the First Funding Agreement into common shares of the Company, and therefore the Company no longer has any debt outstanding.

Ivanhoe currently owns 104,796,155 common shares representing approximately 79% of the issued and outstanding common shares of SouthGobi.

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

The Company will be incurring expenditures for the exploration, development, and production of its current coal assets, and will incur expenditures for the acquisition of further coal assets. Revenue from current operations will not be sufficient to meet current expenditure levels. Southgobi believes it has sufficient working capital to meet its funding requirements for the next 12 months.

Cash generated from operations will grow in 2009, but it may not be sufficient to meet all expenditure levels. Management is of the opinion that additional financing is available to continue its planned activities in the normal course.

RELATED PARTY TRANSACTIONS

The Company is a party to a shareholders' cost-sharing agreement with certain other public and private companies, including Ivanhoe (the "Other Companies") pursuant to which the Company and the Other Companies are equal shareholders in GMM and, through GMM, share office space, furnishings and equipment and communications facilities (on a cost recovery basis) and the employment, on a part-time basis, of various administrative, office and management personnel in Vancouver, British Columbia. Costs of the shared office facilities and the shared part-time employees are recovered from the Company proportionate to the time spent by the shared part-time employees on matters pertaining to the Company. Certain of the directors and officers of the Company are also officers and directors of GMM. The Company has utilized the services of the GMM staff and office since September 1, 2003 and has incurred costs of $1.5 million and $1 million for the six months ended June 30, 2008 and 2007, respectively.

All amounts outstanding under the line of credit facility, created pursuant to the First Funding Agreement with Ivanhoe, bore interest at three month LIBOR plus two percent. All amounts advanced under the Second Funding Agreement bore interest at an annual rate equal to the three month LIBOR plus 3.30% per cent per annum.

During the three months ended June 30 2008, $nil (2007 - $233,000) of interest was paid on the line of credit facilities with Ivanhoe.

Both credit facilities are now terminated.

OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value. As at August 15, 2008: 132,789,782 common shares were issued and outstanding and 4,936,555 share purchase options were outstanding. On a fully diluted basis, 137,726,337 common shares were outstanding.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

In February 2008, the Canadian Accounting Standards Board ("AcSB") confirmed that publicly listed companies will be required to adopt IFRS for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011, and in April 2008, the AcSB issued for comment it's Omnibus Exposure Draft, Adopting IFRS in Canada. Early adoption may be permitted, however it will require exemptive relief on a case by case basis from the Canadian Securities Administrators.

The Company has developed an implementation strategy and timetable, and during the third and fourth quarters of 2008 plans to finalize the detailed assessment of any additional impact on our local accounting policies, disclosures, financial systems and processes, including our internal control systems. The Company will also establish the appropriate governance structure to coordinate the transition to IFRS, and will continue to invest in training and resources throughout the transition period to facilitate a timely conversion.

RISK FACTORS

The business of mineral exploration and extraction involves a high degree of risk. Few properties that are explored are ultimately developed into production.

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

OUTLOOK

The Company's principal business is the exploration and development of coal properties, with its primary focus being high quality coal deposits. The Company continues to develop a diversified coal asset base with its principal property assets in Mongolia and Indonesia.

Resources for the Ovoot Tolgoi property in Mongolia are found in two different areas, referred to as the South-East and West Fields. As reported in July 2008, the resources have increased to 258.9 million tonnes of measured and indicated and 145.3 million tonnes of inferred from 149.6 million tonnes of measured and indicated and 29.1 million tonnes of inferred.

The Company has established a schedule for the development of commercial operations on the Ovoot Tolgoi Project. Production commenced in the West Field in April 2008, with three coal products developed for export from the Ovoot Tolgoi mine- thermal coal, premium thermal coal and metallurgical coal. Revenue is anticipated in the latter part of 2008.
At the Sumber coal project, which is comprised of the N, O, and E fields the Company has intersected significant thickness in near-surface seams of high-quality coking and thermal coal.

For 2008, SouthGobi is continuing its coal exploration program in the Gobi area of southern Mongolia. The 2008 program is dedicated to further delineating the surface resources at the Ovoot Tolgoi and Sumber projects and confirming the underground coal resource and the potential for the development of an underground mining operation at Ovoot Tolgoi.

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

SouthGobi commenced an integrated exploration and development program at the Mamahak coal project in Indonesia. The 2008 drilling program and development work has identified semi-soft coking coal that is amenable to surface mining. The Company’s new Indonesian coal project is well situated to target the Japanese, Korean, Indian and Chinese coastal markets.

The Company continues to identify potential customers in China and Western Inner Mongolia to whom it could sell its coal. These customers include end users, distributors, steel mills, power plants and industrial consumers.

The proceeds from the equity financings will be used for the initial development of the open-pit coal mine at the Company’s Ovoot Tolgoi project, and for additional drilling and engineering focused on developing the underground coal mine at the Ovoot Tolgoi site. Proceeds will also be used for investigating new projects, equipment deposits and for general corporate and administrative purposes.

With continued strong economic growth, driven mainly from China and India, the global supply of coal products continues to adjust to increased demand. The Company believes that the market fundamentals for its coal products will provide it the strategic advantage to grow and diversify.

Management continues to focus its efforts on developing metallurgical and thermal coal deposits in the South Gobi region of Mongolia and Indonesia. The Company will also continue its exploration efforts on identification and drilling of prospective copper-gold targets on its exploration licenses in Mongolia and Indonesia.

The Company is continuing its strategic review of the metals division to identify the most effective means of optimizing value for the shareholders. This review will encompass the evaluation of available options, including reorganizing the metals division into a separate company.

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

August 26, 2008