SouthGobi Resources Ltd.

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

September 30, 2010

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

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

1. OVERVIEW

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

The Company's common shares trade on the Toronto Stock Exchange ("TSX") under the symbol SGQ. Upon completion of the International Offering and the Canadian Offering and the secondary listing of the common shares on the Hong Kong Stock Exchange on January 29, 2010, the Company's shares also trade on the Hong Kong Stock Exchange under stock code symbol 1878.

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

The Ovoot Tolgoi Mine, strategically located approximately 40 kilometers ("km") from the China-Mongolia border, is the Company's flagship producing asset. The Company commenced mining at Ovoot Tolgoi's Sunset Pit in April 2008 and commenced coal sales in September 2008. Current products from the Ovoot Tolgoi Mine include coals with coking (or metallurgical) applications primarily a raw semi-soft coking coal, and raw higher ash coals with applications as either thermal coal or can be washed into semi-soft coking coal. Since the commencement of production in late 2008 until September 30, 2010, the Company has sold approximately 2.5 million tonnes of coal from the Ovoot Tolgoi Mine. During the nine months ended September 30, 2010, the Company sold approximately 1.1 million tonnes of coal. The Ovoot Tolgoi Mine is covered by a single 9,308 hectare ("ha") mining license and a corresponding permit to mine.

The Soumber Deposit is located approximately 20km to the east of the Ovoot Tolgoi Mine, which could allow the operations to share existing infrastructure in the event a mine is developed there. Preliminary exploration results show potential for thick seams of coking coal, and a resource has been established confirming the deposit. The Company has completed additional exploration and drilling on the deposit and results are still pending. Preparatory work for a formal license application continues.

1. OVERVIEW (Continued)

The Company has conducted substantial exploration activities at the Ovoot Tolgoi Underground Deposit and has delineated mineral resources at this project. The Ovoot Tolgoi Underground Deposit is covered by the existing Ovoot Tolgoi Mining License. In addition, the Company owns the Tsagaan Tolgoi Deposit in Mongolia, which has a mining license.

1.1 Corporate Developments

<u>Ovoot Tolgoi Complex</u>

Coal shipments from the Ovoot Tolgoi Mine commenced in late September 2008. Throughout 2009, the Company continued coordinating efforts with the Mongolian Government and various agencies to improve border crossing access for coal shipments. In July 2009, Mongolian and Chinese officials met at the Mongolian-Chinese border and allocated designated gates for coal exports to create an expedited coal border crossing corridors.

As a result of continuing discussions with the Mongolian Government, border access has improved through early 2010, which has allowed for increased shipments to the Company's market in China.

Total shipments for the quarter ended September 30, 2010 were 194,000 tonnes with an average realized selling price of $37 per tonne. Total shipments for the nine months ended September 30, 2010 were 1.1 million tonnes at an average realized price of $39 per tonne. Total shipments for the year ended December 31, 2009 were 1.3 million tonnes with an average realized selling price of $29 per tonne.

The Company continues to ramp up production at the Ovoot Tolgoi Mine. The additional equipment for the second mining fleet including the larger Liebherr 996 hydraulic shovel ($34m^3$), four 218 tonne Terex haul trucks and various auxiliary equipment was delivered throughout the fourth quarter of 2009 and early 2010 and full commissioning was completed in June 2010. The third fleet was originally expected to be mining from January 2011 but was fully commissioned in October 2010. The third fleet includes one Liebherr 996 hydraulic excavator ($34m^3$) and five 218 tonne Terex haul trucks. Additional fourth and fifth fleets of equipment have been ordered for delivery in 2011. Furthermore, in 2011 the Company intends to upgrade its first mining fleet by replacing the Liebherr 994 hydraulic shovel with a newer, more productive Liebherr R9250 hydraulic excavator that will primarily work with the continued operation of the Terex TR100 (91 tonne capacity) truck fleet from the first fleet.

1. OVERVIEW (Continued)

On October 12, 2009, the Company announced that it completed a prefeasibility study for the Ovoot Tolgoi Mine resulting in the identification of Proven and Probable Mineral Reserves. The independent estimate prepared by Norwest Corporation ("Norwest") calculated 105 million tonnes of proven and 9.1 million tonnes of probable surface coal reserves at July 1, 2009. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are set out in the Technical Report entitled, "Coal Geology, Resources and Reserves Ovoot Tolgoi: A Production Property. Omnogovi Aimag, Mongolia" dated October 21, 2009, and available at www.sedar.com.

The Company also announced that it had received an updated independent NI 43-101 compliant resource estimate for the Ovoot Tolgoi Complex, prepared by Norwest. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are set out in the Technical Report entitled, "Coal Geology, Resources and Reserves Ovoot Tolgoi: A Production Property. Omnogovi Aimag, Mongolia" dated October 21, 2009, and available at www.sedar.com.

The Ovoot Tolgoi Complex surface and underground resources contain measured resources of 181.7 million tonnes plus indicated coal resources of 68.1 million tonnes, with an additional inferred coal resource of 33.5 million tonnes as at June 1, 2009.

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

To further enhance the value of our products, the Company commenced construction of a basic coal-handling facility in June 2010. The coal-handling facility has been re-designed to include dry air separators and is expected be operational at the end of 2011.

Soumber Deposit

On October 12, 2009, the Company reported that it had received an initial independent NI 43-101 compliant resource estimate for the Soumber coal project, prepared by Norwest. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are set out in the Technical Report entitled, "Soumber Property Umnugobi Aimag, Mongolia" dated October 21, 2009, and available at www.sedar.com.

The Soumber coal project and resource area is estimated to contain initial measured resources of 13.1 million tonnes plus indicated coal resources of 8.3 million tonnes, with an additional inferred coal resource of 55.5 million tonnes as at August 11, 2009.

1. OVERVIEW (Continued)

In March 2010, drilling re-commenced at the Soumber Deposit to expand and better define the resource. The 2010 drilling program is complete, though results from coal laboratory analyses are still pending. Preparatory work for a formal mining license application continues.

Regional Infrastructure

In October 2010, the Company entered into a contract for $48 million to design and construct a coal-haul highway. The 45 kilometre highway will link the Ovoot Tolgoi Mine with Ceke, a major coal terminal on the China side of the border with rail connections to key coal markets in China. The new coal-haul highway will be 17 meters wide and will consist of four fully paved lanes, with a one metre central median in order to provide capacity well in excess of 20 million tonnes of coal per year. The new highway is scheduled to be completed by the end of 2012. It will be constructed with a concession granted by the Mongolian Government as per the country's recently passed Concession Law.

1.2 Corporate Activity

The Company's common shares began trading on the main board of the TSX on December 3, 2009. SouthGobi was previously listed on the TSX Venture Exchange.

On January 29, 2010, the Company closed a global equity offering of 27 million common shares at a price of Cdn$17.00 per common share, for gross proceeds of Cdn$459 million. The Company commenced trading on the Main Board of the Hong Kong Stock Exchange on the same day and became the first Canadian mining company to have dual listings on the Hong Kong Stock Exchange and the TSX.

On February 10, 2010, the Mongolian National Chamber of Commerce and Industry selected SouthGobi Sands LLC, a wholly-owned subsidiary of SouthGobi, as the "Local Job Creator of the Year" for 2009. The purpose of this commemorative prize is to encourage and support the hiring of local residents in remote areas of Mongolia.

On February 26, 2010, Citigroup Global Markets Canada Inc. and Macquarie Capital Markets Canada, representatives of the Canadian underwriters of the Company's global equity offering, partially exercised their over-allotment option and purchased an additional 228,100 common shares of the Company at a price of Cdn$17.00 per share for gross proceeds of Cdn$3.9 million.

1. OVERVIEW (Continued)

On March 29, 2010 the Company converted $250 million of the $500 million convertible debenture into 21,471,045 common shares of the Company. Following the conversion China Investment Corporation ("CIC"), through its indirect wholly owned subsidiary, owns approximately 13% of the Company.

On May 11, 2010, the Company's shareholders approved the Company's name change to SouthGobi Resources Ltd. (formerly SouthGobi Energy Resources Ltd.).

On June 8, 2010, the Company announced that its Board of Directors authorized a share repurchase program to purchase up to 2.5 million common shares of the Company on each or either of the Toronto Stock Exchange and the Hong Kong Stock Exchange, in aggregate representing up to 5 million common shares of the Company. As of November 10, 2010, the Company had repurchased 140,250 shares on the Hong Kong Stock Exchange and 120,500 shares on the Toronto Stock Exchange for a total of 260,750 common shares at a total cost of approximately $2.6 million. As of November 10, 2010, the Company has cancelled all shares repurchased.

On June 28, 2010, the Company announced it had commenced construction of a basic coal-handling facility at its producing Ovoot Tolgoi Complex in southern Mongolia.

On October 19, 2010, the Company announced it had signed a special agreement for the purchase of the Company's entire outstanding inventory of Sunset Pit No. 8/9/10 seam coal and a proportion of additional Sunset Pit No. 8/9/10 seam coal to be mined for the rest of the fourth quarter in the amount of one million tonnes.

On October 19, 2010, the Company announced Gavin May, Chief Operating Officer, will be leaving the Company effective November 30, 2010 to pursue other business opportunities.

On October 19, 2010, the Company announced Curt Church, previously General Manager of Ovoot Tolgoi, has been appointed Vice President, Mining Operations.

1. OVERVIEW (Continued)

On October 26, 2010, the Company announced that it had entered into an agreement with Aspire Mining Limited ("Aspire") to acquire 105,726,650 common shares of Aspire in a private placement at a price of A$0.19 per share, for an aggregate of approximately A$20.1 million. On completion of the private placement, the Company will hold approximately 19.9% of Aspire. Closing of the transaction is expected to be on or before January 31, 2011 and is subject to the approval of the Australian Stock Exchange and the Foreign Investment Review Board (FIRB).

Aspire is a coal resource company which owns 100% of the Ovoot Coking Coal Project in Mongolia along with the Nurant and Shanagan Coal Projects. In addition, Aspire owns a 49% interest in the Windy Knob gold and base metals project located in Western Australia.

As of November 10, 2010, Ivanhoe directly owned 104,807,155 common shares representing approximately 57% of the issued and outstanding common shares of SouthGobi.

2. FORWARD-LOOKING STATEMENTS

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

3. CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with IFRS requires the Company to establish accounting policies and to make estimates that affect both the amount and timing of the recording of assets, liabilities, revenues and expenses.

A detailed summary of all of the Company's significant accounting policies is included in Note 4 to the annual Consolidated Financial Statements for the year ended December 31, 2009. Note 3 to the annual Consolidated Financial Statements for the year ended December 31, 2009, provides a review of the significant changes to the reported financial position and results of operations of the Company under Canadian GAAP and IFRS.

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

Mineral properties

All direct costs related to the acquisition of mineral property interests are capitalized into intangible assets on a property by property basis. Exploration costs, net of incidental revenues, are charged to operations in the period incurred until such time as it has been determined that a property has economically recoverable reserves, in which case subsequent exploration costs and the costs incurred to develop a property are capitalized into property, plant and equipment ("PPE"). On the commencement of commercial production, depletion of each mining property will be provided on a unit-of-production basis using estimated resources as the depletion base.

The commencement of commercial production is deemed to occur on a determination made by management. Management's determination of when commercial production commences is based on several qualitative and quantitative factors including but not limited to the following:

- the elevation or bench where the coal to be mined has been reached
- the commissioning of major mine and plant equipment is completed
- operating results are being achieved in a consistent manner

However, the production phase does not commence with the removal of *de minimis* saleable mineral materials that occur in conjunction with the removal of overburden or waste material for the purpose of obtaining access to an ore body.

3. CRITICAL ACCOUNTING ESTIMATES (Continued)

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

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

Inventory valuation

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

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

Stripping costs

Stripping costs incurred during the development of a mine are capitalized into PPE. Stripping costs incurred during the commercial production phase are variable production costs that are included in the costs of inventory produced during the period that the stripping costs are incurred, unless the stripping activity can be shown to give rise to future benefits from the mineral property, in which case the stripping costs would be capitalized into PPE.

3. CRITICAL ACCOUNTING ESTIMATES (Continued)

Future benefits arise when stripping activity increases the future output of the mine by providing access to a new ore body that the previously deferred stripping costs in an area did not give access to. When stripping activities give rise to a future economic benefit, the costs associated with these activities are capitalized into PPE. Capitalized stripping costs are depleted on a unit-of-production basis, using estimated resources as the depletion base.

Income taxes

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

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

Revenue recognition

Revenue represents the fair value of consideration received and receivable that is derived from the sales of coal. Sales revenues are recognized when the risks and rewards of ownership pass to the buyer, collection is reasonably assured and the price is reasonably determinable. The revenue from sales of coal in the ordinary course of business is recognized when coal is either loaded onto a truck, when it is unloaded at the final destination or depending on the terms of the contract.

Share-based payments

Share-based payment transactions

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

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

3. CRITICAL ACCOUNTING ESTIMATES (Continued)

Equity-settled transactions

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

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

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

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

Property, plant and equipment

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

Depreciation is provided at rates calculated to write off the cost of PPE, less their estimated residual value, using the straight-line method or unit-of-production method.

4. MINERAL PROPERTIES

4.1 Qualified Persons

Disclosure of a scientific or technical nature in this MD&A with respect to the Company's Coal Division was prepared by, or under the supervision of Stephen Torr, P.Geo., the Company's Resource Manager. Mr. Torr is a "qualified person" for the purposes of National Instrument 43-101 of the Canadian Administrators ("NI 43-101").

4.2 Mongolia Exploration and Mining Licenses

In May 2007, when the Company acquired Ivanhoe's Coal Division, including Ivanhoe's entire interest in the Ovoot Tolgoi Complex (formerly Nariin Sukhait), the Tsagaan Tolgoi Deposit and various coal exploration projects in Mongolia. To complete the transaction, 35 coal exploration licenses held by Ivanhoe, along with other assets and personnel, were transferred to the Company. The Company already owned a further 19 exploration licenses with coal potential, and with the additional 35 licenses, a total of 54 licenses covering an area of approximately 2.1 million hectares ("ha") were then available for coal exploration.

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

As at September 30, 2010, the Company held 20 licenses, including two mining licenses, which in total cover an area of approximately 803,000 ha.

The 18 exploration licenses are located around the existing mining area in the western part of the South Gobi Province, but also further east, including a substantial holding around another known third-party owned Mongolian coal deposit called Tavan Tolgoi. Out of the 20 licenses, five may be affected by a new Mongolian law that prohibits minerals exploration and mining in certain areas.

Pursuant to the Mining Prohibition in Specified Areas Law, the Mongolian Government was to define the boundaries of the areas in which exploration and mining would be prohibited by October 16, 2009. However, the Mongolian Government has not yet approved and published this information.

A draft list of licenses has been prepared that overlap with the prohibited areas described in the new law based on information submitted by water authority agencies, forest authority agencies and local authorities for submission to the Mongolian Government. The Mongolian Government must give its final approval before the final list can be published; licenses may be added or subtracted to the list at any time prior to approval and publication of the final list.

4. MINERAL PROPERTIES (Continued)

Four of the Company's exploration licenses and the Tsagaan Tolgoi mining license may be included on the draft list of licenses published by the Mongolian Government, potentially affecting the status of those licenses under the Mining Prohibition in Specified Areas Law.

Activities currently being carried out on the exploration properties include drilling, trenching and geological reconnaissance. The Company has no immovable assets located in any of the potentially affected areas and the loss of any or all of the potentially affected properties would not materially and adversely affect the existing operations. The loss of the Tsagaan Tolgoi mining license would however impact the Company's resources.

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

4.3 Properties in Mongolia

<u>Ovoot Tolgoi Mine</u>

The Ovoot Tolgoi Complex comprises the Ovoot Tolgoi Mine together with the Ovoot Tolgoi Underground Deposit.

The Ovoot Tolgoi Mine is located in the southwest corner of the Omnogovi Aimag (South Gobi Province) of Mongolia. The deposit is within the administrative unit of Gurvantes Soum, 270km southwest of the provincial capital of Dalanzadgad and 700km southwest 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. Mining operations at the Ovoot Tolgoi property are found in two distinct areas, referred to as the Sunset Pit to the west and the Sunrise Pit to the east.

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

4. MINERAL PROPERTIES (Continued)

On October 12, 2009, the Company announced an independent resource estimate prepared by Norwest under the requirements of NI 43-101. Norwest estimated that the Ovoot Tolgoi Mine contained approximately 114.1 million tonnes of reserves, calculated as 105.0 million tonnes of proven and 9.1 million tonnes of probable surface coal reserves at July 1, 2009, 135.9 million tonnes of measured resources, 35.1 million tonnes of indicated resources and 13.0 million tonnes of inferred resources. The Mineral Resources are inclusive of Mineral Reserves.

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

Current products from the Ovoot Tolgoi Mine include coals with coking (or metallurgical) applications primarily a raw semi-soft coking coal and raw higher-ash coals with applications as either thermal coal or can be washed into semi-soft coking coal.

In-pit sampling and on-site laboratory analysis determines which product is currently being mined and the products are then separately stockpiled and blended to meet specific customer requirements.

To further enhance product value, the Company commenced construction of a basic coal-handling facility in June 2010. The basic coal-handling facility will include a 300-tonne–capacity dump hopper, which will receive run-of-mine coal from the Ovoot Tolgoi Mine and feed a coal rotary breaker that will size coal to a maximum of 50 millimeters and reject oversize ash. In November 2010, the Company approved an expansion of its coal handling facility project. The facility has been re-designed and will now include dry air separation as an additional stage through the insertion of vibrating air tables. With this expansion of the coal handling project, completion is now estimated at the end of 2011. Prior to the operation of the permanent coal handling facility, temporary screening operations have commenced at Ovoot Tolgoi. The screening operation performs a similar function to the basic coal handling facility, namely rejects oversize ash and sizes the coal to a maximum size of 50 millimeters.

4. MINERAL PROPERTIES (Continued)

In the third quarter of 2010, coal shipments were approximately 194,000 tonnes compared to total shipments in the third quarter of 2009 of approximately 457,000 tonnes. Total shipments since the mine commenced production have now exceeded 2.5 million tonnes.

In order to increase the amount of coal traffic across the border, in July 2009, Chinese and Mongolian authorities agreed to create designated coal transportation corridors at the Shivee Khuren-Ceke border crossing. This facility is predominantly complete and is already in partial use. It permits coal to be transported across the border through three corridors that are separate from other, non-coal, border traffic. The Company believes that these improvements in the border crossing capacity will allow the Company to substantially increase the amount of coal shipped into China. On April 28, 2010, the Mongolian Government approved a plan that would allow the border check-point to operate 24 hours per day, seven days per week.

The Ovoot Tolgoi Mine's proximity to the Shivee Khuren-Ceke border crossing allows the Company's customers to transport coal by truck on an unpaved road from the mine site to China. The Company has engaged a contractor to design and build a new coal-haul highway from the Ovoot Tolgoi Complex to the Mongolia-China border. The coal-haul highway is expected to cost approximately $48 million and is expected to be completed by the end of 2012 and have a capacity well in excess of 20 million tonnes per year.

A north-south railway line currently connects Ceke with Jiayuguan City in Gansu Province and with the interior of China. Another east-west railway line from Ceke to Linhe, an industrial city in eastern Inner Mongolia, is expected to be operational on a commercial basis in 2011. This line is anticipated to have an initial transportation capacity of approximately 15 million tonnes per year, increasing to 25 million tonnes per year. Using this route, coal can be shipped to active coal markets to the east such as the region around Baotou and Hebei Province, and further east to ports on China's Bohai Gulf.

Since December 2008, the Company has been engaged in various levels of discussions with railway contractors regarding the feasibility of developing a coal railway spur from the Ovoot Tolgoi Mine to the Mongolia-China border. Discussions by the Mongolian parliament and the Government of Mongolia indicate an increased willingness to approve development of new north-south railway spurs linking Mongolian mines to China at some point in the future. However, while the Company continues to evaluate a north-south railway spur from the Ovoot Tolgoi Mine, it is currently focusing on improving truck transportation. Coal trucked to China through the Shivee Khuren-Ceke checkpoint can readily be loaded onto the Chinese rail lines mentioned above.

4. MINERAL PROPERTIES (Continued)

SouthGobi Sands LLC, a wholly owned Mongolian subsidiary of SouthGobi, employed 455 employees as at September 30, 2010. Of the 455 employees, 54, including expatriates, are employed in the Ulaanbaatar office, 4 in outlying smaller offices, including the Ceke border point, and 397 at the mine site. Of the total 455 employees based in Mongolia, 443 (97%) are Mongolian nationals and of those, 156 (34%) are residents of the local Gurvantes Soum.

In April 2008, the Company purchased a second fleet of coal mining equipment for the open pit mine, with some equipment commissioned in the fourth quarter of 2009 and the remaining equipment commissioned in June 2010. The new shovel and truck mining fleet consists of a Liebherr 996 hydraulic shovel ($34m^3$) and four Terex MT4400 (218-tonne capacity) trucks. The new fleet will supplement the existing mine fleet consisting of a Liebherr 994 hydraulic shovel ($13.5m^3$) and seven Terex TR100 (91-tonne capacity) trucks.

The third mining fleet, which includes an additional Liebherr 996 hydraulic excavator ($34m^3$), five Terex MT4400 (218-tonne capacity) trucks and various auxiliary equipment, has now been commissioned. The third fleet was originally expected to be mining from January 2011, but was fully commissioned in October 2010. The third fleet is expected to grow capacity by approximately 50% over the performance of the Company's existing fleets, which have been averaging approximately one million bank cubic meters of material movement per month since July.

A fourth fleet of equipment, which includes another Liebherr 996 hydraulic excavator ($34m^3$), four Terex MT4400 (218-tonne capacity) trucks and other support equipment, was ordered in April 2010 for delivery in 2011. The additional larger equipment fleets are expected to increase productive capacity. However, the Company will continue to employ the smaller initial fleet in areas of thinner seams and to supplement the larger equipment.

In October 2010, the Company approved the purchase of additional equipment including one Liebherr R9250 hydraulic excavator, which will replace the current Liebherr 994 hydraulic shovel ($13.5m^3$), and an additional Terex MT4400 (218-tonne capacity) truck. This will provide better fleet flexibility as the Liebherr R9250 hydraulic excavator will be in a back-hoe configuration and can load both the larger MT4400 (218-tonne capacity) trucks and the smaller TR100 (91-tonne capacity) trucks as well as mine the thinner seams more cleanly. An additional fifth fleet has also been approved including one Liebherr R9250 hydraulic excavator and two MT4400 (218-tonne capacity) trucks. This additional equipment is expected to accelerate production. Two additional MT4400 (218-tonne capacity) trucks have also been approved to maintain capacity as cycle times will increase when the coal handling facility is operating in 2011.

4. MINERAL PROPERTIES (Continued)

Throughout the quarter ended September 30, 2010, the Company continued to develop its coal markets in China. Total sales in the quarter ended September 30, 2010 were 194,000 tonnes consisting of raw semi-soft coking coal and raw higher ash coal. Although the Company continues to sell its coal on shorter term contracts, longer term contracts may be pursued as the Company develops contacts with larger customers in China.

Soumber Deposit

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

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

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

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

4. MINERAL PROPERTIES (Continued)

Additional drilling commenced in March 2010. The drilling intends to expand and better define the resource and includes a series of open-holes and core holes. Approximately 45,241m of core (7,163m) and reverse circulation (38,078m) holes have already been drilled on the Soumber Deposit and surrounding areas to the end September 30, 2010.

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

SouthGobi is currently preparing revised studies on the Soumber Deposit, incorporating the additional geological data, according to Mongolian regulatory requirements to enable the Company to proceed to a formal registration of the resource and application for a mining license.

Ovoot Tolgoi Underground Deposit

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

The 2008 exploration program concentrated on the underground located in the Sunset Pit. This drilling was conducted to obtain additional information respecting the structure and quality of the deep underground coal mineralization. The drilling conducted in 2006 and 2007 identified coking and semi-soft coal at depths of between 250m and 600m beneath the lower boundaries of the planned open pits at Sunrise and Sunset. The No. 5 coal seam continues to be open at depth and along strike.

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

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

4. MINERAL PROPERTIES (Continued)

Tsagaan Tolgoi Deposit

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

A coal delineation program was first carried out in 2004, but no work was conducted in 2005. Exploration programs were carried out during 2006 and 2007 to provide the basis for a resource estimate. In February 2008, Norwest estimated 23.4 million tonnes of measured resources, 13.0 million tonnes of indicated resources and 9.0 million tonnes of inferred resources. The coal is of volatile bituminous B to C in rank based on ASTM D388 standards and is suitable for use as a thermal coal. The resources appear to be amenable to surface extraction down to a planned depth of 150 m. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are set out in the Technical Report entitled, "Coal Geology and Resources – Tsagaan Tolgoi Property" dated March 25, 2008, and available at www.sedar.com.

Effective August 12, 2009, the Mongolian Government issued a mining license for the Tsagaan Tolgoi coal field. The Technical and Economic Study has been completed, and is currently under government review. The Detailed Environmental Impact Assessment was approved on April 9, 2010.

The nearest in-country rail line is the Trans-Mongolia Railway that runs northwest to southeast and connects Ulaanbaatar to Beijing. The nearest point on this line to the Tsagaan Tolgoi Deposit is approximately 400km to the east at the Chinese border. Limited infrastructure exists at Tsagaan Tolgoi and will need to be developed prior to commencing mining operations. The Tsagaan Tolgoi Deposit is located close to Ivanhoe's Oyu Tolgoi copper and gold project and has the potential to supply coal to any power project that may, in the future, be established there.

The Tsagaan Tolgoi Deposit mining license may be affected by a new Mongolian law that prohibits minerals exploration and mining in certain areas. Pursuant to the Mining Prohibition in Specified Areas Law, the Mongolian Government was to define the boundaries of the areas in which exploration and mining would be prohibited by October 16, 2009. However, the Mongolian Government has not yet approved and published this information.

The Company has no current plans to develop the Tsagaan Tolgoi Deposit, although the property remains a deposit that could be developed in the future.

4. MINERAL PROPERTIES (Continued)

Tavan Tolgoi Extension Area

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

A field reconnaissance program was carried out on the Tavan Tolgoi Extension licenses in 2006. The exploration area has been surveyed for copper and gold exploration using BHP Falcon aerial geophysics. The Company has obtained the aeromagnetic and aero gravity survey data and is using the results of the upcoming analysis of the Falcon data to help delineate potential coal targets. Exploration work on the extension continued in 2007, 2008 and 2009. A minimum amount of work will be carried out in 2010 to maintain the exploration licenses.

Exploration Program

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

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

Substantive physical exploration for 2010 commenced in March. For the nine months ended September 30, 2010, $14.6 million has been spent, including 60,646m^3 of trenching and over 105,800m of drilling (both core and reverse circulation). Key targets so far have been the Soumber Deposit and the fields surrounding the Soumber Deposit and a target approximately six kilometers to the south-west of the Ovoot Tolgoi Complex known as the SW target. For the nine months ended September 30, 2010 $7.1 million has been spent on the Soumber Deposit and surrounding area.

The drilling program will focus primarily on further definition of known coal occurrences with the intention to bring them to a NI 43-101 compliant resource definition stage and to allow for registration with the Mongolian Government as the next step toward expanding the Company's mining license holdings.

4. MINERAL PROPERTIES (Continued)

Regional Infrastructure

The Company entered into a contract for $48 million to design and construct a coal-haul highway. The 45 kilometre highway will link the Ovoot Tolgoi Mine with Ceke, a major coal terminal on the China side of the border with rail connections to key coal markets in China. The new coal-hauling highway will be 17 meters wide and will consist of four fully paved lanes, with a one metre central median in order to provide capacity well in excess of 20 million tonnes of coal per year. The new highway is scheduled to be completed by the end of 2012. It will be constructed with a concession granted by the Mongolian Government as per the country's recently passed Concession Law.

5. SELECTED QUARTERLY DATA

($ in thousands, except per share information)

	2010	2010	2010	2009				2008
QUARTER ENDED	**30-Sep**	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec
Revenue	**$ 6,597**	$ 17,668	$ 13,917	$ 9,960	$ 11,871	$ 10,666	$ 3,541	$ 3,126
(Loss)/income from mine operations	**(6,674)**	4,400	1,187	1,524	3,234	1,527	328	949
Evaluation and exploration expenses	**(6,314)**	(6,659)	(1,651)	(739)	(2,150)	(1,742)	(768)	(4,959)
Net interest (expense)/income	**(4,385)**	(4,384)	(9,024)	(8,246)	(642)	(356)	(57)	147
Other finance income /(costs)	**51,507**	67,677	(153,410)	(53,536)	-	-	-	-
Total finance income /(costs)	**47,122**	63,293	(162,434)	(61,782)	(642)	(356)	(57)	147
Net (loss)/income from continuing operations before other finance income/(costs)	**(24,012)**	(14,376)	(14,861)	(16,651)	2,224	(5,139)	(6,616)	(11,370)
Income/(loss) from continuing operations	**27,495**	53,301	(168,271)	(70,187)	2,224	(5,139)	(6,616)	(11,370)
Income/(loss) from discontinued operations	**-**	-	-	1,034	(26,006)	(2,772)	(3,344)	(5,637)
Net income/(loss)	**27,495**	53,301	(168,271)	(69,153)	(23,782)	(7,911)	(9,960)	(17,007)
Net income/(loss) per share	**0.15**	0.29	(1.09)	(0.52)	(0.17)	(0.06)	(0.08)	(0.13)

Review of Quarterly Financial Results

The changes in comparative results of operations on a quarter over quarter basis are due primarily to significant fluctuations in the following areas: revenue, exploration expenses, share-based compensation charges, foreign exchange gains and losses, interest expense, impairments, loss on partial conversion of the convertible debenture and fair value change of embedded derivatives in convertible debt. These latter two items are described in Notes 7 and 14 of the Condensed Consolidated Interim Financial Statements.

The Company recorded net income for the three months ended September 30, 2010 of $27.5 million compared to net income of $53.3 million for the three months ended June 30, 2010 and a net loss of $23.8 million for the three months ended September 30, 2009. The net income in the third quarter of 2010 is due primarily to the $49.8 million gain on the fair value change of the embedded derivatives in the CIC convertible debenture.

The net loss from continuing operations before other finance income/(costs) was $24.0 million for the third quarter of 2010 compared to $14.4 million for the second quarter of 2010. In the third quarter of 2010, other finance income/(costs) includes a gain of $49.8 million on the fair value change of the embedded derivatives in the convertible debenture and a $1.7 million mark to market gain on investments. In the second quarter of 2010, other finance income/(costs) includes a $72.2 million gain on the fair value change on the embedded derivatives in the convertible debenture and a $4.6 million mark to market loss on investments. The finance income/(costs) in the first quarter of 2010 included a $151.4 million loss on partial conversion of the convertible debenture,

5. SELECTED QUARTERLY DATA (Continued)

Revenue and income from mine operations relate to the Mongolian Coal Division. Revenues decreased to $6.6 million in the third quarter of 2010 from $17.7 million in the second quarter of 2010 and from $11.9 million in the third quarter of 2009. Revenues have decreased due to both lower sales volumes and lower realized sales prices.

In the third quarter of 2010, the Company shipped approximately 194,000 tonnes at an average realized price of $37 per tonne. This compares to approximately 449,000 tonnes at an average realized selling price of $43 per tonne in the second quarter of 2010 and 457,000 tonnes of coal at an average realized selling price of $28 per tonne in the third quarter of 2009. Third quarter shipments in 2010 were lower due to the low availability of Sunset Pit No. 5 seam semi-soft coking coal in the short-term mine plan and the limited screening capacity for the Sunset Pit No. 8/9/10 seams higher ash higher sulphur coal. Variability in the realized selling price relates to increased prices of individual customer contracts partially offset by changes in the quality of coal sold. During the third quarter of 2010, 83,000 tonnes of the Sunset Pit No. 8/9/10 seams higher ash higher sulphur coal was sold.

In the third quarter of 2010, the Company had a loss from mine operations of $6.7 million. This compares to income from mine operations of $4.4 million in the second quarter of 2010, and $3.2 million in the third quarter of 2009. The loss from mine operations in the third quarter of 2010 includes an inventory impairment of $5.2 million on the Company's raw higher ash coal stockpiles. In addition, the Company recorded a $1.8 million impairment on the Liebherr 994 shovel and related maintenance inventory as the Company has made arrangements for the Liebherr 994 shovel to be replaced by the more productive Liebherr R9250 hydraulic excavator in 2011. The Liebherr 994 shovel will be sold back to the equipment supplier together with directly associated inventory.

Exploration costs for the three months ended September 30, 2010, were $6.3 million as drilling was completed on Soumber and additional drilling continued on greenfield targets in Mongolia. Exploration costs will vary from quarter to quarter depending on the number of projects and the related seasonality of the exploration programs.

5. SELECTED QUARTERLY DATA (Continued)

The income from continuing operations includes finance income for the three months ended September 30, 2010 of $50.4 million compared to $72.9 million in the second quarter of 2010. The finance income relates primarily to the fair value change of embedded derivatives in the CIC convertible debenture. The Company incurred finance costs for the three months ended September 30, 2010 of $3.3 million compared to $9.6 million for the three months ended June 30, 2010. In the first quarter of 2010, finance costs included a $151.4 million loss on partial conversion of the CIC convertible debenture. The large fluctuations in finance income and finance costs in 2010 are due primarily to fluctuations in the Company's share price which impact the carrying value of the CIC convertible debenture. (See Finance Income/Costs) section).

Discontinued operations for the three months ended September 30, 2009 relate to the Indonesia Coal Division.

6. RESULTS OF OPERATIONS

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Volumes, Prices and Costs				
Raw coal production *(millions of tonnes)*	**0.57**	0.36	**1.41**	0.51
Coal sales *(millions of tonnes)*	**0.19**	0.46	**1.07**	0.97
Average realized sales price *(per tonne)*	**$ 37.14**	$ 27.82	**$ 38.80**	$ 28.76
Total cash costs of product sold *(per tonne)*	**$ 22.04**	$ 13.41	**$ 22.66**	$ 15.96
Direct cash costs of product sold *(per tonne)*	**$ 18.59**	$ 11.16	**$ 21.22**	$ 13.75
Operating Statistics				
Sunset				
Total waste material moved *(millions of bank cubic metres)*	**2.90**	1.06	**6.12**	1.41
Strip ratio *(bank cubic metres of waste rock per tonne of coal produced)*	**5.09**	2.98	**4.35**	2.74
Sunrise				
Total waste material moved *(millions of bank cubic metres)*	**0.43**	-	**0.46**	-
Operating Results *(thousands of dollars)*				
Revenue	**$ 6,597**	$ 11,871	**$ 38,182**	$ 26,078
Cost of sales	**(13,271)**	(8,637)	**(39,269)**	(20,989)
Income from mine operations	**(6,674)**	3,234	**(1,087)**	5,089
Administration expenses	**(7,981)**	(6,115)	**(22,351)**	(16,802)
Evaluation and exploration expenses	**(6,314)**	(2,150)	**(14,625)**	(4,660)
Operating loss from continuing operations	**$ (20,969)**	$ (5,031)	**$ (38,063)**	$ (16,373)

6.1 Three Months Ended September 30, 2010 and 2009

In the three months ended September 30, 2010, 0.57 million tonnes of raw coal was produced with a strip ratio of 5.09 compared to 0.36 million tonnes of raw coal produced in the three months ended September 30, 2009. Mining capacity increased in the third quarter of 2010 compared to the third quarter of 2009 due to the full commissioning of the second fleet.

The Company incurred an operating loss from continuing operations for the three months ended September 30, 2010 of $21.0 million compared to a $5.0 million loss in the same period in 2009. The operating loss is impacted by the factors discussed below.

In the three months ended September 30, 2010, the Company shipped approximately 0.19 million tonnes of coal at an average realized selling price of approximately $37 per tonne. This compares to 0.46 million tonnes of coal shipped in the three months ended September 30, 2009 at an average realized selling price of $28 per tonne. The decreased sales volume in the third quarter of 2010 was due to the low availability of Sunset Pit No. 5 seam semi-soft coking coal in the short-term mine plan and the limited screening capacity for the Sunset Pit No. 8/9/10 seams higher ash higher sulphur coal.

6. RESULTS OF OPERATIONS (Continued)

Cost of sales was $13.3 million in the three months ended September 30, 2010, compared to $8.6 million for the three months ended September 30, 2009. Cost of sales is comprised of three main components, direct cash costs of products sold, mine administration costs and non-cash items. Non-cash items include depreciation, depletion of stripping costs, impairments and share-based compensation. Cost of sales will vary depending on sales volume, production and unit costs which directly affects income from mine operations.

The increase in cost of sales in the third quarter of 2010 compared to the same period in 2009 relates primarily to the impairment of the Company's raw higher ash coal stockpiles for $5.2 million together with the impairment of the Liebherr 994 shovel and related maintenance inventory for $1.8 million.

As at September 30, 2010, management undertook an impairment review of the carrying amount of the Company's raw higher ash coal stockpiles. Current selling price of the Sunset Pit No. 8/9/10 seams higher ash higher sulphur coal is approximately $26 per tonne on a screened basis. The carrying cost of this coal was above the estimated selling price of $26 per tonne and as a result a $5.2 million write-down was recorded.

The Liebherr 994 shovel will be replaced by a more productive Liebherr R9250 hydraulic excavator which will improve fleet flexibility. This replacement will take place under an arrangement whereby the Liebherr 994 shovel will be sold back to the equipment supplier together with directly associated maintenance inventory. The transaction will take place when the new Liebherr R9250 hydraulic excavator is delivered in 2011. Management reviewed the carrying value of the Liebherr 994 shovel and related maintenance inventory for impairment and as a result recorded a $1.8 million impairment.

Direct cash costs of product sold were $18.59 per tonne in the three months ended September 30, 2010 compared to $11.16 per tonne for the same period in 2009. The increase in direct cash costs primarily reflects the increased strip ratio of 5.09 compared to a strip ratio of 2.98 for the same period in 2009. Prices of diesel fuel, (approximately 24% of the Company's direct cash cost) were 16% higher in the three months ended September 30, 2010 compared to the three months ended September 30, 2009.

During the three months ended September 30, 2010, the Company introduced screening of its raw higher ash coals (currently consisting of Sunset Pit No. 8/9/10 seams coal). Screening increases the direct cash cost of those coals impacted.

6. RESULTS OF OPERATIONS (Continued)

Direct cash costs of product sold in the third quarter of 2010 were higher than the third quarter of 2009 however the direct cash costs of product sold were lower than the second quarter of 2010.

Mine administration costs per tonne increased to $3.45 per tonne for the three months ended September 30, 2010, compared to $2.25 per tonne for the three months ended September 30, 2009. The increase per tonne is due to fixed costs being allocated over a relatively lower sales volume in the third quarter of 2010.

Exploration expenses for the three months ended September 30, 2010, were higher than the three months ended September 30, 2009. Increased exploration expense in 2010 relates to a more active exploration program in 2010 including substantially increased drilling.

Administration expenses for the three months ended September 30, 2010 were $8.0 million compared to $6.1 million for the three months ended September 30, 2009. Administration expenses for the three months ended September 30, 2010, include approximately $3.1 million of share-based compensation compared to approximately $2.2 million for the three months ended September 30, 2009.

The administration expenses consist of the following major categories broken down for comparative purposes (see Note 6 of the Condensed Consolidated Interim Financial Statements).

Legal fees for the three months ended September 30, 2010, were consistent with the three months ended September 30, 2009. Legal fees include costs associated with the Company's regulatory affairs including expenses associated with corporate governance, contract negotiations, filing, registration and disclosure.

Corporate administration fees are higher in the three months ended September 30, 2010, compared to the three months ended September 30, 2009. The increase predominantly relates to additional administration costs incurred as the Company continues to expand its management team which has resulted in higher travel and administration support costs. Certain of the Company's administrative staff and office facilities are provided by Global Mining Management Ltd. (see 'Related Party Transactions') on a cost recovery basis. Accordingly, quarterly fluctuations in the costs of administrative and personnel costs can be expected commensurate with increases or decreases in quarterly corporate activity and the level of personnel employed.

6. RESULTS OF OPERATIONS (Continued)

Professional fees have increased for the three months ended September 30, 2010, as compared to the three months ended September 30, 2009. Professional fees include the cost of internal computer systems training and planning, technical reports for the Mongolia project and accruals related to the review and audit of the Company's financial statements.

Salaries and benefits, excluding share-based compensation costs, increased in the three months ended September 30, 2010 to $1.0 million as compared to $0.65 million for the three months ended September 30, 2009. The increase relates to additional staff for the three months ended September 30, 2010.

Sustainability and community relations are costs incurred in Mongolia. Sustainability and community relations expenses were $0.1 million in the third quarter of 2010 compared to $nil in the same period in 2009. The Company is committed to contributing to communities in Mongolia and developing and maintaining a positive relationship with the various communities in which the Company operates.

Public infrastructure costs were $1.3 million in the third quarter of 2010 compared to $nil in the third quarter of 2009. These costs relate to the maintenance and upgrading of public transportation infrastructure used to transport coal from the Ovoot Tolgoi Mine to the Chinese border.

The foreign exchange gains and losses are primarily the result of changes of the U.S. to Canadian dollar ("Cdn$") and the U.S. to Mongolian Tugrik exchange rates during the period.

Listing fees consist of legal, accounting and professional fees incurred for a secondary listing on the Hong Kong stock exchange. On January 29, 2010 the Company closed a global equity offering and commenced trading on the Main Board of the Hong Kong Stock Exchange. Normally the Company would treat all charges as share issue costs upon a successful equity fundraising, however due to the uncertainty in the timing of a possible equity financing in 2009, listing fees were expensed in three months ended September 30, 2009.

6. RESULTS OF OPERATIONS (Continued)

6.2 Nine Months Ended September 30, 2010 and 2009

In December 2009, the Company commenced realigning the Sunset open-pit for a north-south entry. Waste removal at Ovoot Tolgoi was originally along the seam's strike-length, i.e. east-west. This allowed for better utilization of capital when financing was more constrained. Strip ratio and waste movements were lower and customer trucks were allowed to enter directly in the shallow pit for loading. However, such alignment is not beneficial for the longer-term because it becomes less efficient as the pit depth increases. Realigning for a north-south entry is expected to provide the following long-term benefits:

- allow for longer mining faces to be exposed for larger shovels (eg Liebherr 996) to access;
- enable mining of the thinner 8, 9 and 10 seams 'face on' as opposed to 'along strike' enabling cleaner mining and a lower ash, higher value product; and
- allow more efficient access for haul trucks as the pit deepens.

Realigning the pit has impacted operations because the process requires substantial above-trend waste removal. The open-pit realignment was the primary cause of the increase in direct cash costs of production and a constrained availability of coal in the first quarter of 2010. The open-pit realignment has been completed but impacted cost per tonne sold in the second quarter of 2010 as higher cost inventory from the first quarter was sold in the second quarter. Direct cash cost per tonne produced however has decreased from the first quarter of 2010.

In addition to the impact of the pit-realignment, costs for the nine months ended September 30, 2010 were adversely impacted by fleet issues. Delayed commissioning of the final two Terex MT4400 (218-tonne) haul trucks from the second mining fleet meant the Liebherr 996 hydraulic shovel (34m^3) was not operating efficiently in the second quarter of 2010. Furthermore, the Company's Terex TR100 (91-tonne capacity) haul trucks from the first mining fleet experienced poor equipment availability ratios.

Another trend impacting costs is the increased cost of key inputs. Prices of diesel fuel, (approximately 24% of the Company's direct cash cost), were 7% higher in the nine months ended September 30, 2010 compared to the same period for 2009. The Company is also incurring higher relative costs for blasting and tires.

During the three months ended September 30, 2010, the Company introduced screening of its raw higher ash coals (currently consisting of Sunset Pit No. 8/9/10 seams coal). Screening increases the direct cash cost of those coals impacted.

6. RESULTS OF OPERATIONS (Continued)

The Company incurred an operating loss from continuing operations for the nine months ended September 30, 2010 of $38.1 million compared to $16.4 million for the same period in 2009. This variance is due to the factors discussed below.

In the nine month period ended September 30, 2010, the Company shipped approximately 1.07 million tonnes at an average realized selling price of approximately $39 per tonne compared to 0.97 million tonnes at an average realized selling price of approximately $29 per tonne in the nine month period ended September 30, 2009. The average realized selling price has increased due to increased prices of individual contracts in 2010.

Cost of sales was $39.3 million in the nine months ended September 30, 2010, which includes the direct cash cost of products sold, mine administration costs, equipment depreciation, depletion of stripping costs, impairment of inventory and fixed assets and share-based compensation. Cost of sales was $21.0 million for the nine months ended September 30, 2009. The increase in cost of sales for the nine months ended September 30, 2010 is due to the higher sales volumes, higher unit costs and the impairment of the raw higher ash coal stockpiles and the Liebherr 994 shovel and related supplies. The impairment included in cost of sales for the third quarter of 2010 was $7.0 million.

Direct cash costs of product sold were $21.22 per tonne for the nine months ended September 30, 2010 compared to $13.75 per tonne for the same period in 2009. The increase in direct cash costs is due primarily to the realignment of the open-pit which began in December 2009 and the fleet issues in 2010.

Mine administration costs per tonne decreased to $1.44 per tonne for the nine months ended September 30, 2010, compared to $2.21 per tonne for the nine months ended September 30, 2009. The decrease per tonne is due to the higher sales volume in 2010 and a reduction in mine administration costs.

Exploration expenses for the nine months ended September 30, 2010, were $10.0 million higher than the nine months ended September 30, 2009. Increased exploration expense in 2010 relates to a more active exploration program in 2010 including substantially increased drilling.

6. RESULTS OF OPERATIONS (Continued)

Administration expenses for the nine months ended September 30, 2010 were $22.4 million compared to $16.8 million for the nine months ended September 30, 2009. Share based compensation expense allocated to administration expenses was $7.9 million for the nine months ended September 30, 2010 and $8.1 million for the same period in 2009. Other amounts included in the nine months ended September 30, 2010 that account for the increase compared to 2009 are public infrastructure costs offset by an exchange gain in the nine months ended September 30, 2010.

The administration expenses consist of the following major categories broken down for comparative purposes (see Note 6 of the Condensed Consolidated Interim Financial Statements).

Legal fees for the nine months ended September 30, 2010 and September 30, 2009 were for costs associated with the Company's regulatory affairs including expenses associated with corporate governance, contract negotiations, filing, registration and disclosure. Legal fees increased in 2010 due to increased regulatory requirements and corporate activity.

Corporate administration fees increased in the nine months ended September 30, 2010 compared to the same period in 2009. The increase predominantly relates to additional administration costs incurred through the continued expansion of the Company's employee base, higher regulatory and filing fees, investor relations costs, travel expenses and administration support costs.

Professional fees are higher in the nine months ended September 30, 2010 compared to the same period in 2009. Professional fees include the cost of internal computer systems training and planning, technical reports for the Mongolia project and accruals for the review and audit of the Company's financial statements.

Salaries and benefits, excluding share-based compensation costs, increased in the nine months ended September 30, 2010, to $2.8 million as compared to $1.6 million for the nine months ended September 30, 2009. The increase relates to additional staff in 2010.

Sustainability and community relations are costs incurred in Mongolia. Sustainability and community relations expenses were $0.4 million in the nine months ended September 30, 2010 compared to $nil in the nine months ended September 30, 2009. The Company is committed to contributing to communities in Mongolia and developing and maintaining a positive relationship with the various communities in which the Company operates.

6. RESULTS OF OPERATIONS (Continued)

Public infrastructure costs were $3.4 million in the nine months ended September 30, 2010 compared to $nil in the nine months ended September 30, 2009. These costs relate to maintenance and upgrading of public transportation infrastructure used to transport coal from the Ovoot Tolgoi Mine to the Chinese border.

The foreign exchange gains and losses are primarily the result of changes of the U.S. to Canadian dollar ("Cdn$") and the U.S. to Mongolian Tugrik exchange rates during the period.

Listing fees consist of legal, accounting and professional fees incurred for a secondary listing on the Hong Kong stock exchange. On January 29, 2010 the Company closed a global equity offering and commenced trading on the Main Board of the Hong Kong Stock Exchange. Listing fees incurred in 2010 were capitalized as share issue costs. Listing fees incurred in the nine months ended September 30, 2009 were expensed. Normally the Company would treat all charges as share issue costs upon a successful equity fundraising, however due to the uncertainty in the timing of a possible equity financing in 2009, listing fees were expensed in the nine months ended September 30, 2009.

7. NON-IFRS FINANCIAL MEASURES

($ in thousands, unless otherwise stated)

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") refers to certain financial measures, such as "cash costs", which are not standardized measures recognized under IFRS and do not have a standardized meaning prescribed by IFRS. These measures are commonly utilized in the mining industry and are considered informative for management, shareholders and analysts. These measures may differ from those made by other corporations and accordingly may not be comparable to such measures as reported by other mining companies.

Cash costs is the term used by the Company to describe the cash production costs and consists of cost of product, which includes direct and indirect costs of production. The figures disclosed below are for cash cost of product sold and may differ from cash cost of product produced depending on stockpile inventory turnover.

	Three months ended September 30,		Nine months ended September 30,	
	2010	**2009**	**2010**	**2009**
Cash costs, continuing operations				
Cost of sales per financial statements	**$ 13,271**	$ 8,637	**$ 39,269**	$ 20,989
Less non-cash adjustments	**(9,003)**	(2,510)	**(15,062)**	(5,536)
Total cash costs	**4,268**	6,127	**24,207**	15,453
Coal sales *(000's of tonnes)*	**194**	457	**1,068**	968
Total cash costs of product sold *(per tonne)*	**$ 22.04**	$ 13.41	**$ 22.66**	$ 15.96

	Three months ended September 30,		Nine months ended September 30,	
	2010	**2009**	**2010**	**2009**
Cash costs, continuing operations				
Direct cash costs of product sold *(per tonne)*	**$ 18.59**	$ 11.16	**$ 21.22**	$ 13.75
Mine administration cash costs of product sold *(per tonne)*	**3.45**	2.25	**1.44**	2.21
Total cash costs of product sold *(per tonne)*	**$ 22.04**	$ 13.41	**$ 22.66**	$ 15.96

8. EXPLORATION COSTS AND DISCONTINUED OPERATIONS BY DIVISION

($ in thousands)

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Mongolian Coal Division	**$ 6,314**	$ 2,150	**$ 14,625**	$ 4,660
Indonesian Coal Division - Discontinued Operations	**-**	2,862	**-**	9,121
Total Exploration	**$ 6,314**	$ 5,012	**$ 14,625**	$ 13,781

Mongolian Coal Division

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 subsequent costs incurred to develop a property are capitalized. Exploration expenditures include geological consulting, drilling, license fees, office costs and salaries and benefits.

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

The exploration expenditures for the three months ended September 30, 2010 were $6.3 million compared to $2.1 million in the three months ended September 30, 2009. Exploration activities include drilling, trenching and geological reconnaissance. The Soumber exploration program accounts for the majority of the exploration expenditures and involves reverse circulation work, core diamond drilling, hole logging as well as a water and a geotechnical study program. The 2010 drilling program for the Soumber Deposit is complete, though results from coal laboratory analysis are still pending. The 2010 exploration expenditures also include the Company's greenfields exploration.

Indonesian Coal Division – Discontinued Operations

The sale of the Mamahak Deposit is disclosed as discontinued operations in 2009. Exploration expenditures were $2.9 million for the three months ended September 30, 2009. The Company continued exploration activities in Indonesia in 2009 until development work was suspended in October 2009.

9. FINANCE INCOME/(COSTS)

($ in thousands)

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Fair value change of embedded derivatives in convertible debenture	**$ 49,772**	$ -	**$ 120,633**	$ -
Loss on partial conversion of convertible debenture	**-**	-	**(151,353)**	-
Interest expense on convertible debenture	**(4,964)**	-	**(19,472)**	-
Interest expense on line of credit facilities	**(28)**	(632)	**(117)**	(1,030)
Mark to market gain (loss) on investments	**1,735**	-	**(3,506)**	-
Accretion of asset retirement obligation	**(20)**	(11)	**(53)**	(31)
Interest income	**627**	1	**1,851**	6
	$ 47,122	$ (642)	**$ (52,017)**	$ (1,055)

In November 2009, the Company entered into a financing agreement with a wholly owned subsidiary of CIC for $500 million in the form of a secured, convertible debenture bearing interest at 8.0% with a maximum term of 30 years. The financing is required primarily to support the accelerated investment program in Mongolia and up to $120 million of the financing may also be used for working capital, repayment of debt due on funding, general and administrative expense and other general corporate purposes.

The convertible debenture is a hybrid debt instrument, containing a debt host component and three embedded derivatives. The debt host is measured at amortized cost using the effective interest method. The embedded derivatives are measured at fair value and all changes in fair value will be recognized in profit or loss immediately.

Pursuant to the debenture conversion terms, the Company had the right to call for the conversion of up to $250 million of the debenture upon achieving a public float of 25% of its common shares based on a conversion price of the lower of Cdn$11.88 and the 50-day volume-weighted average price ("VWAP"). On March 29, 2010, the Company exercised this right and completed the conversion of $250 million of the convertible debenture into 21,471,045 shares at a conversion price of $11.64 (Cdn$11.88). On March 29, 2010, the Company also settled all the accrued interest payable in shares on the converted $250 million by issuing 90,000 shares for the $1.4 million in accrued interest converted at the 50-day VWAP conversion price of $15.97 (Cdn$16.29). On April 1, 2010, the Company also settled the outstanding accrued interest payable in cash on the converted $250 million with a cash payment of $5.7 million.

9. FINANCE INCOME/(COSTS) (Continued)

For the three months ended September 30, 2010, the fair value change on the embedded derivative was a gain of $49.8 million, compared with a $72.2 million gain in the second quarter of 2010. The fair value of the embedded derivatives is driven by many factors including, share price, foreign exchange rates and volatility. During the third quarter of 2010, the share price dropped from Cdn$12.50 at June 30, 2010 to Cdn$10.37 at September 30, 2010 resulting in a significant decrease in the fair value of the embedded derivative which resulted in a gain of $49.8 million. Finance costs for the nine months ended September 30, 2010 include a $151.4 million loss on partial conversion of the convertible debenture and interest expense of $19.5 million for the nine months ended September 30, 2010.

In 2009, as part of the sale of the Metals Division, the Company obtained a $30 million working capital credit facility from Ivanhoe. The credit facility was for a one year term with a one year discretionary extension. The credit facility was unsecured and carried an interest rate equal to LIBOR plus 750 basis points. In July 2009, the Company and Ivanhoe agreed to increase the existing working capital credit facility from $30 million to $60 million. The amended credit facility had an original maturity date of December 31, 2010, was unsecured and had an interest rate of LIBOR plus 750 basis points. The amended facility also required repayment in the event that the Company acquired additional financing from a third party source and provided for an extension fee of $1.5 million payable in the event any portion of the facility was outstanding past March 31, 2010. In November 2009, after receiving the financing from CIC, the Company repaid the $50 million in principal plus $1.6 million in accrued interest. The Company incurred interest expense of $0.6 million for the three months ended September 30, 2009 and $1.0 million for the nine months ended September 30, 2009.

On December 18, 2009, the Company established a line of credit facility with Golomt Bank in Mongolia ("Bank line of credit"). The Bank line of credit is a twelve month revolving line of credit facility with a maximum draw-down available of $3.0 million. The Bank line of credit facility is used by the Company's Mongolian subsidiaries as part of their working capital management. The Company incurred interest expense of $0.03 million for the three months ended September 30, 2010 and $0.12 million for the nine months ended September 30, 2010.

The mark to market adjustment on investments was a gain of $1.7 million for the three months ended September 30, 2010 and a loss of $3.5 million for the nine months ended September 30, 2010, compared to $nil for both the three and nine month period ended September 30, 2009. The gain includes the mark to market adjustment on the 50 million shares of Kangaroo Resources Ltd., which were received as proceeds for the sale of the Indonesia Coal Division, and certain money market instruments.

9. FINANCE INCOME/(COSTS) (Continued)

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

Interest income was higher in the three and nine months ended September 30, 2010 compared to the same periods in 2009, due to higher cash balances which relate to the CIC convertible debenture and the completion of the equity financings in early 2010. Lower interest income during 2009 reflects lower average cash balances. The current economic climate has resulted in very low interest rates especially for $US denominated investments.

10. TAXES

In the three and nine months ended September 30, 2010, the Company recorded current income tax expense of $0.67 million and $1.0 million respectively related to its Mongolian operations compared to $0.71 million in the same periods in 2009. The Company believes profitable operations in Mongolia are probable and has therefore recorded a deferred income tax recovery related to deductible temporary differences and the carry forward of unused tax losses of $3.7 million in the first nine months of 2010 and $8.6 million in the first nine months of 2009.

11. LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Highlights

($ in thousands)

	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Cash used in operating activities	**$ (22,335)**	$ (4,118)	**$ (57,467)**	$ (20,216)
Cash used in investing activities	**(29,600)**	(8,598)	**(105,517)**	(24,403)
Cash (used in) generated by financing activities	**(1,790)**	12,626	**419,050**	37,006
Effect of foreign exchange rate changes on cash	**(4)**	(5)	**67**	(16)
Increase/(decrease) in cash for the period	**(53,729)**	(95)	**256,133**	(7,629)
Cash balance, beginning of the period	**667,204**	2,806	**357,342**	10,340
Cash balance, end of the period	**$ 613,475**	$ 2,711	**$ 613,475**	$ 2,711

General market conditions

There are some risks to the Chinese growth outlook, however the fundamental demand story in China remains strong. The Company expects demand for imported coal in China and other markets to increase into the foreseeable future. Management continues to monitor external conditions and their impact on the Company's business plans for the remainder of the year.

Cash used in operating activities

At September 30, 2010, the Company had cash resources of $613.5 million compared to cash resources of $357.3 million at December 31, 2009. At September 30, 2010, the Company also had short and long term money market investments of $77.5 million for a total of $691.0 million in cash and cash equivalents and money market investments.

Cash used in continuing operations was $22.3 million for the three months ended September 30, 2010, compared to $1.7 million for the three months ended September 30, 2009. For the nine months ended September 30, 2010 cash used in continuing operations was $57.5 million compared to $9.4 million for the nine months ended September 30, 2009. Cash used in discontinued operations for the three and nine months ended September 30, 2010 was $nil compared to $2.4 million and $10.8 million for the three and nine months ended September 30, 2009.

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

In the three months ended September 30, 2010, the Company earned net income from continuing operations before tax of $26.2 million. In the nine months ended September 30, 2010, the Company incurred a net loss from continuing operations before tax of $90.1 million. This compares to a net loss from continuing operations before tax for the three and nine months ended September 30, 2009 of $5.7 million and $17.4 million, respectively. Included in the net income for the three months ended September 30, 2010 is a $49.8 million gain on the fair value change of the embedded derivatives in the convertible debenture. The net loss for the nine months ended September 30, 2010 includes a $151.4 million loss on the partial conversion of the convertible debenture. In 2010, the Company recorded revenue of $6.6 million for the three months ended September 30, 2010 and $38.2 million for the nine months ended September 30, 2010 compared to $11.9 million and $26.1 million for the comparative periods in 2009. With the increased activities at the Ovoot Tolgoi site and the operations in Mongolia, accounts receivable, inventory, and accounts payable increased during the nine months ended September 30, 2010.

Accounts receivable include funds due from government taxation authorities (Goods and Services Tax or Value Added Tax ("VAT")). Verification of the collectability of the funds from government taxation authorities was conducted in the fourth quarter of 2008, early 2009 and the fourth quarter of 2009. Payment of accounts receivable due from government taxation authorities in Mongolia could be delayed, and is being used to offset current income taxes payable in future periods.

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

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

Prepaid balances and deposits have increased during 2010. The increase primarily relates to advances for supplies inventory.

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Coal and supplies inventory have increased to $33.4 million at September 30, 2010 from $16.4 million at December 31, 2009 due to increased activity and more mobile equipment on site. Coal and supplies inventory is valued at the lower of cost and net realizable value. Coal inventory cost of $14.0 million at September 30, 2010 and $9.6 million at December 31, 2009 includes direct and indirect labour, operating materials and supplies, transportation costs and an appropriate portion of fixed and variable overhead expenses including depreciation and depletion. Supplies inventory consists of consumable parts and supplies.

The Company had a stockpile of approximately 0.63 million tonnes of coal inventory at September 30, 2010, 0.39 million tonnes at December 31, 2009 and 0.58 million tonnes at September 30, 2009.

Accounts payable have increased in the nine months ended September 30, 2010. Increased activity in Mongolia has been offset by the lower corporate balances.

Cash used for investing activities

Cash used for investing activities was $29.6 million for the three months ended September 30, 2010, compared to $8.6 million for the same period in 2009. For the nine months ended September 30, 2010 cash used for investing activities was $105.5 million compared to $24.4 million for the nine months ended September 30, 2009.

The Company's investment in property, plant and equipment was higher during 2010 as the Company prepares to ramp up production. Deposits for further mining equipment are included as plant and equipment. The Company incurred expenditures in the three and nine months ended September 30, 2010 for mobile and mining equipment, construction projects, tires and deferred stripping in Mongolia. The Company began stripping the Sunrise pit in the second quarter of 2010. The Company incurred expenditures during the three and nine months ended September 30, 2009 for tires, mobile and mining equipment.

In the first quarter of 2010, after the receipt of the proceeds from the equity financing, the Company invested $30.0 million in longer term money market instruments. During the first quarter of 2010, short term money market investments of $15.0 million also matured.

Interest income will increase or decrease depending on the cash position and interest rates. Interest income was higher in the three and nine months ended September 30, 2010 compared to the three and nine months ended September 30, 2009 due to higher cash balances which related directly to the completion of the equity financings and the proceeds from the CIC convertible debenture. The current economic climate has resulted in very low interest rates especially for $US denominated investments.

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Cash provided by financing activities

On January 29, 2010, the Company announced that it had closed the global equity offering of 27 million common shares of the Company at a price of Cdn$17.00 per common share, for gross proceeds of $437.4 million.

On February 26, 2010, the Company announced that Citigroup Global Markets Canada Inc. and Macquarie Capital Markets Canada, representatives of the Canadian underwriters of the Company's global equity offering, partially exercised their over-allotment option and purchased an additional 228,100 common shares of the Company at a price of Cdn$17.00 per share for gross proceeds of $3.7 million.

On December 18, 2009, the Company established a line of credit facility with Golomt Bank in Mongolia. The bank line of credit facility is a twelve month revolving line of credit facility with a maximum draw-down available of $3.0 million. The line of credit facility is secured by a charge over certain equipment held by SouthGobi Sands LLC. The line of credit facility is used by the Company's Mongolian subsidiaries as part of their working capital management. During the nine months ended September 30 2010, the Company had drawings of $35.6 million and repayments of $36.2 million. The principal balance outstanding as at September 30, 2010 was $2.4 million.

On December 31, 2008, the Company announced the sale of its Metals Division to Ivanhoe for $3.0 million and other non-cash consideration. As part of the sale transaction, the Company obtained a $30.0 million credit facility from Ivanhoe. The credit facility was for a one year term with a one year discretionary extension. The credit facility was unsecured and carried an interest rate equal to LIBOR plus 750 basis points. In July 2009, the Company and Ivanhoe agreed to increase the existing working capital credit facility from $30.0 million to $60.0 million. The amended credit facility had an original maturity date of December 31, 2010, was unsecured and had an interest rate of LIBOR plus 750 basis points. The amended facility also required repayment in the event that the Company acquired additional financing from a third party source and provided for an extension fee of $1.5 million payable in the event any portion of the facility was outstanding past March 31, 2010. In November 2009, after receiving the financing from CIC, the Company repaid the $50.0 million in principal plus $1.6 million in interest expense. During the nine months ended September 30, 2009, the Company's drawings under the line of credit were $36.0 million.

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Liquidity, Financing and Working Capital Resources

The Company is an integrated coal exploration, development and production company. Based on proceeds from CIC and the net proceeds from the global equity offering, the Company does not anticipate any additional funding requirements in the near future.

In November 2009, the Company entered into a financing agreement with a wholly owned subsidiary of CIC for $500.0 million in the form of a secured, convertible debenture bearing interest at 8.0% with a maximum term of 30 years. The convertible debenture is secured by a charge over the Company's assets and certain subsidiaries. The financing is required primarily to support the accelerated investment program in Mongolia and up to $120.0 million of the financing may also be used for working capital, repayment of debt due on funding, general and administrative expense and other general corporate purposes.

On March 29, 2010, the Company exercised the right to call for the conversion of up to $250.0 million of the convertible debenture into 21,471,045 shares at a conversion price of $11.64 (Cdn$11.88). Following the conversion CIC through its indirect wholly owned subsidiary, owns approximately 13% of the Company.

On January 29, 2010, the Company announced that it had closed the global equity offering of 27 million common shares of the Company at a price of Cdn$17.00 per common share, for gross proceeds of $437.4 million. On February 26, 2010, the Company announced a partial exercised of the over-allotment option and issued an additional 228,100 common shares of the Company at a price of Cdn$17.00 per share for gross proceeds of $3.7 million.

The Company plans to use the net proceeds from the financings above to carry out the following activities:

- Expansion of the production capacity at the Company's Ovoot Tolgoi open-pit mine
- Assessment, construction and development of regional transportation infrastructure
- Assessment and construction of value added facilities such as a coal-handling facility and a washing plant
- Exploration and development of the Soumber deposit
- General exploration, development and acquisition activities
- Working capital, general and administrative expenses and other general corporate purposes

To date, the Company's actual use of such proceeds has not varied from the anticipated use of proceeds set out above.

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

On June 8, 2010, the Company announced that its Board of Directors authorized a share repurchase program to purchase up to 2.5 million common shares of the Company on each or either of the Toronto Stock Exchange and the Hong Kong Stock Exchange, in aggregate representing up to 5 million common shares of the Company. As of November 10, 2010, the Company had repurchased 140,250 shares on the Hong Kong Stock Exchange and 120,500 shares on the Toronto Stock Exchange for a total of 260,750 common shares. As of November 10, 2010, the Company has cancelled all shares repurchased.

As at September 30, 2010, the Company's gearing ratio was 0.24 (December 31, 2009: 0.97) which was calculated based on the Company's long term liabilities to total assets.

12. RELATED PARTY TRANSACTIONS

The Company is a party to a shareholders' cost-sharing agreement with certain other public and private companies, including Ivanhoe (the "Other Companies") pursuant to which the Company and the Other Companies are equal shareholders in Global Mining Management Ltd. ("GMM") and, through GMM, share office space, furnishings and equipment and communications facilities (on a cost recovery basis) and the employment, on a part-time basis, of various administrative, office and management personnel in Vancouver, British Columbia. Costs of the shared office facilities and the shared part-time employees and service providers are recovered from the Company proportionate to the time spent by the shared part-time employees and service providers on matters pertaining to the Company. Certain of the directors and officers of the Company are also officers and directors of GMM. The Company has utilized the services of the GMM staff and office since September 1, 2003 and has incurred costs of $1.9 million and $1.4 million for the nine months ended September 30, 2010 and September 30, 2009 respectively.

On December 31, 2008, the Company announced the sale of the Metals Division to Ivanhoe for $3.0 million and other non-cash consideration. The Metals Division consisted of a series of base and precious metal exploration properties in Mongolia and Indonesia, related assets, employees and contracts. As part of the sale transaction, the Company obtained a credit facility from Ivanhoe, which allowed the Company to receive loan advances from Ivanhoe to an aggregate maximum of $30.0 million. The credit facility was for a one year term with a one year discretionary extension. The credit facility was unsecured and carried an interest rate equal to LIBOR plus 750 basis points.

12. RELATED PARTY TRANSACTIONS (Continued)

In July 2009, the Company and Ivanhoe agreed to increase the existing working capital credit facility from $30.0 million to $60.0 million. The amended credit facility had an original maturity date of December 31, 2010, was unsecured and had an interest rate of LIBOR plus 750 basis points. The amended facility also required repayment in the event that the Company acquires additional financing from a third party source and provided for an extension fee of $1.5 million payable in the event any portion of the facility was outstanding past March 31, 2010. In November 2009, the Company after receiving the financing from CIC repaid the $50.0 million in principal plus $1.6 million in accrued interest.

13. OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value. As at November 10, 2010, 183,966,730 common shares were issued and outstanding. There are also incentive share options outstanding that are exercisable to acquire 9,474,165 unissued common shares. There are no preferred shares outstanding.

As at November 10, 2010, Ivanhoe directly owned 104,807,155 common shares representing approximately 57% of the issued and outstanding common shares of SouthGobi.

14. INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

15. 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, 2009, which is available at www.sedar.com.

16. OUTLOOK

It is difficult to reliably forecast commodity prices and customer demand for the Company's products; however the Company's sales and marketing efforts continue to provide positive results. There is informal evidence that suggests Mongolia will set a new record for coal shipments to China in 2010 and become a significant supplier of China's coal needs.

In the results for the quarter ended June 30, 2010 the Company highlighted two issues which had the potential to impact the second half of 2010. Firstly, that the near-term mine plan included proportionately less of the better quality raw semi-soft coking coal coming from the Sunset Pit No. 5 seam. Secondly, the Company is currently experiencing areas of higher sulphur than originally anticipated in mine plans and studies. The Company went further to indicate that some of the higher sulphur coal would potentially not be attractive to customers in its current form and may need to be stockpiled until appropriate processing is in place or blending opportunities arise.

The quarter ended September 30, 2010 was impacted by those issues while the Company worked on various projects to mitigate them. Some progress has subsequently been made and on October 19, 2010, the Company announced increased sales volume guidance for the second half of 2010 of approximately 1.5 million tonnes. The Company expects to achieve or exceed this guidance. Physical coal shipments are running at record levels in terms of average daily customer truck movements. October contracted sales of 527,000 tonnes exceeded the previous monthly record of 232,000 tonnes set in June 2009. The Company now anticipates finishing 2010 with a substantial reduction in unsold coal in its inventory.

16. OUTLOOK (Continued)

Pricing of individual products for the fourth quarter of 2010 remains broadly the same as for the third quarter of 2010. However, overall average selling price will likely be substantially reduced to reflect the fact that a large proportion of sales are of the higher ash coal that remained in the stockpile at the end of the third quarter 2010. The current selling price of the screened Sunset Pit No. 8/9/10 seams higher ash higher sulphur coal is approximately $26 per tonne.

With the full commissioning of the third mining fleet in mid-October, capacity to move material in the fourth quarter will be much higher than for the third quarter of 2010. Average capacity for the months of November and December are expected to be 50% higher than for the average monthly capacity in the third quarter of 2010.

SouthGobi has undertaken a number of initiatives to further enhance the value of its operations. Disclosure regarding such initiatives is included in a detailed operating update being made at the same date as these results for the period ended September 30, 2010. The operating update provides analysis regarding the extent of the sulphur issue observed and disclosed in the second quarter 2010 results together with information regarding medium and longer term plans for coal processing and mining fleet development.

The success to date and potential for future growth can be attributed to a combination of the Company's competitive strengths, including the following:

- Projects are strategically located close to China;
- Substantial and growing resources and reserves;
- Produce premium quality coals;
- Low cost structure due to favorable geographic and geological conditions;
- Strong financial profile after the financings in late 2009 and early 2010;
- Established production with strong growth potential through future expansion of existing mine capacity and development of the Company's priority assets; and
- Experienced management team with strong skills in mining, exploration and marketing and are able to leverage the expertise, experience and relationships of its principal shareholder, Ivanhoe.

16. OUTLOOK (Continued)

Overview and Objectives

The Company continues to focus its efforts on mining, development and exploration of coking and thermal coal products in Mongolia for supply of quality products to customers in China. As the Company looks forward through the balance of 2010, the Company is encouraged by the overall long term demand for our products. There are many positive developments in Mongolia, which provide further support that the mining sector will develop its resource base for long term growth. The Company is making progress with its sales and marketing efforts, continuing to focus on efficiency and prudent financial management and intends to manage production levels to meet anticipated demand for the Company's products.

The Company's objectives for 2010 remain unchanged from the previous quarter and are as follows:

- **Grow Ovoot Tolgoi Mine** – The additional capacity of the new mining fleets should support growth in coal availability and sales for 2011 over 2010, and the future.
- **Continue to develop regional infrastructure** – The Company's immediate priority centers on improving roads in the area around Ovoot Tolgoi Mine. SouthGobi has entered into a contract to design and construct a coal-haul highway with capacity well in excess of 20 million tonnes per year for completion by the end of 2012.
- **Advancing the Soumber deposit** – SouthGobi intends to further define the deposit with continued exploration work while also substantially advancing the feasibility, planning and licensing for a mine at Soumber.
- **Value-adding/upgrading coal** – The Company has commenced construction of a basic coal-handling facility at Ovoot Tolgoi Mine and has now re-designed the plan for the facility to include the secondary processing stage of dry air separation.
- **Exploration** – Further greenfields exploration will take place, with the Company planning an exploration budget in the order of $10-20 million.
- **Continuing to focus on production safety, environmental protection, operational excellence and community relations.**

November 10, 2010