SOUTHGOBI RESOURCES LTD.
2010 ANNUAL REPORT

CONTENTS

COMPANY HIGHLIGHTS

THE COMPANY

SouthGobi Resources Ltd. (the "Company") is a premium coal company with an operating mine and several development projects in Mongolia. The Company is one of the largest coal producers in Mongolia in terms of coal sales for export. The Company is listed on both the main boards of the Toronto (TSX: SGQ) and Hong Kong (HKEX: 1878) stock exchanges.

The Company's flagship project is the Ovoot Tolgoi open pit mine located in the South Gobi province of Mongolia, approximately 40 kilometers from the Mongolia-China border (Shivee Khuren-Ceke). Since the commencement of mining operations in mid-2008 the mine has produced approximately 4.0 million tonnes of coal. The most important of the Company's development projects is the Soumber Deposit. The Soumber Deposit is located approximately 20 kilometers east of the Ovoot Tolgoi Mine, which could allow the operations to share existing infrastructure. SouthGobi's coals at both Ovoot Tolgoi and Soumber have the properties of higher value premium coking coals.

As at December 31, 2010, the Company held 16 licenses, including two mining licenses, which in total cover an area of approximately 558,000 hectares. Each of these licenses and the related mining assets are wholly owned by the Company.

MAJOR ACHIEVEMENTS

Some of the major achievements of the Company since January 1, 2010 include:

- The Company has sold 2.5 million tonnes of coal in 2010 for export to China, representing a 92% increase in sales volume compared to 2009.
- Coal was sold at an average sales price of US$35 per tonne, representing a 21% increase compared to 2009.
- SouthGobi has executed sales contracts covering in excess of 4.7 million tonnes of coal for 2011.
- On January 29, 2010, the Company successfully completed a global equity offering for gross proceeds of US$437 million. Simultaneously with the international offering, the Company's shares began trading on the Hong Kong Stock Exchange under the ticker HKEX: 1878.
- On March 29, 2010, SouthGobi converted US$250 million of the China Investment Corporation ("CIC") convertible debenture into common shares. CIC currently holds 13.6% of the Company's common shares outstanding.
- In October of 2010, SouthGobi successfully commissioned the second of its new Liebherr 996 mining excavators at Ovoot Tolgoi. With three operating fleets, the Company's raw coal mining capacity substantially grew in 2010. Production in the month of December 2010 was 470,000 tonnes of raw coal mined.
- On December 23, 2010, the Company invested US$20 million for a 19.9% stake in Aspire Mining Limited, a mineral exploration Company with exciting coking coal resource development prospects in Mongolia.

OUR RESERVES AND RESOURCES

Below is a summary of the Company's reserves and resources *(expressed in millions of tonnes):*

Reserves

Area	Proven	Probable	Total
Ovoot Tolgoi Mine	62.8	44.0	106.8

Resources

Area	Measured	Indicated	Inferred	Total
Ovoot Tolgoi Mine	136.3	35.8	12.9	185.0
Ovoot Tolgoi Underground	52.0	42.1	84.2	178.3
Soumber Deposit	36.8	24.6	65.8	127.2
Tsagaan Tolgoi	23.4	13.0	9.0	45.4
Total Resources	248.5	115.5	171.9	535.9

MESSAGE FROM THE CHAIRMAN

PETER G. MEREDITH
DIRECTOR, CHAIRMAN OF THE BOARD

Every year it seems our company transforms and 2010 was yet another year of strong accomplishment for SouthGobi. Having raised over US$900 million in new capital in late 2009 and early 2010, the Company embarked on its biggest ever year of investment. In 2010, the Company invested US$200 million of new capital in growing our Mongolian mining operation.

A key macro trend driving our business was continued growth in China's requirements for imported coking coal. During 2010, China imported approximately 30% more coking coal than 2009. We believe this trend is 'here to stay' and that we will see China become the world's largest importer of internationally traded coking coal in the next few years. China's requirement to import more coking coal is driven by rapidly rising domestic costs of coking coal production as lower cost resources are rapidly exhausted and the nation continues to invest in catching up to world class mining safety standards.

2010 was the year that Mongolia clearly demonstrated its position as the natural supplier to China's coking coal import needs. Mongolian coking coal trade with China more than tripled from 2009 to 2010 and Mongolia gained significant market share to provide roughly one third of China's coking coal import needs. The market share gain from Mongolia came at the expense of traditional coking coal suppliers including Australia and Canada, which both lost market share. Prior to 2010, Mongolia's position as the key supplier to the fastest growing consumer of international coking coal was not clear. The key reason is that when China first became an importer of coking coal in 2006 and 2007, most Mongolian capacity was undeveloped, including our Ovoot Tolgoi resource. The initial demand from China was met by existing producers through brownfields expansions, de-bottlenecking and re-allocation of sales from other markets to China because it takes longer for new greenfields capacity to come on line. What is clear now though is that Mongolia has a number of advantages in supplying China's needs, which are coming to the fore now that the resources have been brought into development. Mongolian coking coal is generally much lower cost to mine because these new resources are generally open-pit mineable with low waste to coal ratios. Mongolia is also becoming more integrated with Chinese infrastructure as China is aggressively rolling out new railway investment taking dedicated coal carrying rail lines to the Mongolia-China border.

SouthGobi continues to be positioned at the forefront of the Mongolia to China coal trade. In 2010 the Company sold 2.5 million tonnes of coal in its second full calendar year of production at our flagship Ovoot Tolgoi Mine, representing growth of 92% over 2009. We finished the year having commissioned two new larger mining fleets and poised for a similar step change in our capacity for 2011 over 2010.

STRATEGY

Our strategy, to extract full value from our leadership position in the Ovoot Khural Basin, remains in place albeit with significant advancement through 2010. We always point out that the Ovoot Khural Basin hosts Permian Age coals generally with the properties of higher value coking coals, typically in open pit mineable deposits, and is the closest coal production base to China. 92% of SouthGobi's resource base is located within the Ovoot Khural Basin at and around our Ovoot Tolgoi Mine. Our job is to drive the integrated development of the Ovoot Khural Basin involving: identification of additional premium coal resources through exploration; development and growth of existing mines and resources; construction of lasting infrastructure; and the introduction of value-added processing such as coal washing.

"SouthGobi continues to be positioned at the forefront of the Mongolia to China coal trade."

PEOPLE

SouthGobi finished 2010 with 544 employees, which means we created 210 new jobs during the course of the year. What is most important to us is that SouthGobi continues to train and add new people to its workforce safely. In 2010, we had no major safety incidents and our lost time injury frequency rate (LTIFR) fell versus 2009, remaining well within the standards expected for world class mining safety. Safety is important because employees are our most valuable resource. Most of our employees are in Mongolia, where our key operations are located and of the 521 people employed there, 97% were Mongolian nationals and 36% were from the local soums (districts) of Gurvantes and Noyon that surrounds our Ovoot Tolgoi Mine.

Our senior executive team, led by Alexander Molyneux as President and CEO, continues to build out through new additions and internal promotions. Once again they've done a great job navigating SouthGobi through another transformational year of development and on behalf of shareholders and the Board of Directors I thank them for their efforts.

SOCIAL CONTRIBUTION

I'm proud to say that, in another year of records, SouthGobi's social contribution was not forgotten. The company continued to do more than in any prior year. Among other contributions, SouthGobi commenced construction of a new kindergarten that will accommodate approximately 100 students, undertook road construction to link local communities with the road network to the Mongolia-China border and assisted with winter aid, including donation of diesel for power generation and winterized gers (Mongolian traditional dwelling structure). Our Ulaanbaatar office took part in the Habitat for Humanity project in Mongolia's capital city for the first time. More than 30 of our employees directly participated in the construction of new homes for poorer residents.

SouthGobi has great momentum going into 2011 and as Chairman of the Company, I look forward to working with the board to support our team in achieving even more.

Peter G. Meredith
CHAIRMAN

MESSAGE FROM THE PRESIDENT AND CEO

ALEXANDER MOLYNEUX
PRESIDENT AND CEO

SouthGobi, through its extensive existing resources and prospective exploration permits across the Ovoot Khural Basin in Mongolia, has tier one global coking coal assets.

The quality of SouthGobi's business is represented by a number of factors, including:

- **Strategic location** – Our Ovoot Tolgoi producing mine and the Ovoot Khural Basin more broadly is the closest coal resource to China. Furthermore, China has developed infrastructure on its side of the border such that Ovoot Tolgoi is only around 50 kilometers away from the nearest dedicated coal carrying railway. The markets in Northern China near our properties are also very attractive.
- **Substantial yet growing resources** – SouthGobi has 364.0 million tonnes of measured and indicated resources, with a further 171.9 million tonnes in the inferred category. However, exploration is still a core part of the Company's medium term future. SouthGobi has 538,093 hectares of exploration permits in Mongolia.
- **Premium quality coal** – Generally the coal contained in our Ovoot Khural Basin deposits have coking characteristics and the coal at our Soumber Deposit is considered hard coking coal. In 2010, the Company commenced construction of a coal handling facility at the Ovoot Tolgoi Mine, which should be complete by the end of 2011. This facility will upgrade the quality of Ovoot Tolgoi coals, enhancing margins for that mine.
- **Leading cost structure** – Our direct cash costs are the lowest of any publicly listed Mongolian coking coal producer and generally lower than Chinese peers.
- **Strong growth potential** – Having raised capital in 2009 and 2010, the Company is on a program to rapidly deploy that capital for growth. In 2010 SouthGobi commissioned two additional mining fleets taking coal sales to approximately 2.5 million tonnes, 92% above 2009. Capital continues to be invested in our projects to achieve roughly four times the 2010 coal sales levels in 2013 or 2014.

Having established a platform to grow, in terms of raising capital and gaining liquid listings for SouthGobi on the Toronto main board and Hong Kong Stock Exchange, our goals for 2010 were focused on investing in growth, quality upgrades and infrastructure. We made huge advancements on these tracks and did so with safe and reliable mining operations.

MINING AND EXPLORATION

In 2010 mining activity at Ovoot Tolgoi achieved record levels once again. A total of 10.9 million bank cubic meters of waste material was moved and approximately 2.8 million tonnes of coal was mined representing increases over 2009 levels of 379% and 316% respectively.

The driver of growth in our mining activity was the full commissioning of two larger Liebherr 996 (34 cubic meter scoop capacity) based mining fleets. During the course of 2010, the second mining fleet was fully commissioned with the addition of two Terex MT4400 (218 tonne) trucks. In October 2010, the third mining fleet was commissioned consisting of an additional Liebherr 996 excavator and five Terex MT4400 trucks. With these fleets commissioning, capacity built up during the year, culminating in December mining levels of 1.7 million bank cubic meters of waste and 470,000 tonnes of raw coal.

2010 also saw the introduction of basic processing at Ovoot Tolgoi. To enhance the value of the higher ash coals from the #8/9/10 seams, we introduced mobile screens. Passing those coals through the screens generally reduces the ash content to enable an 18% saleable product, which is more attractive to customers than the raw coal.

SouthGobi accelerated its exploration program in Mongolia in 2010. We spent approximately US$18.8 million, drilled 109,600 linear meters and trenched 60,646 cubic meters. It can be said that these levels represent record exploration levels for the Company. A core focus was continuing to grow the Soumber Deposit and build our understanding of it as we prepare for mine planning there. Overall, SouthGobi's measured and indicated resources grew by 56.4 million tonnes and inferred resources grew by 73.9 million tonnes.

FUNDING AND CAPITAL MARKETS

In January 2010, SouthGobi completed its long planned Asian secondary listing by listing its shares on the Hong Kong Stock Exchange and raising US$437 million (gross) with a concurrent offering. SouthGobi is now listed on the main boards of both the Toronto and Hong Kong Stock Exchanges.

2010 was a record year for investment for SouthGobi. We spent US$200 million in capital for our mining operation, primarily for expansion. We also invested US$19 million for exploration and acquired a 19.9% stake in Aspire Mining Limited for US$20 million.

We finished the year with approximately US$617 million of cash and cash-like liquidity at our disposal so the Company is still well funded for the growth prospects that lay ahead of us.

SAFETY AND ENVIRONMENT

Once again we delivered our goals with no major safety or environmental incidents. I'm very proud of the safety focus of our team. It's the most important metric for us to 'win' on.

To further enhance our focus on safety, the Board formed a Safety, Health and Environment Committee. Some of the more experienced mining practitioners among our directors are on that committee and I am a member as well, so I can report on a regular basis and work with those directors for continuous improvement in our safety and environmental practices.

OBJECTIVES FOR 2011

Our objectives for 2011 are to continue to follow from those of 2010 and include:

- **Grow Ovoot Tolgoi Mine** – Our aim is to finish 2011 with roughly two thirds more material movement capacity than where we finished 2010. This will come from the introduction of two further additional mining fleets (one Liebherr 996 excavator based and one Liebherr R9250 excavator based), plus we are upgrading our first mining fleet by replacing its Liebherr 994 (13.5 cubic meter) shovel with a Liebherr R9250 (17.0 cubic meter) excavator.
- **Continue to develop regional infrastructure** – During 2010 we commenced designing a new coal haul highway that will better link Ovoot Tolgoi with the Mongolia-China border and the infrastructure available there. In 2011, our aim is to substantially advance the construction of that road so it can be operational as planned some time during the 2012 year.
- **Advancing the Soumber Deposit** – Having grown Soumber somewhat in 2010, we will now aim to move ahead to mine planning and completing the mine licensing process during 2011.
- **Value-adding/upgrading coal** – The Company has commenced construction works for its coal handling facility. For 2011, we aim to complete that facility with the inclusion of dry air separation process and have it operating prior to the end of the year.
- **Exploration** – Further greenfields exploration will take place, with the Company planning an exploration campaign budget in the order of US$10–$20 million.
- **Continuing to focus on production safety, environmental protection, operational excellence and community relations.**

I see SouthGobi as completing major steps in its build out during 2011. We're starting to see the financial impact of our investment in terms of operating cash flows and I firmly believe we will have some meaningful milestones in that regard this year.

I'm proud of the team we have in place. They have the right experience and the right priorities.

Alexander Molyneux
PRESIDENT AND CEO

BOARD OF DIRECTORS

Peter Meredith

CHAIRMAN OF THE BOARD, NON-EXECUTIVE DIRECTOR

Mr. Meredith, 67, joined the Company on August 13, 2003 and has been a Director since then. He was the Chief Executive Officer of the Company from June 2007 to October 2009, and Chairman of the Board since October 2009. He has served as the Deputy Chairman of Ivanhoe Mines Ltd., the Corporation's principal shareholder, since May 2006, overseeing Ivanhoe's business development and corporate relations. Prior to joining Ivanhoe, Mr. Meredith spent 31 years with Deloitte and Touche LLP, Chartered Accountants, and retired as a partner in 1996.

Mr. Meredith is a Chartered Accountant, certified by the Canadian Institute of Chartered Accountants and is a member of the Institute of Chartered Accountants of British Columbia, the Institute of Chartered Accountants of Ontario and the Ordre des comptables agréés du Québec. Mr. Meredith is a member of the Institute of Corporate Directors.

Alexander Molyneux

PRESIDENT AND CHIEF EXECUTIVE OFFICER, DIRECTOR

Mr. Molyneux, 36, joined the Company as President on April 27, 2009. On October 11, 2009, he was given the additional responsibilities of Chief Executive Officer and appointed as a Director. He is based in Hong Kong, and was most recently Managing Director, Head of Metals & Mining Investment Banking, Asia Pacific, with Citigroup. He has spent approximately 10 years providing specialist advice and investment banking services to mining and industrial corporations, including nine years involved in coal-related transactions. Over the past nine years, he has advised coal-related public offerings, mergers and acquisitions, bond and debt offerings totaling several billion dollars. He joined Citigroup from UBS in early 2007 as Head of Metals & Mining Investment Banking.

Mr. Molyneux holds a Bachelor degree in Economics from Monash University in Australia and is a member of the Institute of Corporate Directors.

Pierre Lebel

INDEPENDENT NON-EXECUTIVE DIRECTOR AND LEAD DIRECTOR

Mr. Lebel, 61, joined the Company on August 13, 2003 and has been a Director since then. Mr. Lebel is the Company's Lead Director and served as its Chairman from 2003 until June 2007. He has a distinguished career in mining spanning over 30 years, with a primary focus on mine financing, construction and development. Mr. Lebel currently serves as Chairman and a Director of Imperial Metals Corporation, a TSX-listed mine developer and operator. In 1998, Mr. Lebel was awarded the E.A. Scholz Medal by the BC and Yukon Chamber of Mines in recognition of his outstanding contribution towards the construction and development of Imperial's Mount Polley copper/gold mine in British Columbia.

Mr. Lebel holds a Masters of Business Administration from McMaster University and a Bachelor of Laws (LLB) from the University of Western Ontario. He is a barrister and solicitor admitted by the Law Societies of British Columbia and Alberta. He is also a member of the Board of Directors of the Mining Association of British Columbia and a member of the Institute of Corporate Directors.

André Deepwell

INDEPENDENT NON-EXECUTIVE DIRECTOR

Mr. Deepwell, 56, joined the Company on August 13, 2003 and has been a Director since then. He has been the Chief Financial Officer and Corporate Secretary of a number of natural resource companies over the last 15 years and is currently Chief Financial Officer and Corporate Secretary of Imperial Metals Corporation, a TSX-listed mine developer and operator. Mr. Deepwell has been involved in all aspects of debt and equity financing and financial reporting for mining enterprises ranging from grassroots exploration to mine development and production.

Mr. Deepwell is a Chartered Accountant, certified by the Institute of Chartered Accountants of British Columbia. He is a member of the Institute of Corporate Directors.

R. Stuart (Tookie) Angus

INDEPENDENT NON-EXECUTIVE DIRECTOR

Mr. Angus, 62, joined the Company on May 25, 2007 and has been a Director since then. Mr. Angus is an independent consultant to the mining industry and has over 35 years' experience advising companies in the mineral resources industry. Previously, he was Managing Director – Mergers and Acquisitions with Endeavour Financial Corporation, which provides financial advisory services to the mining and minerals industries. Prior to joining Endeavour Financial in 2003, he was a senior partner in the law firm, Fasken Martineau DuMoulin, as head of its Global Mining Group.

Mr. Angus holds a Bachelor of Laws (LLB) from the University of British Columbia and is a retired member of the Law Society of British Columbia. He is a member of the Institute of Corporate Directors.

Robert Hanson

INDEPENDENT NON-EXECUTIVE DIRECTOR

Mr. Hanson, 50, joined the Company on May 25, 2007 and has been a Director since then. He is the Chairman of Hanson Capital Investments Limited, Strand Hanson Ltd. and Hanson Family Holdings Ltd. (formerly Hanson Transport Group), and he is also Managing Partner of Millennium Hanson Internet Partners. He was Chairman of Hanson Westhouse Limited from February 1998 to April 2009 and an Associate Director of N.M. Rothschild & Sons from 1983 to 1990, serving in London, Hong Kong, Chile and Spain. From 1990 to 1997, he served on the Board of Directors of Hanson PLC, responsible for strategy, mergers and acquisitions transactions.

Mr. Hanson was educated at Eton and received his Master of Arts in English Language & Literature from St Peter's College, Oxford. He is a trustee of the Hanson Foundation and a founding trustee of the Raisa Gorbachev Foundation fighting child cancers. He is a member of the Institute of Corporate Directors.

John Macken
NON-EXECUTIVE DIRECTOR

Mr. Macken, 59, joined the Company as a Non-Executive Director on June 25, 2007. He was the Chairman of SouthGobi Resources Ltd. from June 2007 to October 2009. He joined Ivanhoe Mines Ltd., the Company's principal shareholder, in 2003 and is its President. He has been a member of Ivanhoe's Executive Committee since its formation in March 2005. Prior to joining Ivanhoe, Mr. Macken spent 19 years with Freeport McMoran Copper and Gold, most recently as Freeport's Senior Vice-President of Strategic Planning and Development.

Mr. Macken holds a Bachelor of Arts and a Bachelor of Arts in Engineering (Hons.) from Trinity College at Dublin University in Ireland. He is a Chartered Engineer certified by the Institute of Engineers in Ireland and was a Professional Engineer certified by the Province of Ontario, Canada.

R. Edward Flood
INDEPENDENT NON-EXECUTIVE DIRECTOR

Mr. Flood, 65, joined the Company on August 13, 2003 and has been a Director since then. He was its interim President and Chief Executive Officer from March 2007 to June 2007. He has been a Director of Ivanhoe Mines Ltd., the Corporation's principal shareholder, since its founding in 1994 and was also its President from founding until May 1999. He is the Chairman, Chief Executive Officer and President of Western Uranium Corporation, a mineral exploration corporation with a focus on uranium. Mr. Flood served as Deputy Chairman of Ivanhoe Mines Ltd. until February 2007, assisting in developing Ivanhoe's growth and its establishment as a significant presence in Asia's mineral exploration and mining sectors. Prior to joining Ivanhoe, from 1993 to 1995, Mr. Flood was a principal at Robertson Stephens & Co., a U.S. investment bank, and a member of Robertson Stephens' investment team. He also held the position of senior mining analyst with Haywood Securities Inc. from 1999 to 2001, and Managing Director, Investment Banking, Haywood Securities (UK) Ltd. from March 2007 to March 2010.

Mr. Flood holds a Masters of Science in Geology from the University of Montana and a Bachelor in Science in Geology from the University of Nevada. He is a member of the Institute of Corporate Directors.

W. Gordon Lancaster
INDEPENDENT NON-EXECUTIVE DIRECTOR

Mr. Lancaster, 67, is an independent business consultant who joined the Company on May 11, 2010 and has been a Director since then. Previously he was Chief Financial Officer of Ivanhoe Energy Inc., an international heavy-oil development and production company whose core operations are in Canada, United States of America, Ecuador and China. Prior to joining Ivanhoe Energy Inc. in 2004, he was Chief Financial Officer of Power Measurement Inc., a Victoria-based high-tech company that is a world leader in the design, development, manufacture and marketing of enterprise energy management systems.

Mr. Lancaster is a Chartered Accountant certified by the Institute of Chartered Accountants of British Columbia and, prior to entering industry in 1982, he had a 20-year career in public accounting with Deloitte & Touche, with the last five years as a partner in that firm's Vancouver office. He is a member of the Institute of Corporate Directors.

SENIOR MANAGEMENT

Terry Krepiakevich
CHIEF FINANCIAL OFFICER

Mr. Krepiakevich, 58, joined the Company on July 17, 2006 and has been the Chief Financial Officer since then. He has been a Director of Alexco Resource Corp., a TSX-listed and NYSE-listed mineral resources company, since July 2009. He was previously the Chief Financial Officer of Extreme CCTV Inc., a formerly TSX-listed company (since acquired), from November 2000 to July 2006 and was also a Director from June 2001 to July 2006. Mr. Krepiakevich was the Chief Executive Officer and a Director of First Industrial Capital Corp. from September 1997 to March 2004. He was the Vice President of Finance and Chief Financial Officer of Maynards Industries from July 1988 to June 2000.

Mr. Krepiakevich is a Chartered Accountant, certified by the Institute of Chartered Accountants of British Columbia.

Curt Church
VICE PRESIDENT OF MINING OPERATIONS

Mr. Church, 38, joined the Company on January 14, 2008 as the Manager of Mining for SouthGobi Sands. He was promoted to the General Manager of Ovoot Tolgoi Coal Operations in July 2008 and to the Vice President of Mining Operations in August 2010. He has over 17 years of experience in the mineral resources industry. Mr. Church was the superintendent of mobile fleet management for the Boroo Gold Mine of Centerra Gold Corp., a TSX-listed mineral resources firm, beginning in March 2007, having been its general foreman and senior foreman from August 2006. From December 2003 to September 2004 he was a mine shift supervisor at the Rosebel Gold Mine for Cambior. From July 2000 to November 2003 he was a production team leader for the Ekati Diamond Mine of BHP Billiton, having formerly been its drill and blast team leader. From May 1993 to October 1994 he was a heavy equipment operator for Morsky Construction Ltd., a privately owned firm.

Mr. Church received a Certificate for completion of a D90K2SP Drill Clinic in the U.S. in 1999. He completed a course in Surface Mine Rescue Training and passed his Fire Service Training Examinations for Basic Fire Attack Strategy & Tactics and Engine Service Response from the Northwest Territories (Canada) Department of Safety and Public Services, all in 1995.

Dave Bartel
VICE PRESIDENT OF MONGOLIAN OPERATIONS

Mr. Bartel, 53, joined the Company on January 1, 2007 as the Manager of Engineering for SouthGobi Sands. He was promoted to the General Manager of SouthGobi Sands in November 2007 and Vice President of Mongolian Operations in September 2009. He has over 30 years' experience in the mineral resources industry. He was formerly an independent consultant to the coal mining industry and a project manager and consultant to the coal and other mining industries with Wiley Consulting LLC. Starting in September 1982, he held various positions including Chief Engineer and Director of Environmental and Engineering Services for the Coal Division of Entech Inc., the non-regulated arm of Montana Power Co., and various subsidiaries of that company. He was a mining engineer for Phillips Coal Co. from August 1981 to September 1982. From June 1979 to July 1981 he was a mining engineer for Utah International Co.

Mr. Bartel received his Bachelor of Science in Mining Engineering with High Honors from the Colorado School of Mines in 1979. He is a Registered Professional Engineer in the states of Colorado, Montana and Arkansas.

DIRECTORS' REPORT

The Board of Directors (the "Board") of SouthGobi Resources Ltd. is pleased to present their report along with the audited consolidated financial statements (the "Financial Statements") of SouthGobi Resources Ltd. together with its subsidiaries (collectively the "Company") for the financial year ended December 31, 2010 ("Financial Year").

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activity of the Company is to provide business services and general mining support services for its subsidiaries and the principal activities of the Company are the mining, development and exploration of coal properties. The Company's principal subsidiaries are set out in Note 28 of the Financial Statements and the activities of the principal subsidiaries of the Company at December 31, 2010 are set out in the table below:

Name	Country of Incorporation	Issued and fully paid share capital	Principal activities
Asia Gold International Holding Company Ltd.	British Virgin Islands	Nil	Investment holding
SouthGobi Resources (Hong Kong) Ltd.	Hong Kong	HK$1	Business services
Dayarbulag LLC	Mongolia	MNT 12,120,000	Investment holding
SouthGobi Sands LLC	Mongolia	MNT 11,655,000	Coal mining, development and exploration of properties in Mongolia
Transbaikal Gold	Russia	10,000 Russian Roubles	Research, exploration and extraction of minerals
SGQ Coal Investment Pte. Ltd.	Singapore	US$1	Investment holding
SGQ Dayarcoal Mongolia Pte. Ltd.	Singapore	US$1	Investment holding

The analysis of the principal activities by geographical location of the operations of the Company for the Financial Year is set out in Note 4 of the Financial Statements.

RESULTS

The results of the Company for the Financial Year are set out in the Consolidated Statement of Comprehensive Income on page 82.

DIVIDENDS

The Board has not recommended, declared or paid any dividends for the Financial Year.

PROPERTY, PLANT AND EQUIPMENT

Details of the movement in the property, plant and equipment of the Company during the Financial Year are set out in Note 17 of the Financial Statements.

SHARE CAPITAL

Details of the movement in the share capital of the Company during the Financial Year are set out in the Consolidated Statement of Changes in Equity on page 84.

During the Financial Year the Company repurchased its own shares on the Toronto Stock Exchange and Hong Kong Stock Exchange. Details of the shares repurchased are set out on page 130. The Board believes the Company has adequate financial resources for its current growth requirements and believes the shares of the Company have been undervalued.

RESERVES

Details of the reserves available for distribution to the shareholders as at December 31, 2010 are set out in the Consolidated Statement of Changes in Equity on page 84.

DIRECTORS

The directors during the Financial Year and up to the date of this report are as follows:

Executive Directors

Mr. Alexander Molyneux

Non-Executive Directors

Mr. Peter Meredith (CHAIRMAN)
Mr. John Macken

Independent Non-Executive Directors

Mr. Pierre Lebel (LEAD DIRECTOR)
Mr. André Deepwell
Mr. R. Stuart (Tookie) Angus
Mr. Robert Hanson
Mr. R. Edward Flood
Mr. W. Gordon Lancaster

The term of office for each of the directors will end at the conclusion of the forthcoming annual general meeting. Each of the directors offers themselves for re-election at the annual general meeting scheduled for May 17, 2011.

In accordance with article 14.1 of the articles of continuation for the Company, each of the directors, including the independent non-executive directors, are subject to retirement and re-election annually at the annual general meeting.

DIRECTORS' SERVICE CONTRACTS

None of the directors proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

No contracts of significance to which the Company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at December 31, 2010 or at any time during the Financial Year.

DIRECTORS' INTERESTS IN COMPETING BUSINESSES

During the Financial Year and up to the date of this report, to the best knowledge of the directors, none of the directors had any interests in businesses that compete or are likely to compete, either directly or indirectly with the Company.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN SHARES AND SHARE OPTIONS

At December 31, 2010, the interests of the directors, Terry Krepiakevich, the Chief Financial Officer, Curt Church, the Vice President of Mining Operations and Dave Bartel, the Vice President of Mongolian Operations, in the shares and share options of the Company and its associated corporations were as follows:

Shares

Name	Name of company	Nature of interest	Shares held	Approximate percentage interest in the company
Peter Meredith	SouthGobi Resources Ltd	N/A	nil	nil
	Ivanhoe Mines Ltd.	Personal	70,000	0.012%
Alexander Molyneux	SouthGobi Resources Ltd	N/A	10,000	0.005%
	Ivanhoe Mines Ltd.	N/A	nil	nil
Pierre Lebel	SouthGobi Resources Ltd.	Personal	5,100	0.003%
	Ivanhoe Mines Ltd.	N/A	nil	nil
André Deepwell	SouthGobi Resources Ltd.	Personal	29,000	0.016%
	Ivanhoe Mines Ltd.	N/A	nil	nil
R. Stuart (Tookie) Angus	SouthGobi Resources Ltd.	N/A	nil	nil
	Ivanhoe Mines Ltd.	N/A	nil	nil
Robert Hanson	SouthGobi Resources Ltd.	Personal	22,500	0.012%
	Ivanhoe Mines Ltd.	N/A	nil	nil
John Macken	SouthGobi Resources Ltd.	N/A	nil	nil
	Ivanhoe Mines Ltd.	Personal	183,358	0.032%
R. Edward Flood	SouthGobi Resources Ltd.	N/A	nil	nil
	Ivanhoe Mines Ltd.	Personal	309,784	0.054%
W. Gordon Lancaster	SouthGobi Resources Ltd.	N/A	nil	nil
	Ivanhoe Mines Ltd.	N/A	nil	nil
Terry Krepiakevich	SouthGobi Resources Ltd.	Personal	11,076	0.006%
	Ivanhoe Mines Ltd.	N/A	nil	nil
Curt Church	SouthGobi Resources Ltd.	Personal	5,900	0.003%
	Ivanhoe Mines Ltd.	Personal	nil	nil
Dave Bartel	SouthGobi Resources Ltd.	N/A	nil	nil
	Ivanhoe Mines Ltd.	N/A	nil	nil

Share Options

Name	Name of company	Number of options held
Peter Meredith	SouthGobi Resources Ltd.	685,000
	Ivanhoe Mines Ltd.	1,936,000
Alexander Molyneux	SouthGobi Resources Ltd.	950,000
	Ivanhoe Mines Ltd.	50,000
Pierre Lebel	SouthGobi Resources Ltd.	225,000
	Ivanhoe Mines Ltd.	nil
André Deepwell	SouthGobi Resources Ltd.	200,000
	Ivanhoe Mines Ltd.	nil
R. Stuart (Tookie) Angus	SouthGobi Resources Ltd.	115,000
	Ivanhoe Mines Ltd.	nil
Robert Hanson	SouthGobi Resources Ltd.	115,000
	Ivanhoe Mines Ltd.	72,500
John Macken	SouthGobi Resources Ltd.	411,000
	Ivanhoe Mines Ltd.	4,900,000
R. Edward Flood	SouthGobi Resources Ltd.	115,000
	Ivanhoe Mines Ltd.	82,250
W. Gordon Lancaster	SouthGobi Resources Ltd.	150,000
	Ivanhoe Mines Ltd.	nil
Terry Krepiakevich	SouthGobi Resources Ltd.	400,000
	Ivanhoe Mines Ltd.	25,000
Curt Church	SouthGobi Resources Ltd.	395,000
	Ivanhoe Mines Ltd.	nil
Dave Bartel	SouthGobi Resources Ltd.	305,500
	Ivanhoe Mines Ltd.	nil

Other than the holdings disclosed in the preceding table none of the directors, senior management and their associates had any interests or short positions in any shares, underlying shares or debentures of the Company or of its associated corporations as at December 31, 2010.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the Company were entered into or existed during the Financial Year.

SHARE OPTION SCHEME

The particulars of the Company's share option scheme are set out in Note 23 of the Financial Statements.

The following table discloses movements in the Company's share options for the Financial Year:

Name	Outstanding at beginning of year	Granted during year	Exercised during year	Forfeited during year	Expired during year	Outstanding at year end
Peter Meredith	665,000	100,000	(80,000)	—	—	685,000
Alexander Molyneux	625,000	325,000	—	—	—	950,000
Pierre Lebel	190,000	35,000	—	—	—	225,000
André Deepwell	165,000	35,000	—	—	—	200,000
R. Stuart (Tookie) Angus	200,000	35,000	(120,000)	—	—	115,000
Robert Hanson	230,000	35,000	(150,000)	—	—	115,000
John Macken	376,000	35,000	—	—	—	411,000
R. Edward Flood	130,001	35,000	(50,001)	—	—	115,000
W. Gordon Lancaster	—	150,000	—	—	—	150,000
Terry Krepiakevich	400,000	150,000	(150,000)	—	—	400,000
Curt Church	195,000	200,000	—	—	—	395,000
Dave Bartel	220,500	85,000				305,500
Total for directors and senior management	3,396,501	1,220,000	(550,001)	—	—	4,066,500
Total for other share option holders	3,857,220	2,225,500	(549,445)	(324,250)	—	5,209,025
Total	**7,253,721**	**3,445,500**	**(1,099,446)**	**(324,250)**	**—**	**9,275,525**

ARRANGEMENT TO PURCHASE SHARES AND DEBENTURES

Other than the option holdings disclosed above, at no time during the Financial Year was the Company a party to an arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company.

SUBSTANTIAL SHAREHOLDERS

The register of interests in shares and short positions of the Company showed that as at December 31, 2010, the Company has been notified of the following interests in shares representing 10% or more of the Company's issued share capital:

Name	Nature of interest	Shares held	Approximate percentage of issued shares
Ivanhoe Mines Ltd.	Beneficial	104,807,155	57%
China Investment Corporation	Beneficial	24,642,611	13%

Other than as disclosed above, the Company has not been notified of any relevant interests or short positions in the issued share capital of the Company as at December 31, 2010.

EMOLUMENT POLICY

The emolument policy of the executives of the Company is set up by the Compensation and Benefits Committee on the basis of merit, qualifications and competence. The emolument policy for the rest of the employees is determined on a department-by-department basis with the executive in charge of each department determining the emoluments for senior employees and managers in the department and the emoluments for non-senior employees being determined by an appropriately designated manager. The emolument policy for non-executives is administered in conjunction with the human resources department and is done on the basis of merit, qualifications and competence.

The emolument policy for the directors of the Company is decided by the Compensation and Benefits Committee and approved by the Board, having regard to comparable market statistics.

The Company also has a share option plan as incentive to the Company's officers, employees, directors and eligible persons. Details of the plan are set out in Note 23 of the Financial Statements.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's articles of continuation or under the laws of Canada that would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

SUFFICIENCY OF PUBLIC FLOAT

The requirement that a prescribed percentage of shares of any class of listed securities must at all times be held by the public does not apply to the Company.

MAJOR CUSTOMERS AND SUPPLIERS

Details of the Company's transactions with its major suppliers and customers during the Financial Year are set out below:

Purchases

The largest supplier accounted for 60% of the Company's purchases.

The five largest suppliers accounted for 76% of the Company's purchases.

Sales

The largest customer accounted for 57% of the Company's sales.

The four largest customers accounted for 100% of the Company's sales.

At no time during the Financial Year did a director, an associate of a director or a shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company's share capital) have an interest in any of the Company's five largest suppliers or four largest customers.

CHARITABLE DONATIONS

During the Financial Year the Company made charitable donations amounting to $255,000.

EVENTS AFTER REPORTING PERIOD

The Company has no significant events to report that occurred after December 31, 2010.

INDEPENDENT AUDITOR

A resolution will be submitted at the annual general meeting to re-appoint Deloitte & Touche LLP as auditors of the Company.

On behalf of the Board

Peter Meredith

DIRECTOR, CHAIRMAN OF THE BOARD

March 30, 2011

CORPORATE GOVERNANCE REPORT

CORPORATE GOVERNANCE

The Board of Directors (the "Board") considers good corporate governance practices to be an important factor in the continued and long-term success of the Company by helping to maximize shareholder value over time.

To further this philosophy and ensure the Company follows good governance practices the Board has taken the following steps:

- approved and adopted a mandate for the Board;
- appointed Pierre Lebel an independent non-executive director, as "Lead Director", with specific responsibility for maintaining the independence of the Board and ensuring the Board carries out its responsibilities contemplated by applicable statutory and regulatory requirements and stock exchange listing standards;
- appointed an Audit Committee, a Nominating and Corporate Governance Committee, a Compensation and Benefits Committee and a Mergers and Acquisitions Committee consisting solely of independent directors;
- established a Safety, Health and Environment Committee;
- approved charters for all of the Company's Board committees, except the Safety, Health and Environment and Mergers and Acquisitions Committees, formalizing the mandates of those committees;
- established a management Disclosure Committee for the Company, with the mandate to oversee the Company's disclosure practices including the establishment of a sub-committee charged with overseeing the Company's technical disclosure;
- formalized the Company's Corporate Disclosure, Confidentiality and Securities Trading Policy, and Disclosure Controls and Procedures;
- adopted a formal Code of Business Conduct and Ethics and companion booklet for the Company that governs the behavior of directors, officers and employees and which is also distributed to consultants;
- adopted formalized written position descriptions for the Chairperson, Lead Director, CEO and CFO, clearly defining their respective roles and responsibilities;
- adopted a whistleblower policy administered by an independent third party;
- Directors and Senior Management of the Company have completed , or are in the process of completing, a *Foreign Corrupt Practices Act* training program;
- formalized a process for assessing the effectiveness of the Board as a whole, the committees of the Board and the contribution of individual directors, on a regular basis; and
- adopted an executive compensation model for the Company.

COMPLIANCE WITH CORPORATE GOVERNANCE

The Company has, throughout the Financial Year, applied the principles and complied with the requirements of its corporate governance practices as defined by the Board and all applicable statutory, regulatory and stock exchange listings standards. The Company's current practices are reviewed and updated regularly to ensure that the latest developments in corporate governance are followed and observed.

BOARD COMPOSITION

Corporate governance guidelines adopted by the Canadian Securities Administrators ("CSA") recommend that a majority of the directors of a corporation be independent directors. Under the CSA corporate governance guidelines, an "independent director" is a director who has no direct or indirect material relationship with the Company, including as a partner, shareholder or officer of an organization that has a relationship with the Company. A "material relationship" is one that would, or in the view of the Board could be reasonably expected to, interfere with the exercise of a director's independent judgment. The Board believes that as at December 31, 2010 and as at the date of this report six of its nine directors are "independent directors" under the CSA corporate governance guidelines.

As at the date of this report, the Board has determined that it consists of six independent directors and three non-independent Directors, as follows:

Independent directors	Non-independent directors
Mr. Pierre Lebel (Lead Director)	Mr. Alexander Molyneux (President and Chief Executive Officer)(1)
Mr. André Deepwell	Mr. Peter Meredith (Chairman)(2)
Mr. R. Stuart (Tookie) Angus	Mr. John Macken(2)
Mr. Robert Hanson	
Mr. R. Edward Flood	
Mr. W. Gordon Lancaster	

NOTES:

(1) Mr. Molyneux is a non-independent director in his capacity as a senior officer of the Company.

(2) Messrs. Macken and Meredith, executive officers of Ivanhoe, are considered to be non-independent directors as a result of the material relationship between the Company and Ivanhoe, and in the case of Mr. Meredith, as a former member of management of the Company.

As at the date of this report, Ivanhoe held approximately 57% of the Company's issued and outstanding common shares. The Board has determined that the Company currently has six of nine directors in Messrs. Lebel, Deepwell, Angus, Hanson, Flood and Lancaster who are independent of Ivanhoe. The Board believes that it includes over half of its directors who do not have an interest in or relationships with either the Company or its principal shareholder and which fairly reflects the investment in the Company by shareholders other than the principal shareholder.

The directors are satisfied with the size and composition of the Board and believe that the current board composition results in a balanced representation on the Board among management and non-management directors, and the Company's major shareholder. While the Board functions effectively given the Company's stage of development and the size and complexity of its business, the Board, through its Nominating and Corporate Governance Committee, will continue to seek qualified candidates to augment its experience and expertise and to enhance the Company's ability to effectively develop its business interests.

Mr. Meredith currently serves as Chairman of the Board and from June 2007 to October 2009 was the Chief Executive Officer of the Company. Mr. Molyneux was appointed as Chief Executive Officer of the Company on October 11, 2009. The Board is of the view that appropriate structures and procedures are in place to allow the Board to function independently of management while continuing to provide the Company with the benefit of having a Chairman of the Board with extensive experience and knowledge of the Company's business.

The Board has created the position of Lead Director, with specific responsibility for maintaining the independence of the Board and ensuring that the Board carries out its responsibilities. Mr. Lebel has served as the Company's Lead Director since 2007. Mr. Lebel does not serve in a similar capacity with any other company.

The Company has received from each of the independent non-executive directors, the respective confirmation of independence pursuant to listing rules in all applicable jurisdictions. The Company considers all the independent non-executive directors as independent.

To the best knowledge of the Company none of the directors of the Company are related. Relationships include financial, business or family relationships. Each director is free to exercise their independent judgment.

MANDATE OF THE BOARD

Under the *British Columbia Business Corporations Act* ("BCBCA"), the directors of the Company are required to manage the Company's business and affairs, and in doing so to act honestly and in good faith with a view to further the best interests of the Company. In addition, each director must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The Board is responsible for supervising the conduct of the Company's affairs and the management of its business. The Board's mandate includes setting long-term goals and objectives for the Company, formulating the plans and strategies necessary to achieve those objectives and supervising senior management in their implementation. Although the Board delegates the responsibility for managing the day-to-day affairs of the Company to senior management personnel, the Board retains a supervisory role in respect of, and ultimate responsibility for, all matters relating to the Company and its business.

The Board's mandate requires that the Board be satisfied that the Company's senior management will manage the affairs of the Company in the best interest of the shareholders, in accordance with the Company's principles, and that the arrangements made for the management of the Company's business and affairs are consistent with their duties described above. The Board is responsible for protecting shareholder interests and ensuring that the incentives of the shareholders and of management are aligned. The obligation of the Board must be performed continuously, and not merely from time to time, and in times of crisis or emergency the Board may have to assume a more direct role in managing the affairs of the Company.

In discharging this responsibility, the Board's mandate provides that the Board oversees and monitors significant corporate plans and strategic initiatives. The Board's strategic planning process includes annual budget reviews and approvals, and discussions with management relating to strategic and budgetary issues.

As part of its ongoing review of business operations, the Board periodically reviews the principal risks inherent in the Company's business, including financial risks, through periodic reports from management of such risks, and assesses the systems established to manage those risks. Directly and through the Audit Committee, the Board also assesses the integrity of internal control over financial reporting and management information systems.

In addition to those matters that must, by law, be approved by the Board, the Board is required under its mandate to approve annual operating and capital budgets, any material dispositions, acquisitions and investments outside of the ordinary course of business or not provided for in the approved budgets, long-term strategy, organizational development plans and the appointment of senior executive officers. Management is authorized to act, without Board approval, on all ordinary course matters relating to the Company's business.

The mandate provides that the Board also expects management to provide the directors, on a timely basis, with information concerning the business and affairs of the Company, including financial and operating information and information concerning industry developments as they occur, all with a view to enabling the Board to discharge its stewardship obligations effectively. The Board expects management to efficiently implement its strategic plans for the Company, to keep the Board fully apprised of its progress in doing so and to be fully accountable to the Board in respect to all matters for which it has been assigned responsibility.

The Board has instructed management to maintain procedures to monitor and promptly address shareholder concerns and has directed and will continue to direct management to apprise the Board of any major concerns expressed by shareholders.

Each Committee of the Board is empowered to engage external advisors as it sees fit. Any individual director is entitled to engage an outside advisor at the expense of the Company provided such director has obtained the approval of the Nominating and Corporate Governance Committee to do so. In order to ensure that the principal business risks borne by the Company are identified and appropriately managed, the Board receives periodic reports from management of the Company's assessment and management of such risks. In conjunction with its review of operations, the Board considers risk issues when appropriate and approves corporate policies addressing the management of the risk of the Company's business.

The Board takes ultimate responsibility for the appointment and monitoring of the Company's senior management. The Board approves the appointment of senior management and reviews their performance on an ongoing basis.

The Company has a disclosure policy addressing, among other things, how the Company interacts with analysts and the public, and contains measures for the Company to avoid selective disclosure. The Company has a Disclosure Committee responsible for overseeing the Company's disclosure practices. This committee consists of the President and Chief Executive Officer, Chief

Financial Officer, Vice President and Corporate Secretary, Corporate Communications and Investor Relations, the Vice President — Project Evaluation and Development and the Resource Manager — Project Evaluation and Development, and receives advice from the Company's outside legal counsel. The Disclosure Committee assesses materiality and determines when developments justify public disclosure. The committee reviews the disclosure policy annually and as otherwise needed to ensure compliance with regulatory requirements as well as review all documents which are reviewed by the Board and Audit Committee. The Board reviews and approves the Company's material disclosure documents, including its annual report, annual information form and management proxy circular. The Company's annual and quarterly financial statements, Management's Discussion and Analysis and other financial disclosure are reviewed by the Audit Committee and recommended to the Board prior to its release.

COMMITTEES OF THE BOARD

Audit Committee

The Board has established an Audit Committee, which operates under a charter approved by the Board. It is the Board's responsibility to ensure that the Company has an effective internal control framework. This includes internal controls to deal with both the effectiveness and efficiency of significant business processes, the safeguarding of assets, the maintenance of proper accounting records, and the reliability of financial information as well as non-financial considerations such as the benchmarking of operational key performance indicators. The Company's Audit Committee consists of Messrs. Deepwell, Lebel and Lancaster. Mr. Deepwell is the chairman of the Audit Committee.

The primary objective of the Audit Committee of the Company is to act as a liaison between the Board and the Company's independent auditors (the "Auditors") and to assist the Board in fulfilling its oversight responsibilities with respect to (a) the financial statements and other financial information provided by the Company to its shareholders, the public and others, (b) the Company's compliance with legal and regulatory requirements, (c) the qualification, independence and performance of the Auditors and (d) the Company's risk management and internal financial and accounting controls, and management information systems.

Although the committee has the powers and responsibilities set forth in its charter, the role of the committee is oversight. The members of the committee are not full-time employees of the Company and may or may not be accountants or auditors by profession or experts in the fields of accounting or auditing and, in any event, do not serve in such capacity. Consequently, it is not the duty of the committee to conduct audits or to determine that the Company's financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of management and the Auditors.

All services to be performed by the Company's independent auditor must be approved in advance by the Audit Committee or a designated member of the Audit Committee ("Designated Member"). The Designated Member is a member of the Audit Committee who has been given the authority to grant pre-approvals of permitted audit and non-audit services. Pre-approvals by the Designated Member are ratified by the Audit Committee at the next meeting thereof.

The Audit Committee has considered whether the provision of services other than audit services is compatible with maintaining the auditors' independence and has adopted a policy governing the provision of these services. This policy requires the pre-approval by the Audit Committee or the Designated Member of all audit and non-audit services provided by the external auditor, other than any *de minimis* non-audit services allowed by applicable law or regulation. The decisions of the Designated Member to pre-approve permitted services need to be reported to the Audit Committee at its regularly scheduled meetings. Pre-approval from the Audit Committee or Designated Member can be sought for planned engagements based on budgeted or committed fees. No further approval is required to pay pre-approved fees. Additional pre-approval is required for any increase in scope or in final fees. Pursuant to these procedures, 100% of each of the services provided by the Company's external auditor relating to the fees reported as audit, audit-related, tax and other fees were pre-approved by the Audit Committee or the Designated Member.

The committee held four meetings during the Financial Year. In performing its duties in accordance with the Audit Committee Charter, the Audit Committee has:

- overseen the relationship with the Company's auditors;
- reviewed the interim and annual financial statements;
- reviewed and assessed the effectiveness of systems of risk management and internal controls; and
- reported to the Board on the proceedings and deliberations of the Committee.

Nominating and Corporate Governance Committee

The Board has established a Nominating and Corporate Governance Committee, which operates under a charter approved by the Board. The primary objective of the Nominating and Corporate Governance Committee is to assist the Board in fulfilling its oversight responsibilities by (a) identifying individuals qualified to become Board and committee of the Board members and recommending that the Board select director nominees for appointment or election to the Board; and (b) developing and recommending to the Board corporate governance guidelines for the Company and making recommendations to the Board with respect to corporate governance practices. The Nominating and Corporate Governance Committee monitors the disclosure of conflicts of interest to the Board and ensures that no director will vote or participate in a discussion on a matter in respect of which such director has a material interest. Committee Chairs perform the same function with respect to meetings of each Board committee. The members of the Nominating and Corporate Governance Committee are Messrs. Hanson, Deepwell, Lebel, Angus, Lancaster and Flood. Mr. Hanson is the chairman of the Nominating and Corporate Governance Committee.

Compensation and Benefits Committee

The Board has established a Compensation and Benefits Committee, which operates under a charter approved by the Board. The primary objective of the Compensation and Benefits Committee is to discharge the Board's responsibilities relating to compensation and benefits for the Directors and executive officers of the Company. This role includes reviewing and approving executive compensation including long-term incentive components and making applicable recommendations to the Board, administering the Employee Incentive Plan ("EIP"), determining the recipients of, and the nature and size of share compensation awards and bonuses granted from time to time, and reviewing reports as may be required under applicable laws and regulations. The members of the Compensation and Benefits Committee are Messrs. Angus, Deepwell, Lebel, Lancaster and Flood. Mr. Flood resigned from the committee on February 16, 2011. Mr. Angus is the chairman of the Compensation and Benefits Committee.

Safety, Health and Environment Committee

The Board has established a Safety, Health and Environment ("SH&E") Committee. The primary objective of the SH&E Committee is to review and oversee the Company's established SH&E policies and procedures at the Company's project sites. The Committee also reviews any incidents that occur and provides guidance on how to prevent any recurrences. The members of the SH&E Committee are Messrs. Hanson, Molyneux and Macken. Mr. Hanson is the chairman of the SH&E Committee.

Mergers and Acquisitions Committee

The Board has established a Mergers and Acquisitions ("M&A") Committee. The primary objective of the M&A Committee is to review, assess and provide guidance on all potential acquisitions, divestitures and strategic investment transactions to which the Company may become a party. The members of the M&A Committee are Messrs. Lebel, Angus and Flood. Mr. Lebel is the chairman of the M&A Committee.

Ad Hoc/Special Committees

In appropriate circumstances, the Board may establish a special committee to review a matter in which several directors or management may have a conflict of interest.

MEETINGS OF THE BOARD AND COMMITTEES OF THE BOARD

The Board holds regular quarterly meetings. Between quarterly meetings, the Board meets as required, generally by means of telephone conferencing facilities. As part of the quarterly meetings, the non-management directors also have the opportunity to meet separate from management. If required, between regularly scheduled Board meetings, a meeting of non-management Directors, chaired by the Lead Director, is held by teleconference to update the Directors on corporate developments since the last Board meeting. Management also communicates informally with members of the Board on a regular basis, and solicits the advice of the Board members on matters falling within their special knowledge or experience.

During the Financial Year, eight meetings of the Board of Directors, four meetings of the Audit Committee, four meetings of the Nominating and Corporate Governance Committee, five meetings of the Compensation and Benefits Committee, one meeting of the Safety, Health and Environment Committee and one meeting of the Mergers and Acquisitions Committee were held. Attendance by directors at the Board and Committee meetings is shown below:

Attendance record for the Board and Board Committee meetings during the Financial Year	Board meetings	Audit Committee meetings	Nominating and Corporate Governance Committee meetings	Compensation and Benefits Committee meetings	Safety, Health and Environment Committee meetings	Mergers and Acquisitions Committee meetings
	Number of Attendances / Number of Meetings					
Executive Directors						
Mr. Alexander Molyneux	8/8	N/A	N/A	N/A	1/1	N/A
Non-Executive Directors						
Mr. Peter Meredith (CHAIRMAN)	8/8	N/A	N/A	N/A	N/A	N/A
Mr. John Macken	7/8	N/A	N/A	N/A	1/1	N/A
Independent Non-Executive Directors						
Mr. Pierre Lebel (LEAD DIRECTOR)	8/8	3/4	4/4	4/5	N/A	1/1
Mr. André Deepwell	8/8	4/4	4/4	5/5	N/A	N/A
Mr. R. Stuart (Tookie) Angus (1)	6/8	2/2	3/4	5/5	N/A	1/1
Mr. Robert Hanson (2)	7/8	N/A	4/4	2/2	1/1	N/A
Mr. R. Edward Flood (3)	8/8	N/A	1/1	1/1	N/A	1/1
Mr. W. Gordon Lancaster (4)	6/6	2/2	2/2	2/2	N/A	N/A

NOTES

(1) Mr. Angus resigned from the Audit Committee on May 11, 2010

(2) Mr. Hanson resigned from the Compensation and Benefits Committee on May 11, 2010

(3) Mr. Flood joined the Nominating and Corporate Governance Committee and the Compensation and Benefits Committee on November 8, 2010 and resigned from the Compensation and Benefits Committee on February 16, 2011

(4) Mr. Lancaster was appointed as a Director of the Company on May 11, 2010 and joined the Audit Committee, the Nominating and Corporate Governance Committee and the Compensation and Benefits Committee on August 4, 2010

CODE OF BUSINESS CONDUCT AND ETHICS

The Company has adopted a Code of Business Conduct and Ethics and Corporate Securities Trading Policy with companion booklet and Corporate Securities Trading Policy with companion booklet and a Statement of Values and Responsibilities applicable to all employees, consultants, officers and directors regardless of their position in the organization, at all times and everywhere the Company does business. The Code of Business Conduct and Ethics provides that the Company's employees, consultants, officers and directors will uphold its commitment to a culture of honesty, integrity and accountability and the Company requires the highest standards of professional and ethical conduct from its employees, consultants, officers and directors. In 2010 the Company's management created a companion booklet to the Code of Business Conduct and Ethics to provide the Company's directors, employees and consultants with information pertaining to anti-bribery laws in Canada and the U.S. under the Foreign Corrupt Practices Act.

Company supervisors, employees and consultants are required to confirm, on an annual basis, that they have received, reviewed and understand the contents and agree to abide by the Company's Code of Business Conduct and Ethics.

The Audit Committee monitors compliance with the Code of Business Conduct and Ethics. The Nominating and Corporate Governance Committee monitors the disclosure of conflicts of interest by directors with a view to ensuring that no director votes or participates in any board deliberations on a matter in respect of which such director has a material interest.

APPOINTMENT AND RE-ELECTION OF DIRECTORS

The Board determines, in light of the opportunities and risks facing the Company, what competencies, skills and personal qualities it should seek in new board members in order to add value to the Company. Based on this framework, the Nominating and Corporate Governance Committee developed a skills matrix outlining the Company's desired complement of directors' competencies, skills and characteristics.

The specific make-up of the matrix includes such items and experiences as international experience, leading growth-orientated companies, mining exploration, diversity, financial literacy, legal knowledge, corporate governance, etc. The committee annually assesses the current competencies and characteristics represented on the Board and utilizes the matrix to determine the Board's strengths and identify any gaps that need to be filled. This analysis assists the committee in discharging its responsibility for approaching and proposing to the full Board new nominees to the Board, and for assessing directors on an ongoing basis.

Unless a director dies, resigns or is removed from office in accordance with the BCBCA, the term of office of each of the incumbent directors ends at the conclusion of the next annual meeting of the shareholders following his or her most recent election or appointment.

At every annual general meeting the shareholders entitled to vote at the annual general meeting for the election of directors are entitled to elect a board consisting of the number of directors for the time being set under the articles of continuation for the Company and all the directors cease to hold office immediately before such election but are eligible for re-election. If the Company fails to hold an annual general meeting on or before the date by which the annual general meeting is required to be held under the BCBCA or the shareholders fail, at the annual general meeting, to elect or appoint any directors then each director then in office continues to hold office until the earlier of:

- the date on which his or her successor is elected or appointed; and
- the date on which he or she otherwise ceases to hold office under the BCBCA or the articles of continuation.

SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted policies in its Corporate Disclosure, Confidentiality and Securities policy that has terms that are no less exacting than those set out in Appendix 10 of the rules governing the listing of securities on the Hong Kong Stock Exchange.

Furthermore, if a director (a) enters into a transaction involving a security of the Company or, for any other reason, the direct or indirect beneficial ownership of, or control or direction over, securities of the Company changes from that shown or required to be shown in the latest insider report filed by the director, or (b) the director enters into a transaction involving a related financial instrument, the director must, within the prescribed period, file an insider report in the required form on the SEDI website at www.sedi.ca and, from January 1, 2011 onwards, a Form 3A is filed with the Stock Exchange of Hong Kong Ltd.

A "related financial instrument" is defined as: (a) an instrument, agreement, security or exchange contract the value, market price or payment obligations of which are derived from, referenced to or based on the value, market price or payment obligations of a security, or (b) any other instrument, agreement or understanding that affects, directly or indirectly, a person's economic interest in respect of a security or an exchange contract.

REMUNERATION OF DIRECTORS

The Compensation and Benefits Committee periodically reviews and makes recommendations to the Board regarding the adequacy and form of the compensation for non-management directors to ensure that such compensation realistically reflects the responsibilities and risks involved in being an effective director, without compromising a director's independence. Directors who are executives of the Company receive no additional remuneration for their services as directors.

All independent non-management directors receive Cdn$25,000 per annum for acting as such. Mr. Lebel receives an additional Cdn$60,000 per annum for acting as the Lead Director of the board. The chair of the Audit Committee receives an additional Cdn$40,000 per annum, for acting in such capacity. The respective chairs of the Compensation and Benefits Committee and the Corporate Governance each receive an additional payment of Cdn$25,000 per annum for acting as such. Additionally, non-management directors receive Cdn$1,500 per in-person Board or Committee meeting attended and Cdn$600 per Board or Committee conference call in which they participate.

In addition to their cash compensation, non-management directors also receive a grant of 35,000 stock options per annum, such options having a five-year term and fully vesting on the first anniversary of the date of the grant.

Details regarding the remuneration of directors of the Company are set out in Note A2 of the Financial Statements.

INTERNAL CONTROLS

The Board is responsible for overseeing the internal controls of the Company. Internal controls are used by the Board to: facilitate the effectiveness and efficiency of operations, safeguard the investment of shareholders and assets of the Company and to ensure compliance with relevant statutory and regulatory requirements. The Company's internal control policies are designed to provide reasonable, but not absolute, assurance against material misstatements and help the Board identify and mitigate, but not eliminate, risk exposure.

The Board conducts annual reviews of the internal controls of the Company to ensure that internal control policies and procedures are adequate. The Audit Committee reviewed the effectiveness of the Company's internal control policies as at December 31, 2010, and is of the view that the internal control system in place is effective in safeguarding the investment of shareholders and assets of the Company.

AUDITORS

Deloitte & Touche LLP is the auditor of SouthGobi Resources Ltd. and is independent within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of British Columbia. The financial reporting responsibilities and audit report of the independent auditors are set out on page 81.

Deloitte & Touche LLP will be nominated at the upcoming annual general meeting for reappointment as auditors of the Company at remuneration to be fixed by the Board. Deloitte & Touche LLP have served as the Company's auditors since August 14, 2003.

Fees paid/payable to the external auditors, Deloitte and Touche LLP, in respect of audit and non-audit services provided during the year ended December 31, 2010 were as follows:

Nature of services rendered	Fees paid/payable (US$ 000's)	
Audit fees (a)	$	457
Non-audit fees (b)	$	154
Total	$	611

NOTES

(a) Fees for audit services billed consisted of:

- audit of the Company's annual financial statements
- reviews of the Company's interim financial statements
- comfort letters, consents and other services related to the Canadian securities regulatory and authorities' matters

(b) Fees for non-audit services billed consisted of:

- fees for tax services consisting of income tax compliance and tax planning and advice relating to transactions and proposed transactions of the Company and its subsidiaries

RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

The directors acknowledge their responsibility in overseeing the preparation of financial statements that give a true and fair view of the financial affairs of the Company. With the assistance of the management of the Company, the directors ensure that the financial statements of the Company are being prepared and published in a timely manner and in accordance with the applicable accounting standards and statutory requirements.

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 coal mining, development and exploration 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 the 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, which can be washed into semi-soft coking coal. From the commencement of production in late 2008 until December 31, 2010, the Company has sold approximately 4.0 million tonnes of coal from the Ovoot Tolgoi Mine. During the year ended December 31, 2010, the Company sold approximately 2.5 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 comprises the Soumber Field and the Biluut Field and 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. Exploration results show potential for thick seams of coking coal, and a resource has been established confirming the deposit. Preparatory work for a formal license application for the Soumber Deposit continues.

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.

SouthGobi owns 19.9% of Aspire Mining Limited ("Aspire"), a company listed on the Australian Stock Exchange. Aspire's primary focus is its ownership of 9 mineral exploration licenses in Mongolia, particularly those pertaining to the newly discovered Ovoot Coking Coal Project. The Company's interest in Aspire was primarily acquired through a placement in December of 2010 to SouthGobi for approximately $20.3 million. As at March 7, 2011, SouthGobi's interest in Aspire had a market value of approximately $75.2 million.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

1. OVERVIEW CONTINUED

1.1 Corporate Developments

Ovoot Tolgoi Complex

Total sales for the quarter ended December 31, 2010 were 1.5 million tonnes with an average realized selling price of $32 per tonne. Total sales for the year ended December 31, 2010 were 2.5 million tonnes at an average realized price of $35 per tonne. Total sales for the year ended December 31, 2009 were 1.3 million tonnes with an average realized selling price of $29 per tonne.

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 Shivee Khuren-Ceke Mongolian-Chinese border and allocated designated gates for coal exports to create expedited coal border crossing corridors.

As a result of continuing discussions with the Mongolian Government, border access improved through early 2010. The relevant authorities continue to work on projects to expand border capacity, which will allow the Company to continue to increase coal shipments in the future. Four designated coal border crossing corridors are under construction at Shivee Khuren-Ceke and are anticipated to open during the course of 2011.

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 has upgraded 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) trucks from the first fleet. The new Liebherr R9250 hydraulic excavator was commissioned at the end of January 2011.

On March 30, 2011, the Company announced that it had updated a prefeasibility study for the Ovoot Tolgoi Mine. The independent estimate prepared by Minarco-MineConsult ("MMC") calculated 106.8 million tonnes of Proven and Probable surface coal Reserves at December 11, 2010.

1. OVERVIEW CONTINUED

1.1 Corporate Developments CONTINUED

The Company also announced that it had received an updated independent NI 43-101 compliant Resource estimate for the Ovoot Tolgoi Complex, prepared by MMC. The Ovoot Tolgoi Complex surface and underground Resources contain Measured coal Resources of 188.3 million tonnes plus Indicated coal Resources of 77.9 million tonnes, with an additional Inferred coal Resource of 97.1 million tonnes as at December 11, 2010. Details of the assumptions and parameters used to calculate these coal Resources and coal quality estimates are set out in a Press Release dated March 30, 2011, and available at www.sedar.com.

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 coal-handling facility in June 2010, including dry air separators and blending capability and is expected be operational at the end of 2011.

Soumber Deposit

On March 30, 2011, the Company reported that it had received an updated independent NI 43-101 compliant Resource estimate for the Soumber Deposit, prepared by MMC. The Soumber Deposit is estimated to contain Measured coal Resources of 36.8 million tonnes plus Indicated coal Resources of 24.6 million tonnes, with an additional Inferred coal Resource of 65.8 million tonnes as at January 25, 2011. Details of the assumptions and parameters used to calculate these coal Resources and coal quality estimates are set out in a Press Release dated March 30, 2011, and available at www.sedar.com.

The Company 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.

Regional Infrastructure

In October 2010, the Company entered into a contract for $48 million to design and construct a coal-haul highway. The 45 km 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 22 meters ("m") wide and will consist of four fully paved lanes, with a 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 Concession Law. Final approval for the contract is subject to a formal review from the Mongolian Government.

Aspire Investment

On December 23, 2010, the Company announced it had completed a private placement with Aspire. At the completion of the private placement, the Company owned approximately 19.9% of Aspire. Aspire is a coal resource company which owns 100% of the Ovoot Coking Coal Project in Mongolia along with the Nuramt, Jilchilibag and Shanagan Coal Projects. In addition, Aspire owns a 49% interest in the Windy Knob gold and base metals project located in Western Australia.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

1. OVERVIEW CONTINUED

1.1 Corporate Developments CONTINUED

In a press release dated October 14, 2010, Aspire announced a maiden JORC compliant coal Resource with an estimated 93.3 million tonnes of Measured coal Resources, 182.4 million tonnes of Indicated coal Resources plus an additional 55.0 million tonnes of Inferred coal Resources for the Ovoot Coking Coal Project. In a press release dated January 14, 2011, Aspire announced that it had received early results from some raw coal quality tests. The raw coal tests results show a coal type of Raw Coking Coal Quality (in situ) with: Inherent Moisture – 0.6%, Ash – 19.5%, Volatiles – 27.1%, Sulphur – 1.1%, Crucible Swelling Index – 7.7 and Energy – 6,618 kcal/kg. Data results are on an air dried basis for raw coal samples. Based on early results, it is expected that the Ovoot Coking Coal Project washed product will be a high fluidity, mid-volatile coking coal.

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. Also during the year, the Company received awards for safety, partner of the year with Habitat for Humanity Mongolia and for tangible contributions for soum economic and social development and regional development through investments and creation of jobs.

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.

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 March 30, 2011, the Company had repurchased 250,750 shares on the Hong Kong Stock Exchange and 1,255,550 shares on the Toronto Stock Exchange for a total of 1,506,300 common shares at a total cost of approximately $19.0 million. The Company cancels all shares after they are repurchased.

1. OVERVIEW CONTINUED

1.2 Corporate Activity CONTINUED

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

On October 19, 2010, the Company announced it had signed an agreement for the purchase of the Company's entire remaining inventory of Sunset Pit No. 8/9/10 seams higher-ash higher sulphur coal and a proportion of additional Sunset Pit No. 8/9/10 seams higher-ash higher sulphur 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.

As of March 30, 2011, Ivanhoe Mines Ltd. ("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. MINERAL PROPERTIES

3.1 Qualified Persons

Disclosure of a scientific or technical nature in this Management Discussion and Analysis ("MD&A") with respect to the Company's Coal Division was prepared by, or under the supervision of Dave Bartel, P.Eng., the Company's Vice President of Mongolian Operations. Mr. Bartel is a "qualified person" for the purposes of National Instrument 43-101 of the Canadian Administrators ("NI 43-101").

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

3. MINERAL PROPERTIES CONTINUED

3.2 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 December 31, 2010, the Company held 16 licenses, including two mining licenses, which in total cover an area of approximately 558,000 ha. The Company dropped four licenses in 2010.

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.

Six 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 these 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.

3.3 Properties in Mongolia

Ovoot Tolgoi Mine

The Ovoot Tolgoi Mine is located in the southwest corner of the Umnugobi 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.

3. MINERAL PROPERTIES CONTINUED

3.3 Properties in Mongolia CONTINUED

In 2011, the Company engaged MMC to update a technical report for the Ovoot Tolgoi Complex, incorporating outstanding data obtained from drilling to the end of 2010.

On March 30, 2011, the Company announced an updated NI 43-101 compliant independent Resource estimate prepared by MMC. MMC estimated that the Ovoot Tolgoi Mine contains approximately 106.8 million tonnes of Proven and Probable surface coal Reserves, 136.3 million tonnes of Measured Resources, 35.8 million tonnes of Indicated Resources and 12.9 million tonnes of Inferred Resources as at December 11, 2010. The Mineral Resources are inclusive of Mineral Reserves.

The coal rank at the Ovoot Tolgoi Mine is high volatile B to A bituminous based on the ASTM D388 standard. 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, which 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 coal-handling facility in June 2010. The 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. The facility will also include dry air separation as an additional stage through the insertion of dry air separation modules. Completion is 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 performs a similar function to the coal-handling facility, namely rejecting oversize ash and sizing the coal to a maximum size of 50 millimeters.

In the fourth quarter of 2010, coal sales were approximately 1.5 million tonnes compared to total sales in the fourth quarter of 2009 of approximately 0.36 million tonnes. Total sales since the mine commenced production are approximately 4.0 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 substantially complete and is already in partial use. It permits coal to be transported across the border through four 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 coal to be transported 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. Final approval for the contract is subject to a formal review from the Mongolian Government.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

3. MINERAL PROPERTIES CONTINUED

3.3 Properties in Mongolia CONTINUED

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.

SouthGobi Sands LLC, a wholly owned Mongolian subsidiary of SouthGobi, employed 521 employees as at December 31, 2010. Of the 521 employees, 58, including expatriates, are employed in the Ulaanbaatar office, 6 in outlying smaller offices, including the Ceke border point, and 457 employees at the mine site. Of the total 521 employees based in Mongolia, 504 (97%) are Mongolian nationals and of those, 186 (36%) are residents of the local Gurvantes and Noyon Soums.

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 shovel and truck mining fleet consists of a Liebherr 996 hydraulic shovel ($34m^3$) and four Terex MT4400 (218-tonne capacity) trucks. This fleet supplements the original 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 fleets 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 ($17m^3$), 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. The new Liebherr R9250 was commissioned at the end of January 2011. 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.

Throughout the quarter ended December 31, 2010, the Company continued to develop its coal markets in China. Total sales in the quarter ended December 31, 2010 were 1.5 million tonnes consisting of raw semi-soft coking coal and raw higher-ash coal.

3. MINERAL PROPERTIES CONTINUED

3.3 Properties in Mongolia CONTINUED

Soumber Deposit

The Soumber Deposit, comprised of the Soumber Field and Biluut Field, is located approximately 20km east of the Ovoot Tolgoi Mine. It lies within the administrative unit of Gurvantes Soum in the Umnugobi 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 24,512m of drilling were completed. In 2009, the Company conducted geotechnical and hydrological programs in the Soumber central field. Exploration programs were conducted on the Biluut field in 2005 and 2008 when over 29 drill holes totaling approximately 6,549m were completed. Exploration at the Biluut field was expanded in 2010 with 67 drill holes totaling 20,507m being completed. 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 six 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.

Additional drilling commenced in March 2010. The drilling expanded and better defined the resource and the Soumber Deposit now includes the Biluut Field to the east of the Soumber Field. The 2010 drilling included a series of open-holes and core holes. As at December 31, 2010, approximately 64,952m of core and reverse circulation holes have already been drilled on the Soumber Deposit and surrounding areas.

On March 30, 2011, the Company reported that it had received an updated NI 43-101 compliant independent Resource estimate for the Soumber Deposit prepared by MMC. MMC estimated that the Soumber Deposit contains Measured coal Resources of 36.8 million tonnes, Indicated coal Resources of 24.6 million tonnes and Inferred coal Resources of 65.8 million tonnes as at January 25, 2011.

The coal rank at the Soumber Deposit is low to medium volatile bituminous based on the ASTM D388 standard producing between 5,000 to 7,800 kcal/kg of heat output. Laboratory data demonstrated that some of the coal benches exhibit potential coking coal characteristics.

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.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

3. MINERAL PROPERTIES CONTINUED

3.3 Properties in Mongolia CONTINUED

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 300m to 600m that is designated for potential underground development is located inside the existing Ovoot Tolgoi mining license.

On March 30, 2011, the Company reported that it had received an updated NI 43-101 compliant independent Resource estimate for the Ovoot Tolgoi Underground Deposit prepared by MMC. MMC estimated that the Ovoot Tolgoi Underground Deposit contains Measured coal Resources of 52.0 million tonnes, Indicated coal Resources of 42.1 million tonnes and Inferred coal Resources of 84.2 million tonnes as at December 11, 2010.

Tsagaan Tolgoi Deposit

The Tsagaan Tolgoi coal field is located in south-central Mongolia. The property is located in the Umnugobi 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 was approved by the Mongolian Government on March 4, 2010. 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.

3. MINERAL PROPERTIES CONTINUED

3.3 Properties in Mongolia CONTINUED

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 premium coal deposits.

Substantive physical exploration for 2010 commenced in March. For the year ended December 31, 2010, $18.8 million has been spent, including 60,646m^3 of trenching and over 109,600m 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 6km to the south-west of the Ovoot Tolgoi Complex known as the SW target. For the year ended December 31, 2010, $8.3 million has been spent on the Soumber Deposit and surrounding area.

The 2010 drilling program focused 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.

Regional Infrastructure

The Company entered into a contract for $48 million to design and construct a coal-haul highway. The 45 km 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 22m wide and will consist of four fully paved lanes, with a 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. Final approval for the contract is subject to a formal review from the Mongolian Government.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

4. SELECTED ANNUAL INFORMATION

($ in thousands, except per share information)

	2010	2009	2008
Revenue	$ **79,777**	$ 36,038	$ 3,126
Operating loss from continuing operations	**(46,977)**	(23,321)	(45,854)
Loss from continuing operations	**(116,195)**	(79,717)	(51,975)
Loss from discontinued operations	**—**	(31,088)	(17,601)
Net loss	**(116,195)**	(110,805)	(69,576)
Loss per share from continuing operations	**(0.66)**	(0.60)	(0.40)
Loss per share from discontinued operations	**—**	(0.23)	(0.14)
Net loss per share	**(0.66)**	(0.83)	(0.54)
Cash and cash equivalents	**492,038**	357,342	10,117
Short term investments (i)	**17,529**	14,999	—
Long term investments (ii)	**107,416**	57,070	—
Total assets	**961,866**	560,684	99,948
Total long term liabilities	**252,527**	543,086	329

(i) Short term investments are money market investments with maturities greater than ninety days and less than one year
(ii) Long term investments include $45.2 million of money market investments, the $10.2 million investment in KRL and the $52.0 million investment in Aspire

The Company's net loss for 2010 was $116.2 million or $0.66 per share compared with $110.8 million or $0.83 per share in 2009 and $69.6 million or $0.54 per share in 2008.

The net loss in 2009 included $31.1 million in discontinued operations for the Indonesia Coal Division ("Mamahak Deposit"). In the fourth quarter of 2009, the Indonesia Coal Division was sold to Kangaroo Resources Ltd. ("KRL") for consideration comprising $1 million in cash and 50 million shares of KRL. The Company had no losses from discontinued operations in 2010.

Revenues increased in 2010 to $79.8 million from $36.0 million in 2009 and $3.1 million in 2008. The Company reported its first sales revenue in the fourth quarter of 2008.

The operating loss from continuing operations in 2010 increased to $47.0 million from $23.3 million in 2009 and $45.9 million in 2008 due to higher operating costs as the Company realigned the Sunset open pit, higher administration costs due to the continued expansion of the Company's employee base and higher exploration costs as the Company had a more active exploration program.

The loss from continuing operations was $116.2 million in 2010 compared to $79.7 million in 2009 and $52.0 million in 2008. The net loss includes financing costs related to the CIC convertible debenture. In 2010, $250.0 million of the convertible debenture was converted to common shares resulting in a $151.4 million non-cash loss on partial conversion of the debt. The fair value change of the embedded derivative in the CIC convertible debenture resulted in a non-cash gain of $100.6 million in the year ended 2010 and a loss of $45.0 million in the year ended December 31, 2009. (See Finance Income/(Costs) section for more details.) The loss from continuing operations excluding non-cash CIC convertible debenture items was $65.5 million for the year ended December 31, 2010 compared to $34.7 million for the year ended December 31, 2009.

4. SELECTED ANNUAL INFORMATION CONTINUED

The Company's total assets at the end of 2010 were $961.9 million compared to $560.7 million in 2009 and $99.9 million at the end of 2008. At December 31, 2010, the Company had $492.0 million in cash and cash equivalents, $17.5 million in short term investments and $107.4 million in long term investments compared to $357.3 million in cash and cash equivalents, $15.0 million in short term investments and $57.1 million in long term investments at December 31, 2009, and $10.1 million in cash and cash equivalents at December 31, 2008. The short and long term investments at December 31, 2010 include money market investments and the Company's investment of $10.2 million in KRL and $52.0 million investment in Aspire. All short term and long term investments have been marked to market at December 31, 2010. The after tax mark to market gain of $27.8 million for the investment in Aspire has been included in other comprehensive income as the investment in Aspire has been classified as available-for-sale. The increase in cash and money market investments relate to the global equity offering in January 2010. The increase in total assets relates to the global equity offering in January 2010 and the continuing development of the Mongolia Coal Division.

The Company's long term liabilities at the end of 2010 were $252.5 million compared to $543.1 million at the end of 2009 and $0.3 million at the end of 2008. The decrease in long term liabilities in 2010 is due to the partial conversion of $250.0 million of the convertible debenture into common shares of the Company.

5. SUMMARY OF QUARTERLY RESULTS

($ in thousands, except per share information unless otherwise indicated)

	2010				2009			
Quarter Ended	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar
Revenue	**$ 41,595**	$ 6,597	$ 17,668	$ 13,917	$ 9,960	$ 11,871	$ 10,666	$ 3,541
Income/(loss) from mine operations	**3,376**	(6,674)	4,400	1,187	1,524	3,234	1,527	328
Evaluation and exploration expenses	**(4,144)**	(6,314)	(6,659)	(1,651)	(739)	(2,150)	(1,742)	(768)
Net interest (expense)/income	**(4,191)**	(4,385)	(4,384)	(9,024)	(8,243)	(642)	(356)	(57)
Other finance income/(costs)	**(15,697)**	51,507	67,677	(153,410)	(53,536)	—	—	—
Total finance income/(costs)	**(19,887)**	47,122	63,293	(162,434)	(61,779)	(642)	(356)	(57)
Net (loss)/income from continuing operations before other finance income/(costs)	**(13,027)**	(24,012)	(14,376)	(14,861)	(16,651)	2,224	(5,139)	(6,616)
Income/(loss) from continuing operations	**(28,720)**	27,495	53,301	(168,271)	(70,187)	2,224	(5,139)	(6,616)
Income/(loss) from discontinued operations	**—**	—	—	—	1,034	(26,006)	(2,772)	(3,344)
Net income/(loss)	**(28,720)**	27,495	53,301	(168,271)	(69,153)	(23,782)	(7,911)	(9,960)
Net income/(loss) per share	**(0.16)**	0.15	0.29	(1.09)	(0.52)	(0.17)	(0.06)	(0.08)

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

5. SUMMARY OF QUARTERLY RESULTS CONTINUED

	2010				2009			
Quarter Ended	**31-Dec**	**30-Sep**	**30-Jun**	**31-Mar**	**31-Dec**	**30-Sep**	**30-Jun**	**31-Mar**
Volumes and prices								
Raw semi-soft coking								
Raw coal production *(millions of tonnes)*	**0.41**	0.18	0.39	0.21	0.16	0.35	—	0.08
Coal sales *(millions of tonnes)*	**0.35**	0.11	0.42	0.40	0.36	0.46	0.38	0.13
Average realized sales price *(per tonne)*	**$ 47.08**	$ 46.04	$ 44.10	$ 36.62	$ 29.55	$ 27.82	$ 29.71	$ 29.26
Raw higher-ash coal								
Raw coal production *(millions of tonnes)*	**0.97**	0.39	0.23	0.01	—	0.01	—	0.08
Coal sales *(millions of tonnes)*	**1.12**	0.08	0.03	0.03	—	—	—	—
Average realized sales price *(per tonne)*	**$ 26.75**	$ 25.34	$ 18.82	$ 21.24	$ —	$ —	$ —	$ —
Total								
Raw coal production *(millions of tonnes)*	**1.38**	0.57	0.62	0.22	0.16	0.36	—	0.16
Coal sales *(millions of tonnes)*	**1.47**	0.19	0.45	0.43	0.36	0.46	0.38	0.13
Average realized sales price *(per tonne)*	**$ 31.56**	$ 37.15	$ 42.63	$ 35.52	$ 29.55	$ 27.82	$ 29.71	$ 29.26
Costs								
Direct cash costs of product sold *(per tonne)*	**$ 18.53**	$ 18.59	$ 21.37	$ 22.25	$ 16.97	$ 11.16	$ 16.64	$ 14.29
Total cash costs of product sold *(per tonne)*	**$ 19.25**	$ 22.04	$ 22.30	$ 23.32	$ 18.29	$ 13.41	$ 18.13	$ 18.51
Operating Statistics								
Sunset								
Total waste material moved *(millions of bank cubic meters)*	**3.56**	2.90	1.73	1.50	0.87	1.06	—	0.34
Strip ratio *(bank cubic meters of waste rock per tonne of coal produced)*	**2.58**	5.09	2.79	6.79	5.38	2.98	—	2.19
Sunrise								
Total waste material moved (millions of bank cubic meters)	**0.73**	0.43	0.02	—	—	—	—	—

5. SUMMARY OF QUARTERLY RESULTS CONTINUED

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, 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 9 and 20 of the Consolidated Financial Statements.

The Company recorded a net loss for the three months ended December 31, 2010 of $28.7 million compared to net income of $27.5 million for the three months ended September 30, 2010 and a net loss of $69.2 million for the three months ended December 31, 2009. The net loss in the fourth quarter of 2010 is due primarily to the $20.0 million loss on the fair value change of the embedded derivatives in the CIC convertible debenture compared to a $49.8 million gain in the third quarter of 2010.

Revenues increased significantly to $41.6 million in the fourth quarter of 2010 from $6.6 million in the third quarter of 2010 and $10.0 million in the fourth quarter of 2009. The increased revenues are primarily due to higher sales volumes.

The Company sold 1.5 million tonnes at an average realized price of $32 per tonne in the fourth quarter of 2010 compared to sales of 0.36 million tonnes at an average realized price of $29 per tonne in the fourth quarter of 2009 and sales of 0.19 million tonnes at an average realized price of $37 per tonne in the third quarter of 2010. The average realized price dropped in the fourth quarter of 2010 compared to the third quarter of 2010 due to the higher proportion of higher-ash coal sales. The increase in production in the fourth quarter of 2010 is a result of the commissioning of the third fleet in the fourth quarter of 2010.

The cost of sales was $38.2 million in the fourth quarter of 2010 compared to $8.4 million in the fourth quarter of 2009. Cost of sales will vary depending on sales volume, production and unit costs, which directly affects income from mine operations. 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. The increase in cost of sales in the fourth quarter of 2010 compared to the fourth quarter of 2009 and the third quarter of 2010 relates primarily to the increased sales volume.

Direct cash cost per tonne sold was $18.53 per tonne for the fourth quarter of 2010 compared to $16.97 per tonne for the fourth quarter of 2009 and $18.59 per tonne for the third quarter of 2010. Direct cash cost per tonne sold increased in the fourth quarter of 2010 compared to the fourth quarter of 2009 due to the sale of higher cost inventory from previous quarters. Direct cash cost per tonne sold decreased in the fourth quarter of 2010 compared to the third quarter of 2010 as production increased due to the commissioning of the third fleet in the third quarter of 2010.

Administration costs in the fourth quarter of 2010 were slightly higher than the fourth quarter of 2009 and relatively unchanged from the third quarter of 2010. The increase in the fourth quarter of 2010 compared to the fourth quarter of 2009 is due to increased office costs, salary costs and government relations costs partially offset by lower professional and legal costs.

Exploration expenses for the three months ended December 31, 2010 were $4.1 million compared to $0.7 million for the three months ended December 31, 2009. The increase relates to Greenfields exploration, ongoing water exploration and reverse circulation and core drilling.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

5. SUMMARY OF QUARTERLY RESULTS CONTINUED

In the fourth quarter of 2010, other finance income/(costs) includes a loss of $20.0 million on the fair value change of the embedded derivative and a mark to market gain of $4.4 million mainly related to the Company's investment in KRL. This compares to a $45.0 million loss on the fair value change of the embedded derivative in the fourth quarter of 2009. In the third quarter of 2010, other finance income/(costs) included 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. The finance income/(costs) in the first quarter of 2010 included a $151.4 million loss on partial conversion of the convertible debenture.

Income tax recovery for the three months ended December 31, 2010, was $0.08 million compared to $1.5 million in the comparative period for 2009.

6. RESULTS OF OPERATIONS

	YEAR ENDED DECEMBER 31,		
	2010	**2009**	**2008**
Volumes, Prices and Costs			
Raw coal production *(millions of tonnes)*	**2.79**	0.67	1.16
Coal sales *(millions of tonnes)*	**2.54**	1.33	0.11
Average realized sales price *(per tonne)*	**$ 34.61**	$ 28.97	$ 29.20
Direct cash costs of product sold *(per tonne)*	**$ 19.66**	$ 14.61	$ 8.30
Total cash costs of product sold *(per tonne)*	**$ 20.70**	$ 16.58	$ 14.09
Operating Statistics			
Sunset			
Total waste material moved *(millions of bank cubic meters)*	**9.69**	2.27	2.54
Strip ratio *(bank cubic meters of waste rock per tonne of coal produced)*	**3.47**	3.36	2.19
Sunrise			
Total waste material moved *(millions of bank cubic meters)*	**1.18**	—	—
Operating Results ***(thousands of dollars)***			
Revenue	**$ 79,777**	$ 36,038	$ 3,126
Cost of sales	**(77,488)**	(29,425)	(2,177)
Income from mine operations	**2,289**	6,613	949
Administration expenses[1]	**(30,497)**	(24,535)	(20,358)
Evaluation and exploration expenses	**(18,769)**	(5,399)	(26,445)
Operating loss from continuing operations	**$ (46,977)**	$ (23,321)	$ (45,854)

[1] Administration expenses for the year ended December 31, 2010 include $5,952 in public infrastructure costs (2009: $nil, 2008: $nil)

6. RESULTS OF OPERATIONS CONTINUED

In 2010, 2.79 million tonnes of raw coal was produced with a strip ratio 3.47 compared to 0.67 million tonnes of raw coal produced in 2009 with a strip ratio of 3.36. Although production was lower in the first half of 2010 due to the realigning of the Sunset Pit, production increased significantly in the fourth quarter of 2010 due to the commissioning of the third fleet, which increased the capacity of the mining operation. During 2009, there was a full mine shut-down from March 2009 to July 2009 and the Sunset open pit realignment, which began in December 2009, all of which negatively impacted production in 2009. In the second quarter of 2010, the Company also began stripping the Sunrise pit. The costs associated with 1.18 million bank cubic meters ("BCM") removed from the Sunrise pit were capitalized as deferred stripping.

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 (e.g. 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 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 was completed in the second quarter of 2010, but subsequently impacted cost per tonne sold as higher cost inventory was sold.

In addition to the impact of the pit realignment, costs for the year ended December 31, 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 in the second quarter of 2010.

Another trend impacting costs is the increased cost of key inputs. Prices of diesel fuel, (approximately 23% of the Company's direct cash cost), were 11% higher in the year ended December 31, 2010 compared to the year ended December 31, 2009. The Company is also incurring higher relative costs for blasting and tires.

In the third quarter of 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.

The Company incurred an operating loss from continuing operations for the year ended December 31, 2010 of $47.0 million compared to $23.3 million for the year ended December 31, 2009. The increase in the operating loss is due to the factors discussed below.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

6. RESULTS OF OPERATIONS CONTINUED

In 2010, the Company had sales of 2.54 million tonnes at an average realized price of approximately $35 per tonne. This compares to 1.33 million tonnes sold in 2009 at an average realized selling price of $29 per tonne. Revenue increased from $36.0 million in 2009 to $79.8 million in 2010 due to the higher sales volume and a higher realized average price. Individual contract pricing has increased through 2010.

Cost of sales was $77.5 million in the year ended December 31, 2010, compared to $29.4 million for the year ended December 31, 2009. The increase in cost of sales is due to the increased sales volume, increased cash costs as well as the impairment of the raw higher-ash coal stockpiles and the Liebherr 994 shovel and related supplies recorded in the third quarter of 2010. Cost of sales comprise 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.

Direct cash costs of product sold were $19.66 per tonne for the year ended December 31, 2010 compared to $14.61 per tonne for the year ended December 31, 2009. The increase in direct cash costs in 2010 is due to the realignment of the Sunset open-pit which began in December 2009 and was completed in the second quarter of 2010, the fleet issues experienced in 2010, higher input costs such as fuel and the screening of some coals which resulted in a recovery loss and additional screening costs. In the third quarter of 2010 the Company began screening to improve the saleability of the raw higher-ash coals. Direct cash cost per tonne sold started decreasing towards the end of 2010 as a result of increased production.

Mine administration costs per tonne decreased to $1.04 per tonne for the year ended December 31, 2010 compared to $1.97 per tonne for the year ended December 31, 2009. The decrease per tonne is due to the higher sales volume in 2010.

Exploration expenses for the year ended December 31, 2010, were $13.4 million higher than for the year ended December 31, 2009. Increased exploration expense in 2010 relates to a more active exploration program in 2010, including substantially increased drilling.

Administration expenses for the year ended December 31, 2010 were $30.5 million compared to $24.5 million for the year ended December 31, 2009. Share-based compensation expense allocated to administration expenses was $10.8 million for the year ended December 31, 2010 and $10.5 million for the year ended December 31, 2009. Other amounts included in the year ended December 31, 2010 that account for the increase compared to 2009 are public infrastructure costs offset by an exchange gain. The public infrastructure costs of $6.0 million in 2010 are costs related to maintenance and upgrading of public transportation infrastructure used to transport coal from the Ovoot Tolgoi Mine to the Chinese border and these costs are included in administration costs.

The administration expenses consist of the following major categories broken down for comparative purposes (see Note 7 of the Consolidated Financial Statements).

Legal fees for the year ended December 31, 2010 and December 31, 2009 were incurred for costs associated with the Company's regulatory affairs including expenses associated with corporate governance, contract negotiations, filing, registration and disclosure. Legal fees in 2010 were comparable to legal fees in 2009.

Corporate administration fees increased in the year ended December 31, 2010 compared to the year ended December 31, 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.

6. RESULTS OF OPERATIONS CONTINUED

Professional fees are slightly lower for the year ended December 31, 2010 compared to the year ended December 31, 2009. Professional fees include accruals for the review and audit of the Company's financial statements, costs for internal computer systems training and planning and costs for technical reports.

Salaries and benefits, excluding share-based compensation costs, increased in the year ended December 31, 2010 to $4.7 million as compared to $3.6 million for the year ended December 31, 2009. The increase relates to additional staff in 2010.

Sustainability and community relations are costs incurred in Mongolia. Sustainability and community relations expenses were $0.7 million in the year ended December 31, 2010 compared to $nil in the year ended December 31, 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 $6.0 million for the year ended December 31, 2010 compared to $nil for the year ended December 31, 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$"), the U.S. dollar to Mongolian Tugrik exchange rates and the U.S. to the Australian dollar ("A$") 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. In 2009, listing costs of $2.5 million were expensed and listing costs of $4.6 million were capitalized. In October 2009 the Company achieved milestones that strongly indicated that the secondary listing application would lead to an equity financing and all listing costs subsequent to that date were capitalized.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

7. NON-IFRS FINANCIAL MEASURES

($ in thousands, unless otherwise stated)

This Management's Discussion and Analysis of Financial Condition and Results of Operations 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. Non-cash adjustments include share-based compensation costs, depreciation, depletion and impairments. 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.

	YEAR ENDED DECEMBER 31,		
	2010	2009	2008
Cash costs, continuing operations			
Cost of sales per financial statements	**$ 77,488**	$ 29,425	$ 2,177
Less non-cash adjustments	**(25,003)**	(7,405)	(586)
Total cash costs	**52,485**	22,020	1,591
Coal sales (000's of tonnes)	**2,536**	1,328	113
Total cash costs of product sold (per tonne)	**$ 20.70**	$ 16.58	$ 14.09

	YEAR ENDED DECEMBER 31,		
	2010	2009	2008
Cash costs, continuing operations			
Direct cash costs of product sold (per tonne)	**$ 19.66**	$ 14.61	$ 8.30
Mine administration cash costs of product sold (per tonne)	**1.04**	1.97	5.79
Total cash costs of product sold (per tonne)	**$ 20.70**	$ 16.58	$ 14.09

8. EXPLORATION COSTS AND DISCONTINUED OPERATIONS BY DIVISION

($ in thousands)

	YEAR ENDED DECEMBER 31,		
	2010	2009	2008
Mongolian Coal Division	**$ 18,769**	$ 5,399	$ 26,445
Indonesian Coal Division - Discontinued Operations	**–**	15,916	9,740
Metals Division - Discontinued Operations	**–**	–	7,911
Total Exploration	**$ 18,769**	$ 21,315	$ 44,096

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 year ended December 31, 2010 were $18.8 million compared to $5.4 million for the year ended December 31, 2009. Exploration activities include drilling, trenching and geological reconnaissance. The Soumber exploration program and the Greenfields 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.

Indonesian Coal Division – Discontinued Operations

The sale of the Mamahak Deposit is disclosed as discontinued operations in 2009. Exploration expenditures were $15.9 million for the year ended December 31, 2009. The Company continued exploration activities in Indonesia in 2009 until development work was suspended in October 2009.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

9. FINANCE INCOME/(COSTS)

($ in thousands)

	YEAR ENDED DECEMBER 31, 2010	2009	2008
Fair value gain/(loss) on embedded derivatives in convertible debenture	$ **100,637**	$ (44,980)	$ –
Fair value loss on embedded derivative in line of credit facility	**–**	–	(7,223)
Loss on partial conversion of convertible debenture	**(151,353)**	–	–
Interest expense on convertible debenture	**(24,294)**	(7,684)	–
Interest expense on line of credit facilities	**(131)**	(1,651)	(747)
Transaction costs on issuance of convertible debenture	**–**	(9,399)	–
Mark to market gain on investments	**870**	843	–
Accretion of decommissioning liability	**(77)**	(40)	(19)
Interest income	**2,441**	77	1,868
	$ **(71,907)**	$ (62,834)	$ (6,121)

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.

For the year ended December 31, 2010, the fair value change on the embedded derivative was a gain of $100.6 million, compared with a $45.0 million loss for the year ended December 31, 2009. The fair value of the embedded derivatives is driven by many factors including, share price, foreign exchange rates and share price volatility. During 2010, the share price dropped from Cdn$17.10 at December 31, 2009 to Cdn$12.18 at December 31, 2010 resulting in a significant decrease in the fair value of the embedded derivative which resulted in a gain of $100.6 million. Finance costs for the year ended December 31, 2010 include a $151.4 million loss on partial conversion of the convertible debenture and interest expense of $24.4 million for the year ended December 31, 2010. Financing costs in 2009 include interest expense of $9.3 million and transaction costs on the issuance of the convertible debenture of $9.4 million.

9. FINANCE INCOME/(COSTS) CONTINUED

In 2009, as part of the sale of the Metals Division, the Company obtained a $30 million working capital credit facility from Ivanhoe which was later increased to $60 million. In November 2009, after receiving the financing from CIC, the Company repaid the $50 million in principal plus $1.6 million in accrued interest.

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 was a twelve month revolving line of credit facility with a maximum draw-down available of $3.0 million. The Bank line of credit facility was used by the Company's Mongolian subsidiaries as part of their working capital management. On December 18, 2010 the line of credit facility was extended to January 18, 2011. On January 18, 2011, the Company signed a new revolving line of credit facility with Golomt Bank for a twelve month period. Under the new agreement the maximum draw-down available is $3.5 million and MNT8.1 Billion (approximately $6.5 million) and bears interest at 11% for any U.S. Dollar amounts outstanding and 12% for any Mongolia Tugrik amounts outstanding. The Company incurred interest expense of $0.13 million for the year ended December 31, 2010 related to the line of credit.

The mark to market adjustment on investments was a gain of $0.87 million for the year ended December 31, 2010 compared to a gain of $0.84 million for the year ended December 31, 2009. The gain includes the mark to market adjustment on the 50 million shares of KRL, which were received as proceeds for the sale of the Indonesia Coal Division, and certain money market instruments. The Company's investment in Aspire has been classified as available-for-sale and therefore the after tax mark to market gain of $27.8 million has been recorded in other comprehensive income.

The Company recognizes decommissioning liabilities 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 for the year ended December 31, 2010 was $2.4 million higher than for the year ended December 31, 2009 due to higher cash balances which relate to the CIC convertible debenture and the completion of the equity financings in early 2010. The current economic climate has resulted in very low interest rates especially for US$ denominated investments.

10. TAXES

For the year ended December 31, 2010, the Company recorded current income tax expense of $1.8 million related to its Mongolian operations compared to $0.5 million for the year ended December 31, 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 $4.5 million for the year ended December 31, 2010 (2009: $6.9 million).

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

11. LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Highlights

($ in thousands)

	YEAR ENDED DECEMBER 31, 2010	2009	2008
Cash used in operating activities	$ (57,848)	$ (35,230)	$ (63,588)
Cash used in investing activities	(217,705)	(105,105)	(57,669)
Cash generated by financing activities	409,342	487,332	134,306
Effect of foreign exchange rate changes on cash	907	5	(4,103)
Increase in cash for the year	134,696	347,002	8,947
Cash balance, beginning of the year	357,342	10,340	1,394
Cash balance, end of the year	$ 492,038	$ 357,342	$ 10,340

General market conditions

There are some risks to the Chinese growth outlook, however China is expected to achieve respectable growth rates in 2011. Chinese demand is expected to increase and it has emerged as a major importer of coal as domestic production has not kept up with demand. Supply disruptions have increased China's demand for Mongolian coal as well as impacted coal prices positively. Management will continue to monitor external conditions and their impact on the Company's business plans for the upcoming year.

Cash used in operating activities

At December 31, 2010, the Company had cash resources of $492.0 million compared to cash resources of $357.3 million at December 31, 2009. At December 31, 2010, the Company also had short and long term money market investments of $62.7 million for a total of $554.7 million in cash and cash equivalents and money market investments.

Cash used in continuing operations was $57.8 million for the year ended December 31, 2010, compared to $16.0 million for the year ended December 31, 2009. Cash used in discontinued operations for the year ended December 31, 2010 was $nil compared to $19.2 million for the year ended December 31, 2009. The increased outflow in 2010 primarily relates to the increased exploration and increased materials and supplies as the mine expands and more mobile equipment is brought on-site.

The Company incurred a net loss from continuing operations before tax of $118.9 million for the year ended December 31, 2010 compared to a net loss from continuing operations before tax of $86.2 million for the year ended December 31, 2009. In 2010, the Company recorded revenue of $79.8 million compared to $36.0 million in 2009. The higher revenue in 2010 was offset by higher operating costs, administration costs, exploration costs and financing costs. With the increased activities at the Ovoot Tolgoi site and the operations in Mongolia, accounts receivable, inventory, and accounts payable increased during the year ended December 31, 2010.

Accounts receivable include funds due from government taxation authorities (Goods and Services Tax or Value Added Tax ("VAT")). VAT accounts receivable due from government taxation authorities in Mongolia may be used to offset income taxes and royalties payable to the government taxation authorities in Mongolia. During 2010, the Company received cash refunds and offset current income taxes payable and royalties against the VAT receivable.

11. LIQUIDITY AND CAPITAL RESOURCES CONTINUED

The Company had previously reported that in July 2009, the Mongolia Tax Laws were amended to preclude producers and exporters of unfinished mineral products from claiming back VAT, however the Mongolian Government had not defined what products would qualify as finished mineral products. Effective November 10, 2010, the Mongolian Government issued the list defining finished mineral products and based on that list, the Company's current coal products do not qualify as finished mineral products. The application of this law is prospective and any amounts accumulated until November 9, 2010 are refundable. Any amounts paid for VAT from November 10, 2010 onwards have either been expensed directly through profit or loss or capitalized as part of a related asset. Verification by the Mongolian Government Taxation Authority of the collectability of the funds is conducted on an annual basis and any outstanding VAT receivable amounts at December 31, 2010 will be available to the Company to offset future taxes and royalties or will be refunded by the Mongolian Government Taxation Authority.

With the completion of the Company's previously announced coal handling facility the Company is confident its coal products will qualify for VAT and from that point forward the Company will once again be eligible to reclaim any paid VAT amounts. The coal handling facility is scheduled to be commissioned by the end of 2011.

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 materials and supplies inventory.

Coal and supplies inventory have increased to $26.2 million at December 31, 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 is $2.4 million at December 31, 2010 compared to $9.6 million at December 31, 2009. Coal inventory cost 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 0.16 million tonnes of coal inventory at December 31, 2010 and 0.39 million tonnes at December 31, 2009. Coal stockpiles at December 31, 2010 were all semi-soft coking coal.

Accounts payable have increased for the year ended December 31, 2010. Increased activity in Mongolia has been offset by the lower corporate balances.

Cash used for investing activities

Cash used for investing activities was $217.7 million for the year ended December 31, 2010, compared to $105.1 million for the year ended December 31, 2009.

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

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

11. LIQUIDITY AND CAPITAL RESOURCES CONTINUED

In the first quarter of 2010, after the receipt of the proceeds from the equity financing, the Company invested in longer term money market instruments. On December 23, 2010, the Company completed the private placement with Aspire for $20.3 million. Pursuant to the private placement, the Company acquired 105,860,186 common shares of Aspire at a price of A$0.19 per share. After giving effect to the transaction, SouthGobi holds approximately 19.9% of Aspire.

Interest income will increase or decrease depending on the cash position and interest rates. Interest income was higher in the year ended December 31, 2010 compared to the year ended December 31, 2009 due to higher cash balances which relate 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.

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 was 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. On December 18, 2010 the line of credit facility was extended to January 18, 2011. On January 18, 2011, the Company signed a new revolving line of credit facility with Golomt Bank for a twelve month period. Under the new agreement the maximum draw-down available is $3.5 million and MNT8.1 Billion (approximately $6.5 million) and bears interest at 11% for any U.S. Dollar amounts outstanding and 12% for any Mongolia Tugrik amounts outstanding. In 2010, the Company had drawings of $46.7 million and repayments of $49.7 million. The principal balance outstanding as at December 31, 2010 was $nil.

Contractual Obligations and Guarantees

($ in thousands)

In the normal course of business, the Company enters into contracts that give rise to commitments for future minimum payments. The following table summarizes the remaining contractual maturities of the Company's operating and capital commitments at December 31, 2010.

	AS AT DECEMBER 31, 2010			
	Within 1 year	2-3 years	Over 3 years	Total
Capital expenditure commitments	$ 126,694	$18,000	$ —	$ 144,694
Minimum rental and lease payments	2,066	2,696	—	4,762
Contractual Obligations	**$ 128,760**	**$20,696**	**$ —**	**$ 149,456**

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.

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 March 30, 2011, the Company had repurchased 250,750 shares on the Hong Kong Stock Exchange and 1,255,550 shares on the Toronto Stock Exchange for a total of 1,506,300 common shares. The Company cancels all shares after they are repurchased.

As at December 31, 2010, the Company's gearing ratio was 0.26 (December 31, 2009: 0.97) which was calculated based on the Company's long term liabilities to total assets.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

11. LIQUIDITY AND CAPITAL RESOURCES CONTINUED

Financial instruments

The fair value of financial assets and financial liabilities at amortized cost is determined in accordance with generally accepted pricing models based on discounted cash flow analysis or using prices from observable current market transactions. The Company considers that the carrying amount of all its financial assets and financial liabilities recognized at amortized cost in the financial statements approximates their fair value.

The fair value of financial instruments that are traded on an active liquid market are determined with reference to the quoted market prices. The fair value of the Company's investment in the shares of KRL, Aspire and its money market investments are determined using this methodology. The Company's investment in shares of KRL and its money market investments are classified as fair value through profit and loss ("FVTPL"). The Company's investment in the shares of Aspire is classified as available-for-sale.

The fair value of the embedded derivatives within the convertible debenture were determined using a Monte Carlo simulation. The risks associated with CIC convertible debenture relate to a potential breach of the Company's obligations under the terms of the CIC convertible debenture. The Company mitigates these risks by ensuring its corporate activities comply with all of its contractual obligations under the CIC convertible debenture.

The fair value of all the other financial instruments of the Company approximates their carrying value because of the demand nature or short-term maturity of these instruments.

	AS AT DECEMBER 31,		
	2010	2009	2008
Financial assets ($ in thousands)			
Loans-and-receivables			
Cash and cash equivalents	$ 492,038	$ 357,342	$ 10,117
Trade and other receivables	30,246	12,328	7,290
Other receivables	238	225	—
Available-for-sale			
Investment in Aspire	52,008	—	—
Fair value through profit and loss (FVTPL)			
Investment in Kangaroo	10,235	9,876	—
Money market investments	62,702	62,193	—
Total financial assets	$ 647,467	$ 441,964	$ 17,407
Financial liabilities ($ in thousands)			
Fair value through profit and loss (FVTPL)			
Convertible debenture - embedded derivatives	$ 154,877	$ 358,272	$ —
Other-financial-liabilities			
Trade and other payables	24,137	12,669	7,400
Amounts due under line of credit facilities	—	3,009	—
Convertible debenture - debt host	96,933	188,791	—
Deposit received for sale of Metals Division	—	—	3,000
Total financial liabilities	$ 275,947	$ 562,741	$ 10,400

11. LIQUIDITY AND CAPITAL RESOURCES CONTINUED

The net loss for the year includes the following amounts of unrealized gains/(losses) from the fair value adjustments to certain financial instruments which are classified as FVTPL:

($ in thousands)

	YEAR ENDED DECEMBER 31,		
	2010	2009	2008
Unrealized gains/(losses) on long term investments	$ 870	$ 843	$ —
Fair value gain/(loss) of embedded derivatives	100,637	(44,980)	(7,223)

The other comprehensive income includes an unrealized gain of $31.7 million for the year ended December 31, 2010 and $nil for the year ended December 31, 2009 and December 31, 2008.

12. ENVIRONMENT

The Company is subject to the Environmental Protection Law of Mongolia (the "EPL") and has the following duties with respect to environmental protection:

- To comply with the EPL and the decision of the government, local self-governing organizations, local governors and Mongolian state inspectors;
- To comply with environmental standards, limits, legislation and procedures and to supervise their implementation with their organization;
- To keep records on toxic substances, adverse impacts, and waste discharged into the environment; and
- To report on measures taken to reduce or eliminate toxic chemicals, adverse impacts, and waste.

In addition to those duties imposed on them by the EPL, mining license holders are required to prepare an initial environment impact assessment analysis before the mine comes into production. The mining license holders must also annually develop and implement an environmental protection plan (including reclamation measures) in co-operation with the Ministry of Environment, which should take into account the results of the environmental impact assessment. The Company received approval of its detailed Environmental Impact Assessment and Environmental Protection Plan from the Mongolian Ministry of Nature and Environment for the mining operation at the Ovoot Tolgoi Mine in 2007.

The Company has implemented a number of internal policies to embrace responsibility for the impact of its business activities on the environment. By conducting studies, carefully designing mine plans, implementing pollution control recommendations from internal and external sources, monitoring the effects of mining on mining areas and carefully designing mine closure plans, the Company seeks to minimize the impact of our activities on the environment.

The Company established an environmental policy in 2008. The environmental policy affirms the Company's commitment to environmental protection. The Company monitors its operations to ensure that it complies with all applicable environmental requirements, and takes actions to prevent and correct problems if needed.

The Board maintains a Safety, Health and Environment Committee. The Committee is composed of independent and non-independent directors. The primary objective of the Safety, Health & Environment Committee is to review and oversee the Company's established safety, health and environmental policies and procedures at the Company's project sites. The Committee also reviews any incidents that occur and provides guidance on how to prevent any recurrences.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

12. ENVIRONMENT CONTINUED

Decommissioning liabilities result from the acquisition, development, construction and ordinary operation of mining property, plant and equipment, and from environmental regulations set by regulatory authorities. The decommissioning liability includes costs related to removal and/or demolition of mine equipment, buildings and other infrastructure, removing contaminated soil, protection of abandoned pits and re-vegetation.

At December 31, 2010, the Company recognized a liability of $3.1 million. The fair value of the decommissioning liability is estimated using a present value technique and is based on existing laws, contracts or other policies and current technology and conditions. The following significant assumptions were made for the purpose of estimating the decommissioning liability:

($ in thousands)

	YEAR ENDED DECEMBER 31,		
	2010	2009	2008
Assumption			
Undiscounted costs	**$ 5,982**	$ 2,270	$ 1,087
Country specific risk free rate	**8.0%**	10.8%	11.0%
Inflation rate	**2.8%**	2.8%	3.5%
Average years to reclamation	**14**	15	16

13. RELATED PARTY TRANSACTIONS

The Company had related party transactions with the following companies related by way of directors or shareholders in common:

- Ivanhoe Mines is the Company's parent company and at December 31, 2010 owned approximately 57% of the outstanding common shares of the Company. Ivanhoe Mines provides various administrative services to the Company on a cost-recovery basis. The Company also provides some office services to Ivanhoe Mines in the Company's Hong Kong Office and recovers the costs for those services on a cost-recovery basis.
- Global Mining Management ("GMM") is a private Company owned equally by seven companies, two of which include the Company and Ivanhoe Mines. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis.
- I2MS.NET Pte. Ltd. ("I2MS") is a private company 100% owned by Ivanhoe Mines. I2MS provides information technology and other related services to the Company on a cost-recovery basis.
- Ivanhoe Capital Aviation LLC ("Ivanhoe Aviation") is a private company 100% owned by Ivanhoe's Executive Chairman. Ivanhoe Aviation operates aircrafts which was rented by the Company on a cost-recovery basis for a portion of the year to facilitate the global equity offering. The contract with Ivanhoe Aviation was terminated in the fourth quarter of 2010.
- Ivanhoe Energy Inc. ("Ivanhoe Energy") is a publicly listed company with two directors in common with the Company. The Company provides some office services to Ivanhoe Energy in the Company's Hong Kong office and recovers the costs for those services on a cost-recovery basis.

13. RELATED PARTY TRANSACTIONS CONTINUED

The following tables summarize related party expenses incurred by the Company with the companies listed above:

($ in thousands)

	YEAR ENDED DECEMBER 31,		
	2010	2009	2008
Corporate administration	**$ 3,832**	$ 1,176	$ 1,893
Salaries and benefits	**2,120**	1,321	1,824
Interest	**—**	1,642	134
Total related party expenses	**$ 5,952**	$ 4,139	$ 3,851

	YEAR ENDED DECEMBER 31,		
	2010	2009	2008
GMM	**$ 2,840**	$ 1,844	$ 2,455
Ivanhoe Mines	**252**	1,787	134
Ivanhoe Capital Aviation	**1,725**	—	—
I2MS	**1,135**	508	1,262
Total related party expenses	**$ 5,952**	$ 4,139	$ 3,851

The Company also recorded recoveries of $0.23 million for the year ended December 31, 2010 compared to $nil for the year ended December 31, 2009 for administration expenses with Ivanhoe Mines and Ivanhoe Energy.

The Company had accounts receivable of $0.43 million at December 31, 2010 ($0.23 million at December 31, 2009) and accounts payable of $0.92 million at December 31, 2010 ($0.61 million at December 31, 2009) with related parties.

On December 31, 2008, the Company announced the sale of the Metals Division to Ivanhoe for $3.0 million and other non-cash consideration. As part of the sale transaction, the Company obtained a one year credit facility from Ivanhoe, which allowed the Company to receive loan advances from Ivanhoe to an aggregate maximum of $30.0 million which was later increased to $60.0 million.

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.

14. 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 March 30, 2011, 183,726,811 common shares were issued and outstanding. There are also incentive share options outstanding that are exercisable to acquire 8,546,491 unissued common shares. There are no preferred shares outstanding.

As at March 30, 2011, Ivanhoe directly owned 104,807,155 common shares representing approximately 57% of the issued and outstanding common shares of the Company.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

15. DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. As of December 31, 2010, the Chief Executive Officer and Chief Financial Officer have each concluded that the Company's disclosure controls and procedures, as defined in National Instrument 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to achieve the purpose for which they have been designed.

Internal controls over financial reporting

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS. Management is also responsible for the design of the Company's internal control over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

The Company's internal controls over financial reporting include policies and procedures that: pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions and disposition of assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with IFRS and that receipts and expenditures are being made only in accordance with authorization of management and directors of the Company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the financial statements.

Because of their inherent limitations, internal controls over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management, under the supervision of the Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Company's internal controls over financial reporting using the framework and criteria established in Internal Control-Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the evaluation, management has concluded that internal controls over financial reporting were effective as at December 31, 2010.

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.

16. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Company's Consolidated Financial Statements, including comparatives, have been prepared in accordance with and using accounting policies in full compliance with the International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"), effective for the Company's reporting for the year ended December 31, 2010.

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 3 to the annual Consolidated Financial Statements for the year ended December 31, 2010.

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 reserves 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.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

16. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS CONTINUED

Decommissioning, restoration and similar liabilities

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 a decommissioning liability (also referred to as an asset retirement obligation) is recognized as its present value in the period in which it is incurred. Upon initial recognition of the liability, a corresponding amount 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 decommissioning liability, 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. Because the estimate of obligations is based on future expectations in the determination of closure provisions, management makes a number of assumptions and judgments. The main factors that can cause expected cash flow changes are changes to laws and legislation, construction of new facilities and changes in the reserve estimate and the resulting amendment to the life of the mine. In general, as the life of a mine ends, the expected cash flows become more reliable. The estimate of a decommissioning liability at the beginning of the mine life, is subject to greater uncertainty due to the amount of time before decommissioning activities begin. (see Environmental section for detailed assumptions).

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, based on current and future contracts less all estimated costs of completion and costs necessary to make the sale which are based on current operations and forecasts. The estimates and assumptions used in the measurement of the coal stockpiles include volume, quality and density. If these estimates or assumptions prove to be inaccurate, it could impact management's valuation of the coal inventory stockpiles.

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.

Future benefits arise when stripping activity increases the future output of the mine by providing access to a new ore body. When determining whether stripping activity has provided access to a new ore body, management uses a number of judgments and assumptions including the current mine plan which may change. 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 reserves as the depletion base. The proven and probable reserves are determined based on a professional evaluation using accepted international standards for the assessment of mineral reserves. The assessment involves the study of geological, geophysical and economic data and the reliance on a number of assumptions. The estimates of the reserves may change, based on additional knowledge gained subsequent to the initial assessment. A change in the original estimate of reserves would result in a change in the rate of depletion.

16. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS CONTINUED

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.

Assessing the recoverability of future income tax assets requires management to make significant estimates related to expectations of future taxable income and the expected timing of the reversals of existing temporary differences.

Deferred income taxes are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against any deductible temporary differences and the carry forward of unused tax credits and unused tax losses can be utilized. The probability of realization is based on management's judgments of future profitability.

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 the fair value of the share-based payment. Otherwise, share-based payments are measured at the fair value of goods or services received.

Equity-settled transactions

The costs of equity-settled transactions with employees are measured by reference to the fair value at the date on which they are granted. The fair value is estimated using the Black-Scholes option pricing model and includes assumptions for the risk free interest rate, expected life, expected volatility and expected dividend per share.

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.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

16. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS CONTINUED

Property, plant and equipment ("PPE")

PPE is stated at cost less accumulated depreciation and any 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. Management estimates the useful life and residual value and any change in these estimates would impact the amount of depreciation and depletion calculated.

The Company assesses at the end of each reporting period whether an asset is impaired. An impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The estimates used by management to determine future cash flows are based on internal management forecasts and budgets and are subject to various risks and uncertainties.

Valuation of Embedded Derivatives

The embedded derivative is valued using a Monte Carlo simulation valuation model. A Monte Carlo simulation model is a valuation model that relies on random sampling and is often used when modeling systems with a large number of inputs and where there is significant uncertainty in the future value of inputs and where the movement of the inputs can be independent of each other. Some of the key inputs used by the Company in its Monte Carlo simulation included: the floor and ceiling conversion prices, the risk-free rate of return, expected volatility of the stock price, forward foreign exchange rate curves (between the Cdn$ and U.S.$) and spot foreign exchange rates.

Recoverability of Trade and Other Receivables

In relation to trade and other receivables, a provision for impairment is made and an impairment loss is recognized in profit and loss when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. Management uses judgment in determining the probability of insolvency or significant financial difficulties of the debtor.

Impairment Testing

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

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

17. RISK FACTORS

There are certain risks involved in the Company's operations, some of which are beyond its control. These risks can be broadly categorized into: (i) risks relating to its business and industry; and (ii) risks relating to its projects in Mongolia. Additional risks and uncertainties not presently known, or not expressed or implied below, or that are presently deemed immaterial, could also harm the Company's business, financial condition and operating results. Some of the following statements are forward-looking and actual results may differ materially from the results anticipated in these forward-looking statements.

Risks Relating to the Company's Business and Industry

Some of the Company's projects may not be completed as planned, costs may exceed original budgets and may not achieve the intended economic results or commercial viability.

The Company's business strategy depends in large part on expanding its production capacity at the Ovoot Tolgoi Mine and further developing its other coal projects into commercially viable mines. Whether a mineral deposit will be commercially viable depends on a number of factors, including: the particular attributes of the deposit, such as size, grade and proximity to infrastructure; commodity prices, which are highly cyclical; and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, importing and exporting of mineral resources and environmental protection. The Company's current intention to develop mines at the Soumber Deposit and the Ovoot Tolgoi Underground Deposit in the future is based on geological, engineering, environmental and mine planning evaluations. The feasibility of mining at these projects as well as at the Tsagaan Tolgoi Deposit has not been and may never be established. If the Company is unable to develop all or any of its projects into a commercial working mine, its business, financial condition and results of operations will be materially and adversely affected.

The Company's projects are subject to technical risk in that they may not perform as designed. Increased development costs, lower output or higher operating costs may all combine to make a project less profitable than expected at the time of the development decision. This would have a negative impact on the Company's business and results of operations. No assurance can be given that the Company would be adequately compensated by third party project design and construction companies (if not performed by the Company) in the event that a project did not meet its expected design specification. For example, in the first quarter of 2010 the Company realigned the Sunset open pit at its Ovoot Tolgoi Mine for a north-south entry rather than an east-west entry. Although the realignment will be beneficial in the longer term, it had a short term impact on operations as the process required substantial above trend waste removal.

As with all exploration properties or projects taken on by mining companies, there is a risk that exploration projects will not be converted to commercially viable mines, in part because actual costs from capital projects may exceed the original budgets. As a result of project delays, cost overruns, changes in market circumstances or other reasons, the Company may not be able to achieve the intended economic benefits or demonstrate the commercial feasibility of these projects, which in turn may materially and adversely affect the Company's business, results of operations and growth projects. For example, as the Company progressed with efforts to prepare for the mining and shipment of a targeted 30,000 tonne trial cargo from the Mamahak Deposit, the Company became aware of the need for additional capital expenditure beyond what was originally budgeted. Based on these requirements and the revised resource estimates contained in the Mamahak Technical Expert Report, the Company suspended further development works at the Mamahak Deposit pending a more detailed operational review. As a result of the suspension, the Company recorded an impairment charge of US$23 million in the third quarter of 2009, which brought the value of the Mamahak Deposit assets to zero as at September 30, 2009.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

17. RISK FACTORS CONTINUED

The Company's coal reserves and resources are estimates based on a number of assumptions, and the Company may produce less coal than its current estimates.

The coal reserve and resource estimates are based on a number of assumptions that have been made by the Qualified Persons in accordance with NI 43-101. Reserve and resource estimates involve expressions of judgment based on various factors such as knowledge, experience and industry practice, and the accuracy of these estimates may be affected by many factors, including quality of the results of exploration drilling and analysis of coal samples, as well as the procedures adopted by and the experience of the person making the estimates.

Estimates of the reserves and resources at the Company's projects may change significantly when new information becomes available or new factors arise, and interpretations and deductions on which reserves and resources estimates are based may prove to be inaccurate. Should the Company encounter mineralization different from that predicted by past drilling, sampling and similar examination, mineral resource and/or reserve estimates may have to be adjusted downward. This downward adjustment could materially affect the Company's development and mining plans, which could materially and adversely affect its business and results of operations.

In addition, the rank of coal ultimately mined may differ from that indicated by drilling results. There can be no assurance that coal recovered in laboratory tests will be duplicated under on-site conditions or in production-scale operations in the event that the actual level of impurities is higher than expected or the coal mined is of a lower quality than expected, the demand for, and realizable price of, the Company's coal may decrease. For example, the Company experienced areas of higher sulphur than originally anticipated in mine plans and studies during 2010. Short term factors relating to reserves, such as the need for orderly development of coal seams or the processing of new or different quality coals, may also materially and adversely affect the Company's business and results of operations.

The inclusion of reserve and resource estimates should not be regarded as a representation that all these amounts can be economically exploited and nothing contained herein (including, without limitation, the estimates of mine lives) should be interpreted as assurance of the economic lives of the Company's coal reserves and resources or the profitability of its future operations.

The Company commenced mining in April 2008 and has recorded operating losses and operating cash outflows to date, and therefore the Company's short operating history may make it difficult for investors to evaluate its business and growth.

The Company commenced mining in April 2008 and currently operates one revenue producing mine. In the year ended December 31, 2010, the Company recorded a net loss. As is typical for a start up mining company, the Company has recorded a deficit since inception. Although the Company has no plans to pay dividends in the near future, should such deficits continue and cash reserve be depleted, it could adversely affect the Company's ability to pay dividends in the future. Due to the Company's limited operating history, there may not be an adequate basis on which to evaluate the Company's future operating results and prospects. Because the Company's past results may not be indicative of the Company's results in the future, investors may have difficulties evaluating the Company's business and prospects.

17. RISK FACTORS CONTINUED

The Company does not insure against all risks to which it may be subject in planned operations and insurance coverage could prove inadequate to satisfy potential claims.

For certain aspects of the Company's business operations, insurance coverage, in particular business interruption insurance, is restricted or prohibitively expensive. The Company currently holds its primary insurance policies through Canadian insurance providers to insure its properties. The Company has taken out insurance for risks including commercial general liability, umbrella liability, aviation premises liability, and kidnap and ransom. The Company maintains mining property insurance for all of its mining assets wherever located, property insurance on its office premises and liability insurance for its Directors and Officers. However, no assurance can be given that the Company will be able to obtain such insurance coverage at economically reasonable premiums (or at all), or that any coverage it obtains will be adequate to cover the extent of any claims brought against it.

Exploration, development and production operations on mineral properties involve numerous risks, including environmental risks, such as unexpected or unusual geological operating conditions, rock bursts or slides, fires, floods, earthquakes or other environmental occurrences, and political and social instability. The Company does not maintain insurance against any environmental or political risks. Should any liabilities arise for which it is not insured or insurance coverage is inadequate to cover the entire liability, they could reduce or eliminate the Company's actual or prospective profitability, result in increasing costs and a decline in the value of the common shares and could materially and adversely affect the Company's business and results of operations.

Licences and permits are subject to renewal and various uncertainties and the Company may only renew its exploration licenses a limited number of times for a limited period of time.

In Mongolia, the Company's exploration licenses are subject to periodic renewal and may only be renewed a limited number of times for a limited period of time. While it anticipates that renewals will be given as and when sought, there is no assurance that such renewals will be given as a matter of course and there is no assurance that new conditions will not be imposed in connection therewith. The Company's business objectives may also be impeded by the costs of holding and/or renewing the exploration licenses in Mongolia. Licence fees for exploration licenses increase substantially upon the passage of time from the original issuance of each individual exploration license. The Company needs to assess continually the mineral potential of each exploration license, particularly at the time of renewal, to determine if the costs of maintaining the exploration licenses are justified by the exploration results to date, and may elect to let some of its exploration licenses lapse. Moratorium on transfers of exploration licenses has been imposed on two separate occasions and there is a risk that a similar moratorium could be imposed such that letting the exploration licenses lapse may be the only practical option in some circumstances. Furthermore, the Company will require mining licenses and permits to mine in order to conduct mining operations in Mongolia. There can be no assurance, however, that such licenses and permits will be obtained on terms favorable to it or at all for the Company's future intended mining and/or exploration targets in Mongolia.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

17. RISK FACTORS CONTINUED

In addition, certain provisions of the Land Law of Mongolia enacted on June 7, 2002, and effective from January 1, 2003, (the "Land Law") and the Mineral Law of Mongolia, enacted on July 8, 2006, and effective August 26, 2006, (the "2006 Minerals Law") provide for the revocation of previously granted land use rights, exploration licenses or mining licenses on the grounds that the affected area of land has been designated as "special needs" territory. The Land Law grants the discretion to declare an area of land for special needs purposes to local governing authorities and identifies various broad categories which qualify as special needs. The 2006 Minerals Law requires the local governing authority that designates an area of land as a special needs territory to compensate the license holder whose rights or license status are affected. If any of the Company's land use rights, exploration licenses or mining licenses in Mongolia are revoked because the underlying land is declared as special needs territory, there is no assurance that the Company will receive adequate compensation or any compensation at all and its business and results of operation might be adversely and materially affected. The Company has had no land use rights or exploration/mining licenses revoked to date.

Prolonged periods of severe weather conditions could materially and adversely affect the Company's business and results of operations.

Severe weather conditions may require the Company to evacuate personnel or curtail operations and may cause damages to the project site, equipment or facilities, which could result in the temporary suspension of operations or generally reduce the Company's productivity. Severe weather conditions have not caused any delay or damages to the Company's operations to date. However, there can be no assurance that severe weather will not occur. Any damages to the Company's projects or delays in its operations caused by prolonged periods of severe weather could materially and adversely affect its business and results of operations.

The Company's business and results of operations are susceptible to the cyclical nature of coal markets and are vulnerable to fluctuations in prices for coal.

The Company expects to derive substantially all of its revenue and cash flow from the sale of coal. Therefore, the market price of the shares, the Company's ability to raise additional financing and maintain ongoing operations and its financial condition and results of operations will be directly related to the demand for, and price of, coal and coal-related products. Coal demand and price are determined by numerous factors beyond the Company's control, including the international demand for steel and steel products, the availability of competitive coal supplies, international exchange rates, political and economic conditions in Mongolia, the People's Republic of China (the "PRC") and elsewhere in the world, milder or more severe than normal weather conditions, and production costs in major coal producing regions. The PRC and international coal markets are cyclical and have in the past exhibited significant fluctuations in supply, demand and prices from year to year. There has been significant price volatility on the coal spot market. An oversupply of coal in the PRC or a general downturn in the economies of any significant markets for the Company's coal and coal-related products could materially and adversely affect its business and results of operations. In addition, the Company's dependence on Asian markets may result in instability in its operations due to political and economic factors in those Asian jurisdictions which are beyond the Company's control. The combined effects of any or all of these factors on coal prices or volumes are impossible for the Company to predict. If realized coal prices fall below the full cost of production of any of its future mining operations and remain at such a level for any sustained period, the Company could experience losses and may decide to discontinue operations, which could require the Company to incur closure costs and result in reduced revenues.

17. RISK FACTORS CONTINUED

The Company's coal mining activities are subject to operational risks including equipment breakdown.

The Company's coal mining operations are subject to a number of operational risks, some of which are beyond its control, which could delay the production and delivery of coal. These risks include unexpected maintenance or technical problems, periodic interruptions to its mining operations due to inclement or hazardous weather conditions and natural disasters, industrial accidents, power or fuel supply interruptions and critical equipment failure, including malfunction and breakdown of its shovels, upon which its coal mining operations are heavily reliant and which would require considerable time to replace. These risks and hazards may result in personal injury, damage to, or destruction of, properties or production facilities, environmental damage, business interruption and damage to its business reputation. In addition, breakdowns of equipment, difficulties or delays in obtaining replacement shovels and other equipment, natural disasters, industrial accidents or other causes could temporarily disrupt the Company's operations, which in turn may also materially and adversely affect its business, prospects, financial condition and results of operations.

The unavailability or shortage of reliable and sufficient coal transportation capacity will reduce the Company's coal revenue by causing it to reduce its production volume or impairing its ability to supply coal to its customers.

The Company anticipates that the majority of its coal production from the projects in Mongolia will be exported into the PRC. While the Company expects to sell and deliver most of its coal from the Ovoot Tolgoi Mine at the mine gate, inadequate transportation infrastructure is likely to affect the pricing terms on which it can sell the coal to customers and the willingness and ability of such customers to purchase coal from it. Potential customers are likely to factor in any delays and the costs and availability of transportation in determining the price they are prepared to pay to purchase the Company's coal. Therefore, its mining operations are anticipated to be highly dependent on road and rail services in Mongolia and, to a lesser extent, in the PRC.

In Mongolia, a bottleneck in the transportation of coal from the Ovoot Tolgoi Mine to customers in the PRC may arise if the road connecting the Ovoot Tolgoi Mine to the Shivee Khuren-Ceke border crossing does not have sufficient capacity to support the increased amount of cargo traffic or is affected by external factors such as disruptions caused by bad weather. The opening hours of the Shivee Khuren-Ceke border crossing also affect the Company's ability to expedite the movement of its coal shipment. There can be no assurance that there would be any other cost effective means of transporting the coal to the Company's primary market in the PRC. As a result, the Company may experience difficulty expediting the movement of its coal shipments and/or significant cost escalation for the transportation services, which could affect its production and reduce its profitability.

In the PRC, rail and road infrastructure and capacity has in the past been affected by extreme weather conditions, earthquakes, delays caused by major rail accidents, the diversion of rolling stock needed to deliver emergency food relief and seasonal congestion during public holidays. There can be no assurance that these problems will not recur or that new problems will not occur. In any of these circumstances, the customers may not be able to take delivery of the Company's coal, which may lead to delays in payment, or refusal to pay, for the Company's coal and, as a result, the Company's business and results of operations could be materially and adversely affected.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

17. RISK FACTORS CONTINUED

The Company's prospects depend on its ability to attract, retain and train key personnel.

Recruiting, retaining and training qualified personnel is critical to the Company's success. The number of persons skilled in the acquisition, exploration and development of mining properties is limited and competition within the mining industry for such persons is intense, in particular, Mongolian law requires that at least 90% of a mining company's employees be of Mongolian nationality. This provision of the law, coupled with the large number of active mining projects in Mongolia, further limit the number of available personnel and increase competition for skilled personnel. As the Company's business activity grows, it will require additional key financial, administrative, mining, marketing and public relations personnel as well as additional operations staff. If the Company is not successful in attracting such key personnel, or retaining existing key personnel, its business and results of operations could be materially and adversely affected.

In addition, the Company's ability, to train operating and maintenance personnel is a key factor for the success of its business activities, if the Company is not successful in recruiting, training and retaining such personnel, its business and results of operations could be materially and adversely affected.

Competition in the coal industry may hinder development plans and adversely affect the Company's coal sales if it is not able to compete effectively.

Continued growth in mining and mineral exploration activities in Mongolia could create an increasing demand for mining equipment and related services. Shortages of, or higher costs for, equipment and services could restrict the Company's ability to carry out the exploration, development and production activities, increase its costs of operations and adversely affect its future plans.

The Company intends to sell a majority of the coal it produces into the PRC. Competition in the PRC coal industry is based on many factors, including, among others, price, production capacity, coal quality and characteristics, transportation capability and costs, blending capability and brand name. The Company's coal business will most likely compete in the PRC with other large PRC and international coal mining companies. Due to their location, some of the Company's PRC competitors may have lower transportation costs than the Company does. The PRC coal market is highly fragmented and the Company faces price competition from some small local coal producers that produce coal for significantly lower costs than the Company due to various factors, including their lower expenditure on safety and regulatory compliance. Some of the Company's international competitors, including the Mongolian coal producers, may have greater coal production capacity as well as greater financial, marketing, distribution and other resources than the Company does, and may benefit from more established brand names in international markets. The Company's future success will depend on its ability to respond in an effective and timely manner to competitive pressure.

17. RISK FACTORS CONTINUED

There are a number of risks associated with dependence on a limited number of customers and inability to attract additional customers.

The Company depends on a relatively small number of customers. The incremental cost of transporting coal products from the Ovoot Tolgoi Mine and its other coal projects over long distances effectively limits the Company's potential customer base to a relatively proximate geographical area. Additionally, the Company has been selling its coal products only since September 2008. The Company currently has four active customers with the largest customer representing approximately 57%, and the remaining customers accounting for 43% of the Company's total sales for the year ended December 31, 2010. The Company's relatively brief history of coal sales makes it difficult to evaluate the strength of its relationships with current customers and its ability to attract additional customers. Accordingly, inability to attract additional customers or the loss of, or a significant reduction in, purchases by any of the limited number of potential customers could materially and adversely affect the Company's future revenue and the economic viability of its exploration and development projects. In order to mitigate this risk, the Company is continually expanding its customer base. As at March 30, 2011 the Company had signed sales contracts with seven customers for coal sales in 2011 and is in discussions with several other potential customers.

In addition, the Company expects to sell the majority of the coal from its Mongolian mining operations to the customers in the PRC. PRC law requires specific authorization to be obtained by entities responsible for the import of coal into the PRC. In the event that the Company's customers, or the agents of such customers who are responsible for importing coal into the PRC on their behalf, fail to obtain and retain the necessary authorizations, their ability to import coal into the PRC may be affected, which could materially and adversely affect the Company's business and results of operations.

The Company's operations are exposed to risks in relation to environmental protection and rehabilitation.

The operations of coal mines involve substantial environmental risks and hazards and the Company's operations are subject to laws and regulations relating to the environment, health and safety and other regulatory matters in Mongolia.

The risk of environmental liability is inherent in the operation of the Company's business. Environmental hazards may occur in connection with the Company's operations as a result of human negligence, force majeure, or otherwise. Claims may be asserted against the Company arising out of its operations in the normal course of business, including claims relating to land use, safety, health and environmental matters. The Company is not insured against environmental liabilities and there can be no assurance that environmental liabilities would not materially and adversely affect its business and results of operations.

In addition, the Company is subject to reclamation requirements. The Company's mines contain a finite amount of recoverable resources and will eventually close. The key tasks in relation to the closure of the mines involve (i) long-term management of permanent engineered structures (for example, spillways, roads, waste dumps); (ii) achievement of environmental closure standards; (iii) orderly retrenchment of employees and contractors; and (iv) relinquishment of the site with associated permanent structures and community development infrastructure and programs to new owners. The successful completion of these tasks is dependent on the Company's ability to successfully implement negotiated agreements with the relevant government, community and employees. The consequences of a difficult closure range from increased closure costs and handover delays to ongoing environmental impacts and corporate reputation damage if desired outcomes cannot be achieved, which could materially and adversely affect the Company's business and results of operations.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

17. RISK FACTORS CONTINUED

Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. The Company may experience increased costs of production arising from compliance with environmental laws and regulations. Should the Company fail to comply with current or future environmental laws and regulations, the Company may be required to pay penalties or take corrective actions, any of which may have a material adverse effect on its results of operations and financial condition.

Foreign currency fluctuations could affect expenses and any future earnings.

The Company is exposed to foreign exchange fluctuations with respect to the Mongolian Tugrik, Chinese Renminbi, Hong Kong dollars, Australian dollars and Canadian dollars. The Company's financial results are reported in U.S. dollars. The salaries for local labourers in Mongolia are paid in local currency. Sales of coal into the PRC have been and may continue to be settled in U.S. dollars. The Company has a subsidiary in Hong Kong where some expenses are incurred in Hong Kong dollars. The Company has long term investments denominated in A$. Since the Company's headquarters is in Canada, a minor portion of its expenses are in Canadian dollars and the Company holds a portion of its cash in Canadian dollars. As a result, its financial position and results are impacted by the exchange rate fluctuations between the aforementioned currencies and the U.S. dollar.

The Company's results of operations are subject, to a significant extent, to economic, political and legal developments in the PRC.

The Company expects that a majority of coal sales from the Ovoot Tolgoi Mine will be made to customers based in the PRC. Accordingly, the economic, political and social conditions, as well as government policies, of the PRC may affect its business. The PRC economy differs from the economies of most developed countries in many respects, including: (i) structure; (ii) level of government involvement; (iii) level of development; (iv) growth rate; (v) control of foreign exchange; and (vi) allocation of resources. The PRC economy has been transitioning from a planned economy to a more market-oriented economy. For the past two decades, the PRC government has implemented economic reform measures emphasizing the utilization of market forces in the development of the PRC economy. Changes in the PRC's political, economic and social conditions, laws, regulations and policies could materially and adversely affect the Company's business and results of operations.

In addition, the PRC government indirectly influences coal prices through its regulation of power tariffs and its control over allocation of the transportation capacity of the national rail system. Any significant downturn in the prices in the PRC could materially and adversely affect the Company's business and results of operations. Additionally, the PRC government could adopt new policies that could shift demand away from coal to other energy sources. Any significant decline in demand for, or over-supply of, coal could materially and adversely affect the Company's revenues from coal export sales.

17. RISK FACTORS CONTINUED

The interests of the Company's principal shareholder, Ivanhoe, may differ from those of its other shareholders.

As of March 30, 2011, Ivanhoe holds approximately 57% of the Company's issued and outstanding shares. The interests of Ivanhoe may conflict with the interests of the Company's other Shareholders and there is no assurance that Ivanhoe will vote its shares in a way that benefits the Company's minority shareholders. Ivanhoe's ownership interest enables Ivanhoe to elect the entire Board without the concurrence of any of the Company's other shareholders. Accordingly, unless applicable laws or regulations would require approval by the Company's minority shareholders, Ivanhoe is in a position to:

- control the Company's policies, management and affairs;
- subject to applicable laws, regulations and the Articles, adopt amendments to certain provisions of the Articles; and
- otherwise determine the outcome of most corporate actions, including a change in control, merger or sale of all or substantially all of the Company's assets.

The Company believes that third parties may be discouraged from making a tender offer or bid to acquire the Company because of this concentration of ownership.

Information in this document regarding future plans reflects current intentions and is subject to change.

Whether the Company ultimately implements the business strategies described in this document will depend on a number of factors including, but not limited to: the availability and cost of capital; current and projected coal prices; coal markets; costs and availability of drilling services, costs and availability of heavy equipment, supplies and personnel; success or failure of activities in similar areas to those in which the Company's projects are situated; and changes in estimates of project completion costs. The Company will continue to gather information about its projects, and it is possible that additional information will cause it to alter its schedule or determine that a project should not be pursued at all. Accordingly, the Company's plans and objectives may change from those described in this document.

Future stock market conditions may change.

There are risks involved with any investment in Common Shares. The market price of the Company's Common Shares may rise or fall depending upon a range of factors and stock market conditions, which are unrelated to the Company's future financial performance. Movements on international stock markets, local interest rates and exchange rates, domestic and international economic and political conditions, as well as government, taxation and other policy changes may affect the stock market. As the Company is a listed company on the TSX and the Hong Kong Stock Exchange, its Common Share price will also be subject to numerous influences including broad trends in the stock market and the share prices of individual companies or sectors.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

17. RISK FACTORS CONTINUED

Future issuances or sales, or perceived possible issuances or sales, of substantial amounts of the Company's Common Shares in the public market could materially and adversely affect the prevailing market price of the Common Shares and the Company's ability to raise capital in the future.

The market price of the Common Shares could decline as a result of future sales of substantial amounts of the Common Shares or other securities relating to the Common Shares in the public market, including sales by its substantial Shareholders, or the issuance of new Common Shares by the Company, or the perception that such sales or issuances may occur. Future sales, or perceived possible sales, of substantial amounts of the Common Shares could also materially and adversely affect the Company's ability to raise capital in the future at a time and at a price favourable to it, and the Company's Shareholders may experience dilution in their holdings upon issuance or sale of additional Common Shares or other securities in the future.

Risks Relating to the Company's Projects in Mongolia

Legislation in Mongolia may be subject to conflicting interpretations, which may have adverse consequences on the Company's business.

The Mongolian legal system shares several of the qualitative characteristics typically found in a developing country and many of its laws, particularly with respect to matters of taxation, are still evolving. A transaction or business structure that would likely be regarded under a more established legal system as appropriate and relatively straightforward might be regarded in Mongolia as outside the scope of existing Mongolian law, regulation or legal precedent. As a result, certain business arrangements or structures and certain tax planning mechanisms may carry significant risks. In particular, when business objectives and practicalities dictate the use of arrangements and structures that, while not necessarily contrary to settled Mongolian law, are sufficiently novel within a Mongolian legal context, it is possible that such arrangements may be invalidated.

The legal system in Mongolia has inherent uncertainties that could limit the legal protections available to the Company, which include (i) inconsistencies between laws; (ii) limited judicial and administrative guidance on interpreting Mongolian legislation; (iii) substantial gaps in the regulatory structure due to delay or absence of implementing regulations; (iv) the lack of established interpretations of new principles of Mongolian legislation, particularly those relating to business, corporate and securities laws; (v) a lack of judicial independence from political, social and commercial forces; and (vi) bankruptcy procedures that are not well developed and are subject to abuse. The Mongolian judicial system has relatively little experience in enforcing the laws and regulations that currently exist, leading to a degree of uncertainty as to the outcome of any litigation, it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction.

In addition, while legislation has been enacted to protect private property against expropriation and nationalisation, due to the lack of experience in enforcing these provisions and political factors, these protections may not be enforced in the event of an attempted expropriation or nationalisation. Expropriation or nationalisation of any of the Company's assets, or portions thereof, potentially without adequate compensation, could materially and adversely affect its business and results of operations.

17. RISK FACTORS CONTINUED

Application of and amendments to legislation could adversely affect the Company's mining rights in its projects or make it more difficult or expensive to develop its projects and carry out mining.

In 2006, the Mongolian Government enacted a new minerals law. The 2006 Minerals Law, which preserves to a limited extent some of the substance of the former 1997 minerals legislation, was drafted with the assistance of legal experts in the area of mining legislation and was widely regarded as progressive, internally consistent and effective legislation. However, the 2006 Minerals Law contains new provisions that have increased the potential for political interference and weakened the rights and security of title holders of mineral tenures in Mongolia. Certain provisions of the 2006 Minerals Law are ambiguous and it is unclear how they will be interpreted and applied in practice. Examples of such provisions include those relating to the designation of a mineral deposit as a Mineral Deposit of Strategic Importance. The Mongolian Government could determine that any one or more of the Company's projects in Mongolia is a Mineral Deposit of Strategic Importance.

In addition, the introduction of new Mongolian laws and regulations and the interpretation of existing ones may be subject to policy changes reflecting domestic political or social changes. For example, on July 16, 2009, Parliament enacted a new law (the "Mining Prohibition in Specified Areas Law") that prohibits minerals exploration and mining in areas such as headwaters of rivers and lakes, forest areas as defined in the Forest Law of Mongolia and areas adjacent to rivers and lakes as defined in the Water Law of Mongolia. Pursuant to the Mining Prohibition in Specified Areas Law, the Mongolian Government was instructed 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. New exploration licenses and mining licenses overlapping the defined prohibited areas will not be granted – and previously granted licenses that overlap the defined prohibited areas will be terminated within five months following the adoption of the law. It is not clear whether such termination will only apply to the overlap areas. The Mining Prohibition in Specified Areas Law provides that affected license holders shall be compensated, but there are no specifics as to the way such compensation will be determined.

The Mineral Resources Authority of Mongolia ("MRAM") has prepared a draft list of licenses 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 Ministry of Mineral Resources and Energy (the "MMRE"). Subsequent to the MMRE's approval of this preliminary list, the Mongolian Government must still give its final approval before the final list can be published. During the MMRE's and the Mongolian Government's review of the draft list of licenses prepared by MRAM, licenses may be added or subtracted to the list at any time prior to approval and publication of the final list.

Six of the Company's exploration licenses and the Tsagaan Tolgoi mining license– included on MRAM's draft list of licenses – may be included on the final list published by the Mongolian Government, potentially affecting the status of those licenses under the Mining Prohibition in Specified Areas Law. Activities being carried out on these properties include drilling, trenching and geological reconnaissance. The Company has no immovable company 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 its existing operations. The loss of the Tsagaan Tolgoi mining licenses would however impact the Company's resources.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

17. RISK FACTORS CONTINUED

As such, there can be no assurance that future political and economic conditions in Mongolia will not result in the Mongolian Government adopting different policies in relation to foreign development and ownership of mineral resources. Any such changes in government or policy may result in changes in laws affecting ownership of assets, environmental protection, labour relations, repatriation of income, return of capital, investment agreements, income tax laws, royalty regulation, government incentive and other areas, each of which may materially and adversely affect the Company's ability to undertake exploration and development activities in the manner currently contemplated. Similarly, any restrictions imposed, or Mongolian Government charges levied or raised (including royalty fees), under Mongolian law for the export of coal could harm the Company's competitiveness.

The Company's ability to carry on business in Mongolia is subject to political risk.

The Company's ability to efficiently conduct its exploration and development activities is subject to changes in government policy or shifts in political attitudes within Mongolia that are beyond the Company's control.

Government policy may change to discourage foreign investment, nationalisation of mining industries may occur or other government limitations, restrictions or requirements not currently foreseen may be implemented. There is no assurance that the Company's assets will not be subject to nationalisation, requisition or confiscation, whether legitimate or not, by any authority or body. The provisions under Mongolian law for compensation and reimbursement of losses to investors under such circumstances may not be effective to restore the value of the Company's original investment.

In addition, Mongolia may experience political instability. Such instability could have a material adverse effect on economic or social conditions in Mongolia and may result in outbreaks of civil unrest, terrorist attacks or threats or acts of war in the affected areas, any of which could materially and adversely affect the Company's business and results of operations.

The Mongolian Government could determine that any one or more of the Company's projects in Mongolia is a Mineral Deposit of Strategic Importance.

Pursuant to the 2006 Minerals Law, the Parliament of Mongolia has wide discretion to designate mineral deposits to be Mineral Deposits of Strategic Importance. The Mongolian Government is empowered to participate on an equity basis with the license holder in the exploitation and/or mining of each Mineral Deposit of Strategic Importance on terms to be negotiated between the Mongolian Government and such license holder. Details of any minerals reserves must be filed by the relevant license holder with the Mongolian Government, and those deposits on the Strategic Deposits List represent most of the largest and highest profile deposits in Mongolia. In addition to deposits currently on the Strategic Deposits List (a list of deposits designated by the parliament of Mongolia to be deposits of strategic importance) and the additional Tier 2 Deposits List (a list of 39 deposits designated by the parliament of Mongolia for further investigation by the Mongolian Government in order to determine if any or all of them should be placed on the Strategic Deposits List), the Mongolian Parliament may at any time designate other deposits not yet currently on such Lists to be Mineral Deposits of Strategic importance, add such deposits to either the Strategic Deposits List or the Tier 2 Deposits List and, in the former case, commence negotiations with the relevant license holder with respect to the terms under which the Mongolian Government will take an interest in such deposit. Whilst the Mongolian Government is in the process of adding the exact location and coordinates for each Mineral Deposit of Strategic Importance, a number of deposits on the Strategic Deposits List are identified by name only with no indication of the latitude and longitude coordinates for the deposit, and it is therefore not always possible to precisely determine the intended geographic area covered by each designated Mineral Deposit of Strategic Importance or to accurately determine whether or not any given license area is within, or overlaps a Mineral Deposit of Strategic Importance.

Under the 2006 Minerals Law, the size of the Mongolian Government's participation is determined largely by the level of state funding which has been provided for the exploration and development of any deposit, with the Mongolian Government entitled to participate up to 50% in the event that there has been state funding of such deposit and up to 34% if there has not. However the 2006 Minerals Law is very vague as to the details and method by which the Mongolian Government will take its interest and the final arrangements in respect of the Mongolian Government's interest in each Mineral Deposit of Strategic importance, including the amount of compensation to be paid to the license holder and the actual form of the Mongolian Government's interest are subject to negotiation between the Mongolian Government and the license holder.

The 2006 Minerals Law also contains provisions requiring any company which holds a Mineral Deposit of Strategic Importance to list no less than 10% of its shares on the Mongolian Stock Exchange. This particular provision of the 2006 Minerals Law has not yet been enforced and it is not clear how it will work in practice.

In recent years there have been a number of proposed amendments to the 2006 Minerals Law suggested by various parties, many of which have centered on amending the 2006 Minerals Law to increase the Mongolian Government's participating interest in excess of 50%. Whilst the 2006 Minerals Law provides that the interest of the Mongolian Government should take the form of an equity interest, based on past practice, and depending on the results of individual negotiations, the interest may be in the form of production or profit sharing or some other arrangement negotiated between the license holder and the Mongolian Government. There can be no assurance that legislation will not be enacted which further strengthens the Mongolian Government's right to participate in privately held mineral resources in Mongolia.

None of the deposits covered by the Company's existing mining licenses or exploration licenses are currently designated as Mineral Deposits of Strategic Importance. However, there can be no assurance that any one or more of these deposits will not be so designated in the future, in which case the Company's business and results of operations may be materially and adversely affected.

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

December 31, 2010 | Unaudited | Expressed in U.S. dollars

18. 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. Mongolia set a new record for coal shipments to China in 2010 and has become a significant supplier of China's coking coal needs.

SouthGobi's marketing efforts have been successful in terms of diversifying the number and nature of the Company's customers. Historically, the Company has only sold to customers on a 'mine gate' basis, whereby customers collect their coal at the mine and are responsible for all logistics. In the past, this posed a restriction for some potential customers that preferred not to deal with logistics and regulatory formalities on the Mongolian side of the border and SouthGobi was generally reliant on two to three major customers at any one time. However, in the first quarter of 2011, the Company opened its second sales channel, being direct delivery to customers in China. Working with a logistics provider, SouthGobi sells directly to certain customers with the point of delivery being the Chinese side of the Shivee Khuren-Ceke border. The availability of the second channel and additional interest in the Mongolia to China coal trade generally is enabling the Company to proliferate its customer base to include end-users and international traders. SouthGobi believes this proliferation combined with transport synergies on the Chinese side of the border can result in improved value for its individual coal products in the future.

Pricing of individual coal products for the fourth quarter of 2010 remained broadly the same as for the third quarter of 2010. However, overall realized average selling price fell to $32 per tonne primarily due to the sale of the accumulated stockpiled Sunset Pit No. 8/9/10 seams higher-ash higher sulphur coal, which was selling on a screened basis at approximately $26 per tonne.

For the first quarter of 2011, SouthGobi has the potential to set a new quarterly record realized average sales price for its coal. Prices of individual coal products have been increased between 15% and 25% on average on a mine-gate equivalent basis (i.e., for direct sales in China considering revenue less outbound transport costs and fees). The Company anticipates that with the changed individual product pricing compared with a sales mix more weighted towards the semi-soft coking coal for the first quarter of 2011, total average realized selling price per tonne should increase more than 50% over the level for the fourth quarter of 2010.

18. OUTLOOK CONTINUED

Sales volumes for the first quarter of 2011 are likely to be substantially lower than for the fourth quarter of 2010 for the reasons that: (a) the fourth quarter of 2010 included a large amount of stock-piled coal, adding to volumes; and (b) the first quarter of each year generally has less shipping days due to the Chinese lunar new year holidays and the Mongolian Tsagaan Tsar festival, which closed the border for some time. However, SouthGobi anticipates coal sales for the first quarter of 2011 to exceed the 426,000 tonnes sold in the first quarter of 2010, which if achieved would represent record volumes for the Company in a first quarter of any given year.

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 resources and reserves with future growth potential;
- 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.

Overview and Objectives

The Company continues to focus its efforts on mining, development and exploration of coking and raw coal products in Mongolia for supply of quality products to customers in China. As the Company looks forward through 2011, 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 2011 remain unchanged from the third quarter of 2010 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 coal-handling facility at Ovoot Tolgoi Mine including 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.
- **Operations** – Continuing to focus on production safety, environmental protection, operational excellence and community relations.

March 30, 2011

FINANCIAL STATEMENTS, NOTES AND APPENDIX

FINANCIAL STATEMENTS

NOTES TO THE FINANCIAL STATEMENTS

ADDITIONAL STOCK EXCHANGE INFORMATION

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of SouthGobi Resources Ltd.

We have audited the accompanying consolidated financial statements of SouthGobi Resources Ltd., which comprise the consolidated statement of financial position as at December 31, 2010 and December 31, 2009, and the consolidated statements of comprehensive income, changes in equity, and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of SouthGobi Resources Ltd. as at December 31, 2010 and December 31, 2009 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Deloitte & Touche LLP

Chartered Accountants
March 30, 2011
Vancouver, Canada

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(expressed in thousands of U.S. Dollars, except for share and per share amounts)

	Notes	YEAR ENDED DECEMBER 31, 2010	2009
CONTINUING OPERATIONS			
Revenue		$ 79,777	$ 36,038
Cost of sales	6	(77,488)	(29,425)
Income from mine operations		2,289	6,613
Administration expenses	7	(30,497)	(24,535)
Evaluation and exploration expenses	8	(18,769)	(5,399)
Operating loss from continuing operations		(46,977)	(23,321)
Finance costs	9	(175,855)	(63,754)
Finance income	9	103,948	920
Loss before tax		(118,884)	(86,155)
Current income tax expense	10	(1,806)	(509)
Deferred income tax recovery	10	4,495	6,947
Loss from continuing operations		(116,195)	(79,717)
Loss from discontinued operations	5	—	(31,088)
Net loss for the year		(116,195)	(110,805)
OTHER COMPREHENSIVE INCOME			
Gain on available-for-sale assets, net of tax	14	27,761	—
Net comprehensive loss attributable to equity holders of the Company		$ (88,434)	$ (110,805)
BASIC AND DILUTED LOSS PER SHARE FROM:			
Continuing operations	11	$ (0.66)	$ (0.60)
Discontinued operations	11	—	(0.23)
Continuing and discontinued operations		$ (0.66)	$ (0.83)

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(expressed in thousands of U.S. Dollars)

	Notes	AS AT DECEMBER 31, 2010	2009
ASSETS			
Current assets			
Cash and cash equivalents	12	$ 492,038	$ 357,342
Trade and other receivables	13	30,246	12,328
Short term investments	14	17,529	14,999
Inventories	15	26,160	16,384
Prepaid expenses and deposits	16	10,026	8,119
Total current assets		575,999	409,172
Non-current assets			
Property, plant and equipment	17	266,771	82,705
Deferred listing costs		—	4,565
Deferred income tax assets	10	11,442	6,947
Long term investments	14	107,416	57,070
Other receivables		238	225
Total non-current assets		385,867	151,512
Total assets		$ 961,866	$ 560,684
EQUITY AND LIABILITIES			
Current liabilities			
Trade and other payables	18	$ 24,137	$ 12,669
Amounts due under line of credit facility	19	—	3,009
Current portion of convertible debenture	20	6,312	4,712
Total current liabilities		30,449	20,390
Non-current liabilities			
Convertible debenture	20	245,498	542,351
Deferred income tax liabilities	10	3,966	—
Decommissioning liability	21	3,063	735
Total non-current liabilities		252,527	543,086
Total liabilities		282,976	563,476
Shareholders' equity/(deficiency)			
Common shares	22	1,061,560	296,419
Share option reserve	24	32,360	22,300
Investment revaluation reserve	24	27,761	—
Accumulated deficit	25	(442,791)	(321,511)
Total shareholder's equity/(deficiency)		687,890	(2,792)
Total shareholder's equity and liabilities		$ 961,866	$ 560,684
Net current assets		$ 545,550	$ 388,782
Total assets less current liabilities		$ 931,417	$ 540,294
Commitments for expenditure (Note 31)			

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

APPROVED BY THE BOARD:

"André Deepwell"
DIRECTOR

"Pierre Lebel"
DIRECTOR

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(expressed in thousands of U.S. Dollars and shares in thousands)

	Number of shares	Common shares	Share option reserve	Investment revaluation reserve	Accumulated deficit	Total
Balances, January 1, 2009	133,193	$ 289,512	$ 12,775	$ —	$ (213,323)	$ 88,964
Shares issued for:						
Exercise of share options	1,324	6,907	(3,010)	—	—	3,897
Share-based compensation charged to operations	—	—	12,535	—	—	12,535
Sale of Metals Division	—	—	—	—	2,617	2,617
Net loss and comprehensive loss for the period	—	—	—	—	(110,805)	(110,805)
Balances, December 31, 2009	134,517	$ 296,419	$ 22,300	$ —	$ (321,511)	$ (2,792)
Shares issued for:						
Cash	**27,228**	**$ 441,130**	**$ —**	**$ —**	**$ —**	**$ 441,130**
Share issue costs	**—**	**(27,200)**	**—**	**—**	**—**	**(27,200)**
Conversion of convertible debenture	**21,471**	**347,643**	**—**	**—**	**—**	**347,643**
Interest settlement on convertible debenture	**90**	**1,436**	**—**	**—**	**—**	**1,436**
Exercise of share options	**1,090**	**7,434**	**(3,200)**	**—**	**—**	**4,234**
Share-based compensation charged to operations	**—**	**—**	**13,260**	**—**	**—**	**13,260**
Common shares repurchased and cancelled	**(911)**	**(5,272)**	**—**	**—**	**(5,085)**	**(10,357)**
Share buy-back costs	**—**	**(30)**	**—**	**—**	**—**	**(30)**
Net loss for the year	**—**	**—**	**—**	**—**	**(116,195)**	**(116,195)**
Other comprehensive income for the year	**—**	**—**	**—**	**27,761**	**—**	**27,761**
Balances, December 31, 2010	**183,485**	**$ 1,061,560**	**$ 32,360**	**$ 27,761**	**$ (442,791)**	**$ 678,890**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENT OF CASH FLOWS

(expressed in thousands of U.S. Dollars)

	Notes	YEAR ENDED DECEMBER 31, 2010	2009
OPERATING ACTIVITIES			
Loss for the year from continuing operations before tax		**$ (118,884)**	$ (86,155)
Adjustments for:			
Depreciation and depletion		**13,219**	5,856
Share-based compensation	23	**13,260**	12,195
Fair value change on embedded derivative	9	**(100,637)**	44,980
Mark to market adjustment on investments		**(870)**	(843)
Interest income		**(2,441)**	(77)
Accrued interest expense		**24,425**	7,693
Transaction costs on issuance of convertible debenture		**—**	9,399
Interest paid		**(21,926)**	—
Loss on partial conversion of convertible debenture	9	**151,353**	—
Unrealized foreign exchange (gain)/loss		**(3,703)**	1,213
Loss on disposal of property, plant and equipment		**3,770**	245
Impairment of inventories	15	**5,751**	—
Impairment of property, plant and equipment	17	**1,833**	—
Accretion of decommissioning liability		**77**	40
Operating cash flows before movements in working capital		**(34,773)**	(5,454)
Increase in inventories		**(15,814)**	(3,443)
Increase in trade and other receivables		**(15,810)**	(8,379)
Increase in prepaid expenses and deposits		**(3,713)**	(6,322)
Increase in trade and other payables		**12,262**	7,595
Cash used in continuing operations		**(57,848)**	(16,003)
Cash used in discontinued operations	5	**—**	(19,227)
Cash used in operating activities		**(57,848)**	(35,230)
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		**(199,770)**	(35,770)
Interest received		**2,336**	37
Proceeds from disposal of property, plant and equipment		**22**	26
Purchase of short term investments		**—**	(15,000)
Maturity of short term investments		**15,000**	—
Purchase of long term investments		**(65,280)**	(47,450)
Maturity of long term investments		**30,000**	—
Increase in other receivables		**(13)**	(225)
Cash used in continuing operations		**(217,705)**	(98,382)
Cash used in discontinued operations	5	**—**	(6,723)
Cash used in investing activities		**(217,705)**	(105,105)
FINANCING ACTIVITIES			
Proceeds from issuance of common shares and exercise of stock options, net of issue costs		**422,729**	3,897
Repurchase of common shares, net of transaction costs		**(10,387)**	—
Increase in deferred charges		**—**	(4,565)
Proceeds from issuance of convertible debenture, net of issue costs		**—**	485,000
Drawings under line of credit facilities		**46,700**	53,000
Repayments of line of credit facilities		**(49,700)**	(50,000)
Cash generated from financing activities		**$ 409,342**	$ 487,332
Effect of foreign exchange rate changes on cash		**907**	5
Increase in cash and cash equivalents		**134,696**	347,002
Cash and cash equivalents, beginning of year		**357,342**	10,340
Cash and cash equivalents, end of year		**$ 492,038**	$ 357,342
COMPRISED OF:			
Cash and cash equivalents of continuing operations		**$ 492,038**	$ 357,342
Cash and cash equivalents of discontinued operations		**—**	—
Total cash and cash equivalents		**$ 492,038**	$ 357,342
Cash		**$ 461,853**	$ 242,352
Money market instruments		**30,185**	114,990
Total cash and cash equivalents		**$ 492,038**	$ 357,342

Supplemental cash flow information (Note 30)

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

1. CORPORATE INFORMATION

SouthGobi Resources Ltd. (formerly SouthGobi Energy Resources Ltd.) is a publicly listed company incorporated in Canada with limited liability under the legislation of the Province of British Columbia and its shares are listed on the Toronto Stock Exchange and Hong Kong Stock Exchange. The company together with its subsidiaries (collectively referred to as the "Company") is an integrated coal mining, development and exploration company. The Company's parent is Ivanhoe Mines Ltd. (the "parent" or "Ivanhoe").

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

The Company's financial statements and those of all of its controlled subsidiaries are presented in U.S. dollars and all values are rounded to the nearest thousand dollars except where otherwise indicated. Information related to shares and stock options is presented in thousands except for per share information, which is presented in U.S. cents.

These consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and settlement of liabilities in the normal course of business.

2. BASIS OF PREPARATION

2.1 Statement of compliance

The Company's Consolidated Financial Statements, including comparatives, have been prepared in accordance with and using accounting policies in full compliance with the International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"), effective for the Company's reporting for the year ended December 31, 2010.

2.2 Basis of presentation

The Company's Consolidated Financial Statements have been prepared on the historical cost basis except for certain non-current assets and financial instruments, which are measured at fair value, as explained in the accounting policies set out in Note 3.

2.3 Adoption of new and revised standards and interpretations

The IASB issued a number of new and revised IASs, IFRSs, amendments and related IFRICs (hereinafter collectively referred to as the "new IFRS") which are effective for the Company's financial year beginning on January 1, 2010. For the purpose of preparing and presenting the Consolidated Financial Statements, the Company has consistently adopted all these new standards for the years ended December 31, 2010 and 2009.

At the date of authorization of these Financial Statements, the IASB and IFRIC has issued the following new and revised standards, amendments and interpretations which are not yet effective during the year ended December 31, 2010.

2. BASIS OF PREPARATION CONTINUED

2.3 Adoption of new and revised standards and interpretations CONTINUED

- IFRS 7 (Amendment) Clarification of required level of disclosure (i)
- IFRS 9 New financial instruments standard that replaces IAS 39 for classification and measurement of financial assets (ii)
- IAS 1 (Amendment) Clarification of statement of changes in equity (i)
- IAS 24 (Revised) Related party disclosures (i)
- IAS 32 (Amendment) Classification of rights issues (iii)
- IAS 34 (Amendment) Disclosure requirements for significant events and transactions (i)
- IFRIC 14 (Amendment) Prepayment of a minimum funding requirement (i)
- IFRIC 19 Extinguishing financial liabilities with equity instruments (iv)

(i) Effective for annual periods beginning on or after January 1, 2011
(ii) Effective for annual periods beginning on or after January 1, 2013
(iii) Effective for annual periods beginning on or after February 1, 2010
(iv) Effective for annual periods beginning on or after July 1, 2010

The Company anticipates that the application of these standards, amendments and interpretations will not have a material impact on the results and financial position of the Company.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1 Basis of consolidation

The Consolidated Financial Statements include the financial statements of the Company and its controlled subsidiaries (Note 28). Control is achieved when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

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

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

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Company's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination (see Note 3.2) and the minority interests' share of changes in equity since the date of the combination. Losses applicable to the minority interests in excess of their interest in the subsidiary's equity are allocated against the interests of the Company except to the extent that the minority interests have a binding obligation and are able to make an additional investment to cover the losses.

3.2 Business combinations

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

3.2 Business combinations CONTINUED

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

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

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

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

3.3 Interest income

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

3.4 Foreign currencies

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

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

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

3.5 Borrowing costs

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

3.6 Retirement benefit costs

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

3.7 Inventories

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

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

3.8 Property, plant and equipment ("PPE")

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

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

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

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

Mineral assets include deferred stripping costs and decommissioning liabilities related to the reclamation of mining properties.

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

3.9 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.

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 reserves as the depletion base.

3.10 Mineral properties

All direct costs related to the acquisition of mineral property interests are capitalized into intangible assets on a property by property basis. Exploration costs, net of incidental revenues, are charged to operations in the period incurred until such time as it has been determined that a property has economically recoverable reserves, in which case subsequent exploration costs and the costs incurred to develop a property are capitalized into PPE. 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.

3.11 Decommissioning, restoration and similar liabilities

The Company recognizes provisions 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 a decommissioning liability (also referred to as an asset retirement obligation) is recognized as its present value in the period in which it is incurred. Upon initial recognition of the liability, a corresponding amount 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 decommissioning liability, the carrying amount of the liability is increased for the passage of time and adjusted for changes to the current market-based discount rate and the amount or timing of the underlying cash flows needed to settle the obligation.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

3.12 Share-based payments

Share-based payment transactions

Employees (including directors and senior executives) of the Company receive a portion of their remuneration in the form of share-based payments, 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.

Equity-settled transactions

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

3.13 Taxation

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

Current income tax

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

Deferred income tax

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

3.13 Taxation CONTINUED

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

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

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

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

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

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

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

3.14 Financial assets

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

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

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

Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) except for losses in value that are considered other than temporary or a significant or prolonged decline in the fair value of that investment below its cost.

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

3.15 Financial liabilities

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

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

Financial liabilities classified as FVTPL include financial liabilities held-for-trading and financial liabilities designated upon initial recognition as FVTPL. Derivatives, including separated embedded derivatives, are also classified as held-for-trading unless they are designated as effective hedging instruments. Transaction costs on financial liabilities classified as FVTPL are expensed as incurred. At the end of each reporting period subsequent to initial recognition, financial liabilities classified as FVTPL are measured at fair value, with changes in fair value recognized directly in profit or loss in the period in which they arise. The net gain or loss recognized in profit or loss excludes any interest paid on the financial liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

3.16 Impairment of financial assets

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

Assets carried at amortized cost

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

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

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

Available for sale

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

3.17 Derecognition of financial assets and financial liabilities

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

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

3.18 Impairment of non-financial assets

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

3.18 Impairment of non-financial assets CONTINUED

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

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

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

3.19 Cash and cash equivalents

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

3.20 Revenue recognition

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

3.21 Provisions

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

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

3.22 Related party transactions

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

3.23 Significant accounting judgments and estimates

The preparation of these financial statements requires management to make judgments and estimates and form assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its judgments and estimates in relation to assets, liabilities, revenue and expenses. Management uses historical experience and various other factors it believes to be reasonable under the given circumstances as the basis for its judgments and estimates. Actual outcomes may differ from these estimates under different assumptions and conditions.

The most significant estimates relate to valuation of embedded derivatives and determination of their expected life; decommissioning liabilities; property, plant and equipment, including coal reserves and resources, depreciation and depletion; recoverability of trade and other receivables, inventory valuation; valuation of deferred income tax amounts, impairment testing and the calculation of share-based payments.

The most significant judgments relate to recoverability of capitalized amounts, accounting for stripping costs, recognition of deferred tax assets and liabilities, accounting for long-term investments, determination of the commencement of commercial production and the determination of the economic viability of a project.

4. SEGMENTED INFORMATION

At December 31, 2010, the Company has one reportable operating segment, being the Mongolian Coal Division. In prior periods, the Company's Indonesia Coal Division was a segment of the Company (Note 5).

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

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

For the Mongolian Coal Division, the Company receives discrete financial information that is used by the chief operating decision maker to make decisions about resources to be allocated to the segment and to assess its performance. The division is principally engaged in coal mining, development and exploration in Mongolia. As at December 31, 2010, the Mongolian Coal Division has achieved commercial production and is earning revenue through the sale of coal to external customers.

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

At December 31, 2010, the Mongolian Coal Division had four active customers with the largest customer accounting for 73% of trade receivables and the other customers accounting for the remaining 27% of trade receivables.

For the year ended December 31, 2010, the largest customer accounted for 57% of revenues, the second largest customer accounted for 40% of revenue and the other customers accounted for the remaining 3% of revenue.

4. SEGMENTED INFORMATION CONTINUED

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

	OPERATING SEGMENTS			
	Mongolian Coal Division	Discontinued Operations (i)	Unallocated (ii)	Consolidated Total
Segment assets				
As at December 31, 2010	$ 342,591	$ –	$ 619,275	$ 961,866
As at December 31, 2009	129,454	–	431,230	560,684
Segment liabilities				
As at December 31, 2010	$ 25,408	$ –	$ 257,568	$ 282,976
As at December 31, 2009	7,300	–	556,176	563,476
Segment Income/(losses)				
For the year ended December 31, 2010	$ (20,022)	$ –	$ (96,173)	$ (116,195)
For the year ended December 31, 2009	6,203	(31,088)	(85,920)	(110,805)
Segment revenues				
For the year ended December 31, 2010	$ 79,777	$ –	$ –	$ 79,777
For the year ended December 31, 2009	36,038	–	–	36,038
Capital Expenditures				
For the year ended December 31, 2010	$ 199,354	$ –	$ 416	$ 199,770
For the year ended December 31, 2009	35,706	6,511	64	42,281
Depreciation and depletion expense				
For the year ended December 31, 2010	$ 13,148	$ –	$ 71	$ 13,219
For the year ended December 31, 2009	5,837	–	19	5,856
Impairment charge on assets (iii)(iv)				
For the year ended December 31, 2010	$ 7,584	$ –	$ –	$ 7,584
For the year ended December 31, 2009	–	15,135	–	15,135

(i) The Indonesian Coal Division was treated as discontinued operations for the year ended December 31, 2009 (Note 5)
(ii) The unallocated amount contains all amounts associated with the Corporate Division
(iii) The impairment charge in the year ended December 31, 2010 relates to inventory (Note 15) and property, plant and equipment (Note 17)
(iv) The impairment charge in the year ended December 31, 2009 relates to the Indonesian Coal Division (Note 5)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

4. SEGMENTED INFORMATION CONTINUED

At December 31, 2010, the Company operates in three geographical areas, being Canada, Hong Kong and Mongolia. Prior to December 23, 2009, the Company had operations in Indonesia (Note 5). The following is an analysis of the revenues and non-current assets by geographical area and reconciled to the Company's Consolidated Financial Statements:

	GEOGRAPHICAL AREA			
	Mongolia	Hong Kong	Canada	Consolidated Total
Revenues				
For the year ended December 31, 2010	$ 79,777	$ —	$ —	$ 79,777
For the year ended December 31, 2009	36,038	—	—	36,038
Non-current assets				
As at December 31, 2010	$ 277,201	$ 401	$ 108,265	$ 385,867
As at December 31, 2009	89,587	49	61,876	151,512

5. DISCONTINUED OPERATIONS

The Company sold the Indonesia Coal Division, which was composed entirely of the Mamahak Coal Project ("Mamahak"), effective December 15, 2009. The Company divested its 85% interest in Mamahak to Kangaroo Resources Limited ("Kangaroo") for consideration comprising of $1 million in cash and 50 million shares of Kangaroo with a fair value of $8,776. Kangaroo is listed on the Australian Securities Exchange (ASX: KRL). The transaction was completed on December 23, 2009 and the Company incurred transaction costs of $1 million related to the disposition of Mamahak. As a result of this transaction, the Company held 6.7% of the outstanding shares in Kangaroo on the closing date of the transaction and those shares were subject to a twelve month lock-up.

The Company disclosed Mamahak as a discontinued operation in the year ended December 31, 2009. The losses from discontinued operations for the year ended December 31, 2009 were $31,088. Included in the losses from discontinued operations for the year ended December 31, 2009 was an impairment charge of $15,135.

6. COST OF SALES

The cost of sales for the Company is broken down as follows:

	YEAR ENDED DECEMBER 31, 2010	2009
Operating expenses	$ 56,850	$ 23,611
Depreciation and depletion	13,054	5,814
Impairment of inventories (Note 15)	5,751	—
Impairment of property, plant and equipment (Note 17)	1,833	—
Cost of sales	$ 77,488	$ 29,425

7. ADMINISTRATION EXPENSES

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

	YEAR ENDED DECEMBER 31, 2010	2009
Corporate administration	$ 6,020	$ 2,839
Legal	957	912
Professional fees	2,795	3,159
Listing fees	—	2,470
Salaries and benefits	15,548	14,024
Sustainability and community relations	718	—
Public infrastructure	5,952	—
Depreciation	118	19
Foreign exchange (gain)/loss	(1,611)	1,112
Administration expenses	$ 30,497	$ 24,535

8. EVALUATION AND EXPLORATION EXPENSES

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

	YEAR ENDED DECEMBER 31, 2010	2009
Assaying	$ 341	$ 273
Drilling and trenching	11,705	2,283
Geological	876	351
Geophysics	1,697	193
Surveying	108	14
License fees	1,223	1,543
Depreciation	47	23
Salaries	1,051	64
Overhead	1,721	655
Evaluation and exploration expenses	$ 18,769	$ 5,399

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

9. FINANCE COSTS AND INCOME

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

	YEAR ENDED DECEMBER 31, 2010	2009
Loss on partial conversion of convertible debenture (Note 20)	$ 151,353	$ —
Fair value loss on embedded derivatives in convertible debenture (Note 20)	—	44,980
Interest expense on convertible debenture (Note 20)	24,294	7,684
Transaction costs on issuance of convertible debenture (Note 20)	—	9,399
Interest expense on line of credit facility (Note 19)	131	1,651
Accretion of decommissioning liability	77	40
Finance costs	**$ 175,855**	$ 63,754

The finance income for the Company is broken down as follows:

	YEAR ENDED DECEMBER 31, 2010	2009
Fair value gain on embedded derivatives in convertible debenture (Note 20)	$ 100,637	$ —
Mark to market gain on investments (Note 14)	870	843
Interest Income	2,441	77
Finance income	**$ 103,948**	$ 920

10. TAXES

The Company and its subsidiaries in Canada are subject to Canadian federal and provincial tax for the estimated assessable profit for the years ended December 31, 2010 and 2009 at a rate of 28.5% and 30%, respectively. The Company had no assessable profit in Canada for the years ended December 31, 2010 and 2009.

The Company's subsidiaries in Hong Kong are subject to Hong Kong profits tax for the years ended December 31, 2010 and 2009 at a rate of 16.5%. No Hong Kong profits tax was provided for as the Company had no assessable profit arising in or derived from Hong Kong in the years ended December 31, 2010 and 2009.

The Company's subsidiaries in Mongolia are subject to Mongolian income tax for the years ended December 31, 2010 and 2009 at a rate of 25%. In the year ended December 31, 2010 the Company recorded a current income tax charge of $1,806 (2009: $509) related to assessable profit derived from Mongolia.

Taxation from other relevant jurisdictions is calculated at the rates prevailing in each of those jurisdictions respectively.

10. TAXES CONTINUED

10.1 Income tax recognized in profit or loss

	YEAR ENDED DECEMBER 31, 2010	2009
Current Tax		
Current tax expense in respect of the current year	$ 1,806	$ 509
Deferred Tax		
Deferred tax recovery recognized in the current year	(4,495)	(6,947)
Total income tax recovery recognized in the current year related to continuing operations	**$ (2,689)**	$ (6,438)

The tax recovery for the Company can be reconciled to the loss for the year per the Consolidated Statement of Comprehensive Income as follows:

	YEAR ENDED DECEMBER 31, 2010	2009
Loss from continuing operations before tax	$ 118,884	$ 86,155
Statutory tax rate	28.50%	30.00%
Recovery of income taxes based on combined Canadian federal and provincial statutory rates	(33,882)	(25,847)
Deduct:		
Lower effective tax rate in foreign jurisdictions	1,905	463
Tax effect of tax losses and temporary differences not recognized	2,789	1,937
Non-deductible expenses	24,708	14,160
Effect of change in future tax rates	1,791	2,849
Tax recovery for the year	**$ (2,689)**	$ (6,438)

10.2 Income tax recognized in other comprehensive income

	YEAR ENDED DECEMBER 31, 2010	2009
Deferred Tax		
Fair value remeasurement of available-for-sale assets	$ (3,966)	$ —
Total income tax recovery recognized in the current year in other comprehensive income	**$ (3,966)**	$ —

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

10. TAXES CONTINUED

10.3 Deferred tax balances

The Company's deferred tax assets/(liabilities) are broken down as follows:

	AS AT DECEMBER 31, 2010	2009
Deferred tax assets	$ 11,442	$ 6,947
Deferred tax liabilities	(3,966)	—
Deferred tax balances	$ 7,476	$ 6,947

The Company's deferred tax assets/(liabilities) are attributable to the following items:

	AS AT DECEMBER 31, 2010	2009
Tax loss carry-forwards	$ 8,515	$ 5,793
Property, plant and equipment	2,880	1,135
Other assets	47	19
Available-for-sale financial assets	(3,966)	—
Deferred tax balances	$ 7,476	$ 6,947

10.4 Unrecognized deferred tax assets

The Company's unrecognized deductible temporary differences and unused tax losses are attributable to the following items:

	AS AT DECEMBER 31, 2010	2009
Non-capital losses	$ 18,952	$ 8,701
Capital losses	3,168	4,183
Deductible temporary differences	5,369	11,815
Deferred tax balances	$ 27,489	$ 24,699

10. TAXES CONTINUED

10.5 Expiry dates

The Company's recognized and unrecognized deferred tax assets related to unused tax losses have the following expiry dates:

	AS AT DECEMBER 31,			
	Local currency		U.S. Dollar Equivalent	Expiry dates
Non-capital losses				
Canadian Dollar	Cdn$	71,451	$ 71,065	2011 - 2030
Mongolian Tugrik	MNT	42,793,003	34,058	2011 - 2021
Hong Kong Dollar	HK$	46,127	5,953	indefinite
Singapore Dollar	SG$	75	58	indefinite
			$ 111,134	
Capital losses				
Canadian Dollar	Cdn$	25,211	$ 25,075	indefinite

11. LOSS PER SHARE

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

	YEAR ENDED DECEMBER 31, 2010	2009
Net loss from continuing operations for the purpose of basic and diluted loss per share	$ 116,195	$ 79,717
Net loss from discontinued operations for the purpose of basic and diluted loss per share	$ —	$ 31,088
Weighted average number of shares for the purpose of basic and diluted loss per share	176,529	133,499

The basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the year. The diluted loss per share reflects the potential dilution of common share equivalents, such as outstanding stock options, share purchase warrants and convertible debentures, in the weighted average number of common shares outstanding during the year, if dilutive. All of the stock options and the convertible debenture were anti-dilutive for the years ended December 31, 2010 and 2009.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

12. CASH AND CASH EQUIVALENTS

Cash and cash equivalents of the Company are comprised of bank balances and short term money market instruments with an original maturity of three months or less. The Company's bank balances and cash equivalents carry prevailing market interest rates which ranged from 0% to 0.35% as at December 31, 2010. The Company's cash and cash equivalents are denominated in the following currencies:

	AS AT DECEMBER 31, 2010	2009
Denominated in U.S. dollars	$ 486,404	$ 357,163
Denominated in Hong Kong dollars	3,666	263
Denominated in Canadian dollars	1,182	(136)
Others	786	52
Cash and cash equivalents	$ 492,038	$ 357,342

13. TRADE AND OTHER RECEIVABLES

The Company's trade and other receivables arise from two main sources: trade receivables due from customers for coal sales and value added tax ("VAT") and goods and services tax ("GST") receivable due from various government taxation authorities. These are broken down as follows:

	AS AT DECEMBER 31, 2010	2009
Trade receivables	$ 15,297	$ 5,200
VAT/GST receivable	14,541	7,029
Other receivables	408	99
Total trade and other receivables	$ 30,246	$ 12,328

Below is an aged analysis of the Company's trade and other receivables:

	AS AT DECEMBER 31, 2010	2009
Less than 1 month	$ 15,604	$ 5,730
1 to 3 months	1,869	3,463
3 to 6 months	2,600	2,613
Over 6 months	10,173	522
Total trade and other receivables	$ 30,246	$ 12,328

13. TRADE AND OTHER RECEIVABLES CONTINUED

At December 31, 2010, 99% of the trade and other receivables that were outstanding over one month are VAT/GST receivables and 100% of the trade and other receivables that were outstanding over six months are VAT/GST receivables. The Company anticipates full recovery of these amounts and therefore no impairment has been recorded against these receivables. The credit risk on the VAT/GST receivable has been further discussed in Note 27.

The Company holds no collateral for any receivable amounts outstanding as at December 31, 2010.

Included in trade and other receivables of the Company are amounts due from related parties which are disclosed in Note 28. The amounts are unsecured, interest free and repayable upon written notice given from the Company.

14. INVESTMENTS

The Company's investments are broken down as follows:

	AS AT DECEMBER 31, 2010	2009
Short term investments		
Money market investments(i)	$ 17,529	$ 14,999
Long term investments		
Investment in Kangaroo	10,235	9,876
Investment in Aspire	52,008	—
Money market investments(ii)	45,173	47,194
	107,416	57,070
Total short and long term investments	$124,945	$ 72,069

(i) Money market investments with maturities greater than ninety days and less than one year
(ii) Money market investments with maturities greater than one year

The Company has classified its investment in Kangaroo (Note 5) as FVTPL with any change in value being recognized through profit and loss. During the year ended December 31, 2010, the Company recognized an unrealized gain of $360 related to its investment in Kangaroo (2009: $1,099).

On December 23, 2010, the Company announced it had completed a private placement with Aspire Mining Limited ("Aspire"). Aspire is listed on the Australian Securities Exchange (ASX: AKM). Pursuant to the private placement, the Company acquired 105,860 shares at A$0.19 per share for an aggregate purchase price of $20,281. After giving effect to the transaction, the Company owns approximately 19.9% of Aspire. The Company has the right to nominate one member to the board of directors of Aspire and the right to maintain its proportionate 19.9% shareholding of Aspire for a period of two years.

The Company has classified its investment in Aspire as an available-for-sale financial asset. The Company has not treated Aspire as an associate because the Company does not have significant influence over Aspire and it is neither a subsidiary nor a joint venture. During the year ended December 31, 2010, the Company recognized an unrealized gain of $27,761, net of tax, in other comprehensive income related to its investment in Aspire (2009: $nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

15. INVENTORIES

The Company's inventories are broken down as follows:

	AS AT DECEMBER 31, 2010	2009
Stockpiles [i]	$ 2,395	$ 9,553
Materials and supplies	23,765	6,831
Total inventories	**$ 26,160**	$ 16,384

(i) Coal inventories are stated at the lower of production cost and net realizable value

The cost of inventories recognized as an expense during the year ended December 31, 2010 is $69,842 (2009: $22,035).

The cost of inventories recognized as an expense during the year ended December 31, 2010 included $5,246 (2009: $nil) in impairments of stockpile inventory and $505 (2009: $nil) in impairments of materials and supplies inventory to their respective net realizable values. As at December 31, 2010, the Company anticipates the entire stockpile balance of $2,395 will be realized within twelve months.

16. PREPAID EXPENSES AND DEPOSITS

The Company's prepaid expenses and deposits are broken down as follows:

	AS AT DECEMBER 31, 2010	2009
Security deposits	$ 913	$ 619
Insurance	933	557
Prepaid exploration license costs	832	1,023
Prepaid income taxes	—	3,109
Vendor pre-payments	7,209	2,683
Other	139	128
Total prepaid expenses and deposits	**$ 10,026**	$ 8,119

17. PROPERTY, PLANT AND EQUIPMENT

The Company's property, plant and equipment is broken down as follows:

	Mobile equipment	Computer equipment	Furniture and fixtures	Machinery and equipment	Buildings and roads	Mineral Assets	Construction in progress	Total
Cost								
As at January 1, 2009	$ 38,544	$ 526	$ 93	$ 2,211	$ 433	$ 3,422	$ 11,411	$ 56,640
Additions	28,900	98	409	538	1,663	5,669	6,225	43,502
Disposals	(756)	(37)	(7)	(125)	—	—	(7)	(932)
Sale of Indonesia Coal Division	—	—	—	—	(1,820)	(3,006)	(2,738)	(7,564)
Reclassifications	—	—	4	598	13,318	—	(13,920)	—
As at December 31, 2009	66,688	587	499	3,222	13,594	6,085	971	91,646
Additions	**156,462**	**278**	**856**	**1,840**	**655**	**31,969**	**15,398**	**207,458**
Disposals	**(5,948)**	**—**	**(5)**	**(13)**	**—**	**—**	**—**	**(5,966)**
Reclassifications	**231**	**—**	**—**	**—**	**—**	**—**	**(231)**	**—**
As at December 31, 2010	**$217,433**	**$ 865**	**$ 1,350**	**$ 5,049**	**$ 14,249**	**$38,054**	**$ 16,138**	**$293,138**
Accumulated depreciation and impairment								
As at January 1, 2009	$ (3,584)	$ (257)	$ (19)	$ (178)	$ (77)	$ (85)	$ —	$ (4,200)
Charge for the year	(4,003)	(76)	(57)	(405)	(834)	(85)	—	(5,460)
Eliminated on disposals	613	34	4	—	—	—	—	651
Sale of Indonesia Coal Division	—	—	—	—	28	40	—	68
As at December 31, 2009	(6,974)	(299)	(72)	(583)	(883)	(130)	—	(8,941)
Charge for the year	**(13,642)**	**(119)**	**(188)**	**(800)**	**(1,790)**	**(597)**	**—**	**(17,136)**
Impairment charges	**(1,833)**	**—**	**—**	**—**	**—**	**—**	**—**	**(1,833)**
Eliminated on disposals	**1,534**	**—**	**2**	**7**	**—**	**—**	**—**	**1,543**
As at December 31, 2010	**$ (20,915)**	**$ (418)**	**$ (258)**	**$ (1,376)**	**$ (2,673)**	**$(727)**	**—**	**$(26,367)**
Net book value								
As at December 31, 2009	$ 59,714	$ 288	$ 427	$ 2,639	$ 12,711	$ 5,955	$ 971	$ 82,705
As at December 31, 2010	**$196,518**	**$ 447**	**$ 1,092**	**$ 3,673**	**$ 11,576**	**$37,327**	**$ 16,138**	**$266,771**

In the year ended December 31, 2010, the Company capitalized interest of $602 (2009: $nil) into construction in progress.

In the year ended December 31, 2010, the Company recorded an impairment charge of $1,833 (2009: $nil) related to certain Mobile equipment. The Company has decided to replace its Liebherr 994 shovel to increase fleet flexibility and has therefore recorded an impairment charge to reduce its net book value to its recoverable amount.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

18. TRADE AND OTHER PAYABLES

Trade and other payables of the Company are principally comprised of amounts outstanding for trade purchases relating to coal mining and exploration activities and amounts payable for financing activities. The usual credit period taken for trade purchases is between 30 to 90 days.

The following is an aged analysis of the trade and other payables:

	AS AT DECEMBER 31,	
	2010	2009
Less than 1 month	$ 24,006	$ 9,630
1 to 3 months	33	892
3 to 6 months	72	705
Over 6 months	26	1,442
Total trade and other payables	$ 24,137	$ 12,669

Included in trade and other payables are amounts due to related parties which are disclosed in Note 28.

19. LINE OF CREDIT FACILITY

On December 18, 2009, the Company established a line of credit facility with Golomt Bank in Mongolia. The line of credit facility was a twelve month revolving line of credit facility with a maximum draw-down available of $3,000. The facility bore interest at 13% per annum and was secured by equipment in Mongolia to a value of not less than 150% of the total facility amount. On December 18, 2010, the line of credit facility was extended to January 18, 2011. On January 18, 2011 the Company signed a new revolving line of credit facility with Golomt Bank for a twelve month period. Under the new agreement, the maximum draw-down available is $3,500 and MNT8.1 Billion (approximately $6,500) and bears interest at 11% for any U.S. Dollar amounts outstanding and 12% for any Mongolia Tugrik amounts outstanding. The line of credit is secured by equipment in Mongolia to a value of not less than 150% of the total facility amount.

The line of credit facility is used by the Company's Mongolian subsidiaries as part of their working capital management. As at December 31, 2010, the Company had no amounts outstanding under the line of credit facility.

The movement of the amounts due under the line of credit facility is as follows:

	YEAR ENDED DECEMBER 31,	
	2010	2009
Balance, beginning of year	$ 3,009	$ –
Amounts advanced	46,700	3,000
Interest expense	131	9
Repayment of principal amounts	(49,700)	–
Interest paid	(140)	–
Balance, end of year	$ –	$ 3,009

20. CONVERTIBLE DEBENTURE

On November 19, 2009, the Company issued a convertible debenture to a wholly owned subsidiary of the China Investment Corporation ("CIC") for $500,000, which is secured and bears 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 $120,000 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 key commercial terms of the financing include:

- Interest – 8% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares, where the number of shares to be issued is calculated based on the 50-day volume-weighted average price ("VWAP").
- Term – Maximum of 30 years.
- Security – First charge over the Company's assets, including shares of its material subsidiaries.
- Conversion price – The conversion price is set as the lower of Cdn$11.88 or the 50-day VWAP at the date of conversion, with a floor price of Cdn$8.88 per share.
- Conversion timing – The Company and CIC each have various rights to call conversion of the debenture into common shares. CIC has the right to convert the debenture, in whole or in part, into common shares twelve months after the date of issue. The Company has the right to call for the conversion of up to $250 million of the debenture on the earlier of twenty four months after the issue date, if the conversion price is greater than Cdn$10.66, or upon the Company achieving a public float of 25% of its common shares under certain agreed circumstances, if the conversion price is greater than Cdn$10.66.
- Company's normal conversion right – After sixty months from the issuance date, at any time that the conversion price is greater than Cdn$10.66, the Company will be entitled to require conversion of the outstanding convertible debenture, in whole or in part, into common shares at the conversion price.
- Representation on the Company's Board – While the debenture loan is outstanding, or while CIC has a minimum 15% direct or indirect stake in the Company, CIC has the right to nominate one director to the Company's Board. The Company currently has eight Board members.
- Voting restriction – CIC has agreed that it will not have any voting rights in the Company beyond 29.9% if CIC ever acquires ownership of such a shareholder stake through exercising the debenture.
- Pre-emption rights – While the debenture loan is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has certain pre-emption rights on a pro-rata basis to subscribe for any new shares to be allotted and issued by the Company for the period which the debenture is outstanding. The pre-emption rights will not apply to new shares issued pursuant to pro-rata public equity offerings made to all shareholders, exercise of stock options and shares issued to achieve a 25% public float.
- Right of first offer – While a portion of the debenture is outstanding, or while CIC has a 15% direct or indirect stake in the Company, CIC has the right of first offer for any direct and indirect sale of Ivanhoe's ownership stake in the Company. At December 31, 2010 Ivanhoe owned directly and indirectly approximately 57% of the Company's issued and outstanding shares.
- Registration Rights – CIC has registration rights under applicable Canadian provincial securities laws in connection with the common shares issuable upon conversion of the debenture.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

20. CONVERTIBLE DEBENTURE CONTINUED

The Company identified that the convertible debenture is a debt host contract to be presented as a liability and contains no equity components. The Company also concluded that the convertible debenture is a hybrid instrument, containing a debt host component and three embedded derivatives – the investor's conversion option, the issuer's conversion option and the equity based interest payment provision (the 1.6% share interest payment) (the "embedded derivatives"). The debt host component is classified as other-financial-liabilities and is measured at amortized cost using the effective interest rate method and the embedded derivatives are classified as FVTPL and all changes in fair value are recorded in income. The difference between the debt host component and the principal amount of the loan outstanding will be accreted to income over the expected life of the convertible debenture.

The embedded derivative was valued upon initial measurement and subsequent periods using a Monte Carlo simulation valuation model. A Monte Carlo simulation model is a valuation model that relies on random sampling and is often used when modeling systems with a large number of inputs and where there is significant uncertainty in the future value of inputs and where the movement of the inputs can be independent of each other. Some of the key inputs used by the Company in its Monte Carlo simulation included: the floor and ceiling conversion prices, the risk-free rate of return, expected volatility of the stock price, forward foreign exchange rate curves (between the Cdn$ and U.S.$) and spot foreign exchange rates.

Based on the Company's valuation as at November 19, 2009, the closing date of the convertible debenture, the value of the embedded derivatives was $313,292 and the value of the debt component was $186,708. The transaction costs of $15,000 were applied on a pro-rata basis to the debt host and embedded derivatives and transaction costs of $9,399 associated with the embedded derivatives were expensed as financing costs and transaction costs of $5,601 associated with the debt host were netted against the debt host component.

Pursuant to the debenture conversion terms, the Company had the right to call for the conversion of up to $250,000 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 $250,000 of the convertible debenture into 21,471 shares at a conversion price of $11.64 (Cdn$11.88). On March 29, 2010, the Company also settled the accrued interest payable in shares on the converted $250,000 by issuing 90 shares for the $1,436 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 debt of $250,000 with a cash payment of $5,742.

The fair value of the shares issued upon the partial conversion, based on their market value, was $347,643 compared to the carrying value of the debt host and embedded derivatives associated with the debt that was converted of $196,290. The difference of $151,353 was recognized in finance costs as a loss upon partial conversion during the year ended December 31, 2010.

Based on the Company's valuations as at December 31, 2010, the fair value of the embedded derivatives decreased by $100,637 compared to December 31, 2009. This decrease was recorded as a gain in finance income for the year ended December 31, 2010.

In the year ended December 31, 2010, the Company also recorded an interest expense of $24,294 (2009: $7,684) related to the convertible debenture. The interest expense is composed of the interest at the contract rate and the accretion of the debt host component of the convertible debenture. To calculate the interest expense, the Company has used the contract life of 30 years and an effective interest rate of 22.2%.

20. CONVERTIBLE DEBENTURE CONTINUED

The movement of the amounts due under the convertible debenture are as follows:

	YEAR ENDED DECEMBER 31,	
	2010	2009
Balance, beginning of year	$ 547,063	$ –
Amounts advanced	–	500,000
Transaction costs	–	(5,601)
Interest expense on convertible debenture	24,896	7,684
Fair value (gain)/loss on embedded derivatives	(100,637)	44,980
Loss on conversion of convertible debenture	151,353	–
Conversion of convertible debenture	(347,643)	–
Interest paid	(23,222)	–
Balance, end of the year	$ 251,810	$ 547,063

The amounts due under the convertible debenture are further broken down as follows:

	AS AT DECEMBER 31,	
	2010	2009
Debt host	$ 90,621	$ 184,079
Fair value of embedded derivatives	154,877	358,272
Interest payable	6,312	4,712
Convertible debenture	$ 251,810	$ 547,063

FINANCIAL STATEMENT PRESENTATION

	2010	2009
Current liabilities		
Current portion of Convertible debenture	$ 6,312	$ 4,712
Non-current liabilities		
Convertible debenture	245,498	542,351
Convertible debenture	$ 251,810	$ 547,063

The assumptions used in the Company's valuation models as at December 31, 2010 and 2009 are as follows:

	AS AT DECEMBER 31,	
	2010	2009
Floor conversion price	Cdn$8.88	Cdn$8.88
Ceiling conversion price	Cdn$11.88	Cdn$11.88
Historical volatility	73%	75%
Risk free rate of return	3.48%	4.09%
Foreign exchange spot rate (U.S.$ to Cdn$)	1.01	0.96
Forward foreign exchange rate curve (U.S.$ to Cdn$)	0.97 - 1.14	0.90 - 0.95

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

21. DECOMMISSIONING LIABILITY

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

At December 31, 2010, the decommissioning liability relates to reclamation and closure costs of the Company's Ovoot Tolgoi project in Mongolia.

The decommissioning liability at Ovoot Tolgoi is calculated as the net present value of estimated future net cash outflows of the reclamation and closure costs, which at December 31, 2010 total $8,840 (2009: $3,449) and are required to satisfy the obligations, discounted at 8% per annum (2009: 10.78% per annum). The settlement of the obligations will occur through to 2024.

The following is an analysis of the decommissioning liability:

	YEAR ENDED DECEMBER 31, 2010	2009
Balance, beginning of year	$ 735	$ 329
Additions	2,251	366
Accretion	77	40
Balance, end of the year	**$ 3,063**	$ 735

22. SHARE CAPITAL

The Company has authorized an unlimited number of common and preferred shares with no par value. At December 31, 2010, the Company had 183,604 common shares outstanding (2009: 134,517) and no preferred shares outstanding (2009: nil).

During the year ended December 31, 2010, the Company repurchased 911 common shares on the Toronto Stock Exchange and Hong Kong Stock Exchange (2009: nil) for an average price of $11.37 per share. As at December 31, 2010, the Company had cancelled 792 of the 911 repurchased common shares. The remaining 119 common shares were cancelled in January 2011.

The weighted average share price during the year ended December 31, 2010 was Cdn$13.72 (2009: Cdn$12.09).

23. SHARE-BASED PAYMENTS

23.1 Stock option plan

The Company has a stock option plan which permits the Board of Directors of the Company to grant options to acquire common shares of the Company at the volume weighted average closing price for the five days preceding the date of grant. The Amended Equity Incentive Plan, approved on May 11, 2010, provides for a rolling rather than a fixed maximum number of common shares which may be issued pursuant to incentive stock options and other equity incentives, awards and issuances. The Compensation and Benefits Committee determines and makes recommendations to the Board of Directors as to the recipients of, and nature and size of, share-based compensation awards in compliance with applicable securities law, stock exchange and other regulatory requirements. The Company is authorized to issue options for a maximum of 10% of the issued and outstanding common shares pursuant to the stock option plan.

23. SHARE-BASED PAYMENTS CONTINUED

23.1 Stock option plan CONTINUED

The stock option plan permits the Board of Directors of the Company to set the terms for each stock option grant, however, the general terms of stock options granted under the amended plan include a maximum exercise period of 5 years and a vesting period of 3 years with one-third of the grant vesting on the first anniversary of the grant, one-third vesting on the second anniversary of the grant and one-third vesting on the third anniversary of the grant. The options granted in the year ended December 31, 2010, were granted with a weighted average maximum exercise period of 5.00 years (2009: 5.95 years) and a weighted average vesting period of 1.88 years (2009: 1.82 years).

During the year ended December 31, 2010, the Company granted 3,446 stock options (2009: 2,671) to officers, employees, directors and other eligible persons at exercise prices ranging from Cdn$9.79 to Cdn$15.09 (2009: Cdn$7.94 to Cdn$14.25) and expiry dates ranging from February 8, 2015 to November 15, 2015 (2009: May 6, 2014 to February 6, 2016). The weighted average fair value of the options granted in the year ended December 31, 2010, was estimated at $5.83 (Cdn$6.07) (2009: $5.95, Cdn$6.56) per option at the grant date using the Black-Scholes option pricing model. The weighted average assumptions used for the calculation were:

	YEAR ENDED DECEMBER 31, 2010	2009
Risk free interest rate	**1.99%**	2.17%
Expected life	**3.4 years**	3.6 years
Expected volatility (i)	**72.15%**	79.54%
Expected dividend per share	**$nil**	$nil

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

A share-based compensation cost of $19,867 for the options granted in the year ended December 31, 2010 (2009: $14,872) will be amortized over the vesting period, of which $5,097 was recognized in the year ended December 31, 2010 (2009: $5,125).

The total share-based compensation calculated for the year ended December 31, 2010 was $13,260 (2009: $12,535). Share-based compensation of $10,820 (2009: $10,471) has been allocated to Administration expenses, $1,516 (2009: $1,590) has been allocated to Cost of sales and $924 (2009: $474) has been allocated to Evaluation and exploration expenses.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

23. SHARE-BASED PAYMENTS CONTINUED

23.2 Outstanding stock options

The following is a summary of option transactions under the Company's stock option plan for the years ended December 31, 2010 and 2009:

	YEAR ENDED DECEMBER 31, 2010		YEAR ENDED DECEMBER 31, 2009	
	Number of options	Weighted-average exercise price (Cdn$)	Number of options	Weighted-average exercise price (Cdn$)
Balance, beginning of year	7,254	$ 9.11	6,586	$ 7.18
Options granted	3,446	12.48	2,671	11.13
Options exercised	(1,099)	4.04	(1,324)	3.16
Options forfeited	(325)	13.31	(679)	9.96
Balance, end of year	9,276	$ 10.82	7,254	$ 9.11

The following table summarizes information about stock options outstanding and exercisable as at December 31, 2010:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE		
Exercise price (Cdn$)	Options outstanding	Weighted-average exercise price (Cdn$)	Weighted-average remaining contractual life (years)	Options outstanding and exercisable	Weighted-average exercise price (Cdn$)	Weighted-average exercise price (Cdn$)
$0.86 - $2.85	184	$ 2.10	0.47	184	$ 2.10	0.47
$3.70 - $6.00	1,883	5.55	2.15	1,561	5.64	1.99
$7.16 - $10.21	1,669	9.11	4.31	689	8.61	3.99
$11.46 - $13.80	4,488	12.69	4.10	784	12.96	3.05
$15.07 - $18.86	1,052	16.48	2.87	573	16.83	2.57
	9,276	$ 10.82	3.53	3,791	$ 9.21	2.59

24. RESERVES

The reserves of the Company net of income tax are broken down as follows:

	AS AT DECEMBER 31, 2010	2009
Share option reserve	$ 32,360	$ 22,300
Investment revaluation reserve	27,761	–
Total reserves	$ 60,121	$ 22,300

24.1 Share option reserve

The Company's share option reserve relates to share options granted by the Company to officers, employees, directors and other eligible persons under its stock option plan. Details about the Company's share-based payments are set out in Note 23.

The following is an analysis of the share option reserve:

	YEAR ENDED DECEMBER 31, 2010	2009
Balance, beginning of year	$ 22,300	$ 12,775
Share-based compensation charged to operations	13,260	12,535
Exercise of share options	(3,200)	(3,010)
Balance, end of year	$ 32,360	$ 22,300

24.2 Investment revaluation reserve

The Company's investment revaluation reserve represents the cumulative gains and losses arising on the revaluation of available-for-sale financial assets that have been recognized in other comprehensive income.

The following is an analysis of the investment revaluation reserve:

	YEAR ENDED DECEMBER 31, 2010	2009
Balance, beginning of year	$ –	$ –
Gain arising on revaluation of available-for-sale financial available-for-sale financial assets (Note 14)	31,727	–
Income tax relating to gain arising on revaluation of available-for-sale financial assets	(3,966)	–
Balance, end of year	$ 27,761	$ –

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

25. ACCUMULATED DEFICIT AND DIVIDENDS

The Company has incurred losses since inception and at December 31, 2010, the Company has accumulated a deficit of $442,791 (2009: $321,511).

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

26. CAPITAL RISK MANAGEMENT

The Company's objectives are to safeguard the Company's ability to continue as a going concern in order to support the Company's normal operating requirements, continue the development and exploration of its mineral properties and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk.

The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue new shares, issue new debt, acquire or dispose of assets or adjust the amount of cash and cash equivalents. In order to facilitate the management of its capital requirements, the Company prepares annual expenditure budgets that are updated as necessary depending on various factors, including capital deployment, results from operations, results from the exploration and development of its properties and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

At December 31, 2010, the Company's capital structure consists of convertible debt (Note 20) and the equity of the Company (Note 22). The Company is not subject to any externally imposed capital requirements. In order to maximize ongoing development efforts, the Company does not pay dividends.

In the year ended December 31, 2010, there were no significant changes in the processes used by the Company's or in the Company's objectives and policies for managing its capital. As at December 31, 2010, the Company's available capital resources, consisting of cash and cash equivalents, short-term money market investments and long-term money market investments, total $554,740. As at December 31, 2010, the Company's total liabilities are $282,976. The Company believes that sufficient capital resources are available to support further expansion and development of its mining assets.

27. FINANCIAL INSTRUMENTS

Details of the significant accounting policies and methods adopted by the Company for each class of financial asset, financial liability and equity instrument are disclosed in Note 3 of the financial statements.

27.1 Categories of financial instruments

The Company's financial assets and financial liabilities are categorized as follows:

	AS AT DECEMBER 31, 2010	2009
Financial assets		
Loans-and-receivables		
Cash and cash equivalents	**$ 492,038**	$ 357,342
Trade and other receivables	**30,246**	12,328
Other receivables	**238**	225
Available-for-sale		
Investment in Aspire (Note 14)	**52,008**	—
Fair value through profit and loss (FVTPL)		
Investment in Kangaroo (Note 14)	**10,235**	9,876
Money market investments (Note 14)	**62,702**	62,193
Total financial assets	**$ 647,467**	$ 441,964
Financial liabilities		
Fair value through profit and loss (FVTPL)		
Convertible debenture — embedded derivatives	**$ 154,877**	$ 358,272
Other-financial-liabilities		
Trade and other payables	**24,137**	12,669
Amounts due under line of credit facilities	**—**	3,009
Convertible debenture — debt host	**96,933**	188,791
Total financial liabilities	**$ 275,947**	$ 562,741

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

27. FINANCIAL INSTRUMENTS CONTINUED

27.2 Fair value

The fair value of financial assets and financial liabilities at amortized cost is determined in accordance with generally accepted pricing models based on discounted cash flow analysis or using prices from observable current market transactions. The Company considers that the carrying amount of all its financial assets and financial liabilities recognized at amortized cost in the financial statements approximates their fair value.

The fair values of the Company's financial instruments classified as FVTPL or available-for-sale are determined as follows:

- The fair value of financial instruments that are traded on an active liquid market are determined with reference to the quoted market prices. The fair value of the Company's investment in the shares of Kangaroo, shares of Aspire and its money market investments were determined using this methodology.
- The fair value of financial instruments that are not traded in an active market are determined using generally accepted valuation models using inputs that are directly (i.e. prices) or indirectly (i.e. derived from prices) observable. The fair value of the embedded derivatives within the convertible debenture (Note 20) were determined using a Monte Carlo simulation. None of the fair value change on the embedded derivatives for the year ended December 31, 2010 is related to a change in the credit risk of the convertible debenture. All of the change in fair value is associated with changes in market conditions.

The fair value of all the other financial instruments of the Company approximates their carrying value because of the demand nature or short-term maturity of these instruments.

The following table provides an analysis of the Company's financial instruments that are measured subsequent to initial recognition at fair value, grouped into Level 1 to 3 based on the degree to which the inputs used to determine the fair value are observable.

- Level 1 fair value measurements are those derived from quoted prices in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1, that are observable either directly or indirectly.
- Level 3 fair value measurements are those derived from valuation techniques that include inputs that are not based on observable market data. As at December 31, 2010, the Company does not have any Level 3 financial instruments.

	Level 1	Level 2	Total
Financial assets at fair value			
Investment in Aspire	$ 52,008	$ —	$ 52,008
Investment in Kangaroo	10,235	—	10,235
Money market investments	62,702	—	62,702
Total financial assets at fair value	$ 124,945	$ —	$ 124,945
Financial liabilities at fair value			
Convertible debenture — embedded derivatives	$ —	$ 154,877	$ 154,877
Total financial liabilities at fair value	$ —	$ 154,877	$ 154,877

There were no transfers between Level 1 and 2 in the year ended December 31, 2010.

27. FINANCIAL INSTRUMENTS CONTINUED

27.3 Financial risk management objectives and policies

The financial risk arising from the Company's operations are currency risk, interest rate risk, credit risk, liquidity risk and commodity price risk. These risks arise from the normal course of operations and all transactions undertaken are to support the Company's ability to continue as a going concern. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. Management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Currency risk

The Company's borrowings, major operating expenses and acquisition costs are denominated in U.S. dollars and a minor portion of the expenses of the Company are in Canadian dollars and Hong Kong dollars. The Company's corporate office is based in Canada and the exposure to exchange rate fluctuations arise mainly on foreign currencies against the functional currency of the relevant Company entities which is the U.S. dollar. The Company does not have any significant foreign currency denominated monetary liabilities.

The Company has not entered into any derivative instruments to manage foreign exchange fluctuations; however, management monitors foreign exchange exposure.

The carrying amounts of the Company's foreign currency denominated monetary assets are as follows:

	AS AT DECEMBER 31,	
	2010	2009
Assets		
Canadian Dollars (Cdn$)	$ 1,182	$ (136)
Hong Kong Dollars (HK$)	3,666	262
Australian Dollars (A$)	639	—
Mongolian Tugriks (MNT)	147	53
	$ 5,634	$ 179

Foreign currency sensitivity analysis

The following table details the Company's sensitivity to a 5% increase or decrease in the U.S. dollar against the foreign currency denominated monetary items in the preceding table. 5% represents management's assessment of the reasonable possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the end of the period for a 5% change in foreign currency rates. A positive number indicates a decrease in loss for the year where the foreign currencies strengthen against the U.S. dollar. The opposite number will result if the foreign currencies depreciate against the U.S. dollar.

	AS AT DECEMBER 31,	
	2010	2009
Decrease in		
Loss for the year	$ 282	$ 9

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

27. FINANCIAL INSTRUMENTS CONTINUED

27.3 Financial risk management objectives and policies CONTINUED

Interest rate risk

The Company is exposed to interest rate risk on the variable rate of interest earned on some of its short and long term money market investments. The fair value interest rate risk on cash and cash equivalents is insignificant as the deposits are either short-term or pay interest at rates of 1.0% or less.

The Company has not entered into any derivative instruments to manage interest rate fluctuations, however, management closely monitors interest rate exposure and the risk exposure is limited.

Interest rate sensitivity analysis

The following table details the Company's sensitivity to a 50 basis points increase or decrease in the interest rate earned on the Company's money market investments with floating rates of return. 50 basis points represents management's assessment of the reasonable possible change in earned interest rates. The sensitivity analysis assumes the financial instruments outstanding at the end of each reporting period were outstanding throughout the whole year. A positive number indicates an increase in the loss for the year where the interest rate has decreased, while the opposite number will result if the interest rate increased.

	AS AT DECEMBER 31,	
	2010	2009
Decrease in		
Loss for the year	$ 87	$ 87

Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. Credit risk for the Company is primarily associated with trade receivables, value added tax ("VAT") receivable, goods and services tax ("GST") receivable and cash equivalents and short and long term money market investments.

The credit risk on trade receivables is managed through an internal process whereby any potential customer is investigated before a sales contract is signed. Risk is further mitigated as the payment terms for all customers range from 10 days to 14 days, which allows the Company to actively monitor the amounts owed by customers and identify any credit risks in a timely manner and reduce the risk of a credit related loss. In addition, the Company reviews the recoverable amount of its receivables at the end of each reporting period to ensure that adequate impairment losses are made for unrecoverable amounts. In this regard, the Company considers that the credit risk associated with trade receivables is significantly reduced.

The VAT/GST receivable includes amounts that have been accumulated to date in various subsidiaries. At December 31, 2010, 99% of the VAT/GST receivable was due from the Mongolian Government Taxation Authority. As per Mongolia tax laws, a tax payer may offset future taxes and royalties payable to the Government against VAT amounts receivable from the Government.

27. FINANCIAL INSTRUMENTS CONTINUED

27.3 Financial risk management objectives and policies CONTINUED

The Company had previously reported that in July 2009, the Mongolia Tax Laws were amended to preclude producers and exporters of unfinished mineral products from claiming back VAT, however the Mongolian Government had not defined what products would qualify as finished mineral products. Effective November 10, 2010, the Mongolian Government defined the list of finished mineral products and the Company's current coal products do not qualify as finished mineral products. Therefore, as of November 10, 2010, the Company no longer qualifies to receive any VAT refunds, the application of this law is prospective and any amounts accumulated until November 9, 2010 are still refundable. Any amounts paid for VAT from November 10, 2010 onwards have either been expensed directly through profit or loss or capitalized as part of the related asset. Verification by the Mongolian Government Taxation Authority of the collectability of the funds is conducted on an annual basis and any outstanding VAT receivable amounts at December 31, 2010 will be available to the Company to offset future taxes and royalties or will be refunded by the Mongolian Government Taxation Authority.

With the completion of the Company's previously announced coal handling facility the Company is confident its coal products will qualify for VAT and from that point forward the Company will once again be eligible to reclaim any paid VAT amounts. The coal handling facility is scheduled to be commissioned by the end of 2011.

The credit risk on cash equivalents is limited because the cash equivalents and short and long term money market investments are composed of money market investments issued by banks and other institutions with high credit ratings as assigned by international credit-rating agencies.

The Company is not exposed to significant credit risk and overall the Company's credit risk has not changed significantly during the year ended December 31, 2010.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to settle or manage its obligations associated with financial liabilities. In the management of liquidity risk, the Company maintains a balance between continuity of funding and the flexibility through the use of borrowings. Management closely monitors the liquidity position and expects to have adequate sources of funding to finance the Company's projects and operations. The directors of the Company are of the opinion that, taking into account the Company cash reserves and external financial resources, the Company has sufficient working capital for its present obligations, that is for at least the next twelve months commencing from December 31, 2010.

The following table details the Company's current and expected remaining contractual maturities for its financial liabilities with agreed repayment periods. The table is based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Company can be required to satisfy the liabilities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

27. FINANCIAL INSTRUMENTS CONTINUED

27.3 Financial risk management objectives and policies

Liquidity risk CONTINUED

	0 to 6 months	6 to 12 months	1 to 5 years	Total
As at December 31, 2010				
Trade and other payables	**$ 24,137**	**$ —**	**$ —**	**$ 24,137**
Convertible debenture — cash interest (Note 20)	**8,000**	**8,000**	**48,000**	**64,000**
	$ 32,137	**$ 8,000**	**$ 48,000**	**$ 88,137**
As at December 31, 2009				
Trade and other payables	$ 12,669	$ —	$ —	$ 12,669
Amounts due under line of credit facilities	170	3,206	—	3,376
Convertible debenture — cash interest (Note 20)	—	21,874	64,000	85,874
	$ 12,839	$ 25,080	$ 64,000	$ 101,919

Commodity price risk

Profitability of the Company depends on the coal prices it is able to realize. Coal prices are affected by numerous factors such as interest rates, exchange rates, inflation or deflation and global and regional supply and demand.

The Company enters into sales contracts with its customers to manage the risk of a significant decrease in the price of coal. The Company has not entered into any coal hedging instruments to manage its exposure to fluctuations in coal prices. As coal sales are the only source of revenue for the Company, a 5% increase or decrease in coal prices will result in a corresponding increase or decrease in revenue.

28. RELATED PARTY TRANSACTIONS

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

Name	Country of incorporation	% EQUITY INTEREST AS AT DECEMBER 31, 2010	2009
Asia Gold International Holding Company Ltd.	British Virgin Islands	**100%**	100%
SouthGobi Resources (Hong Kong) Ltd.	Hong Kong	**100%**	100%
Dayarbulag LLC	Mongolia	**100%**	100%
SouthGobi Sands LLC	Mongolia	**100%**	100%
Transbaikal Gold	Russia	**100%**	100%
SGQ Coal Investment Pte. Ltd.	Singapore	**100%**	100%
SGQ Dayarcoal Mongolia Pte. Ltd.	Singapore	**100%**	100%

28. RELATED PARTY TRANSACTIONS CONTINUED

For the year ended December 31, 2010, the Company had related party transactions with the following Companies related by way of directors or shareholders in common:

- Ivanhoe Mines Ltd. (“Ivanhoe Mines”) – Ivanhoe Mines is the Company parent company and at December 31, 2010 owned approximately 57% of the outstanding common shares of the Company. Ivanhoe Mines provides various administrative services to the Company on a cost-recovery basis. The Company also provides some office services to Ivanhoe Mines in the Company’s Hong Kong office and recovers the costs for those services on a cost-recovery basis.
- Global Mining Management (“GMM”) – GMM is a private Company owned equally by seven companies, two of which include the Company and Ivanhoe Mines. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis.
- Ivanhoe Capital Aviation LLC (“Ivanhoe Aviation”) – Ivanhoe Aviation is a private company 100% owned by Ivanhoe’s Executive Chairman. Ivanhoe Aviation operates aircraft which are rented by the Company on a cost-recovery basis.
- I2MS.NET Pte. Ltd. (“I2MS”) – I2MS is a private company 100% owned by Ivanhoe Mines. I2MS provides information technology and other related services to the Company on a cost-recovery basis.
- Ivanhoe Energy Inc. (“Ivanhoe Energy”) – Ivanhoe Energy is a publicly listed company with two directors in common with the Company. The Company provides some office services to Ivanhoe Energy in the Company’s Hong Kong office and recovers the costs for those services on a cost-recovery basis.

28.1 Related party expenses

The Company’s related party expenses are broken down as follows:

	YEAR ENDED DECEMBER 31, 2010	2009
Corporate administration	**$ 3,832**	$ 1,176
Salaries and benefits	**2,120**	1,321
Interest	**—**	1,642
Total related party expenses	**$ 5,952**	$ 4,139

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

	YEAR ENDED DECEMBER 31, 2010	2009
GMM	**$ 2,840**	$ 1,844
Ivanhoe Mines	**252**	1,787
Ivanhoe Aviation	**1,725**	—
I2MS	**1,135**	508
Total related party expenses	**$ 5,952**	$ 4,139

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

28. RELATED PARTY TRANSACTIONS CONTINUED

28.2 Related party expense recoveries

The Company's expenses recovered from related parties are broken down as follows:

	YEAR ENDED DECEMBER 31, 2010	YEAR ENDED DECEMBER 31, 2009
Corporate administration	$ 233	$ –

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

	YEAR ENDED DECEMBER 31, 2010	YEAR ENDED DECEMBER 31, 2009
Ivanhoe Mines	$ 156	$ –
Ivanhoe Energy	77	–
Total related party expenses recovery	$ 233	$ –

28.3 Related party assets

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

	AS AT DECEMBER 31, 2010	AS AT DECEMBER 31, 2009
Amounts due from GMM	$ 238	$ 225
Amounts due from Ivanhoe Mines	156	–
Amounts due from Ivanhoe Energy	38	–
Total assets due from related parties	$ 432	$ 225

28.4 Related party liabilities

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

	AS AT DECEMBER 31, 2010	AS AT DECEMBER 31, 2009
Amounts payable to GMM	$ 549	$ 240
Accounts payable to Ivanhoe Mines	1	158
Accounts payable to I2MS	367	211
Total liabilities due to related parties	$ 917	$ 609

29. KEY MANAGEMENT PERSONNEL COMPENSATION

The remuneration of directors and other members of key management were as follows:

	YEAR ENDED DECEMBER 31, 2010	YEAR ENDED DECEMBER 31, 2009
Short-term benefits	$ 2,336	$ 1,820
Share-based payments	4,517	5,425
Total renumeration	$ 6,853	$ 7,245

30. SUPPLEMENTAL CASH FLOW INFORMATION

30.1 Non-cash financing and investing activities

The Company incurred the following non-cash investing and financing transactions:

	YEAR ENDED DECEMBER 31, 2010	YEAR ENDED DECEMBER 31, 2009
Conversion of convertible debenture	$ 347,643	$ –
Interest settlement on convertible debenture	1,436	–
Transfer of share option reserve upon exercise of options	3,200	3,010
Acquisition of shares of Kangaroo	–	8,776
Total non-cash financing and investing activities	$ 352,279	$ 11,786

30.2 Cash payments for interest and taxes

The Company made the following cash payments for interest and income taxes:

	YEAR ENDED DECEMBER 31, 2010	YEAR ENDED DECEMBER 31, 2009
Interest paid	$ 21,926	$ 1,642
Taxes paid (i)	–	–
Total cash payments	$ 21,926	$ 1,642

(i) As per Mongolian tax laws the Company offsets current taxes payable against VAT amounts receivable

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

31. COMMITMENTS FOR EXPENDITURE

As at December 31, 2010, the Company had the following commitments that have not been disclosed elsewhere in the Consolidated Financial Statements:

	AS AT DECEMBER 31, 2010			
	Within 1 year	2-3 years	Over 3 years	Total
Capital expenditure commitments	$ 126,694	$18,000	$ —	$ 144,694
Minimum rental and lease payments	2,066	2,696	—	4,762
Commitments	$ 128,760	$20,696	$ —	$ 149,456

32. CONTINGENCIES

Due to the size, complexity and nature of the Company's operations, various legal and tax matters arise in the ordinary course of business. The Company accrues for such items when a liability is both probable and the amount can be reasonably estimated. In the opinion of management, these matters will not have a material effect on the Consolidated Financial Statements of the Company.

33. APPROVAL OF THE FINANCIAL STATEMENTS

The Consolidated Financial Statements of SouthGobi Resources Ltd. for the year ended December 31, 2010 were approved and authorized for issue by the Board of Directors on **March 30, 2011.**

APPENDIX TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

ADDITIONAL STOCK EXCHANGE INFORMATION

Additional information required by the Hong Kong Stock Exchange and not shown elsewhere in this report is as follows:

A1. LOSS FOR THE YEAR

Loss for the year has been arrived at after charging the following items:

	YEAR ENDED DECEMBER 31,	
	2010	2009
Auditor's remuneration	$ 279	$ 198
Loss on disposal of property, plant and equipment	3,770	245
Depreciation		
Depreciation included in administration expenses	118	19
Depreciation included in exploration expenses	47	23
Depreciation included in cost of sales	13,054	5,814
Total depreciation	$ 13,219	$ 5,856
Staff costs		
Directors' emoluments - executive directors (Note A2)	$ 1,798	$ 703
Directors' emoluments - non-executive directors (Note A2)	2,439	2,640
Other staff costs	11,288	10,660
Retirement benefit costs excluding directors	23	20
Staff costs in administration expenses	15,548	14,023
Staff costs included in exploration expenses	1,051	198
Total staff costs	$ 16,599	$ 14,221

A2. DIRECTOR AND EMPLOYEE EMOLUMENTS

The Company's directors' emoluments are broken down as follows:

Directors' emoluments

	YEAR ENDED DECEMBER 31,	
	2010	2009
Directors' fees	$ 377	$ 330
Other emoluments for executive and non-executive directors		
Salaries and other benefits	900	372
Stock-based compensation	2,950	2,633
Retirement benefit contribution	10	8
Directors' emoluments	$ 4,237	$ 3,343

APPENDIX TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

A2. DIRECTOR AND EMPLOYEE EMOLUMENTS CONTINUED

Details of the directors' emoluments are as follows:

Directors' emoluments CONTINUED

YEAR ENDED DECEMBER 31, 2010

Name of Director	Directors' fees	Salaries and other benefits	Stock-based compensation	Retirement benefit contribution	Total
Executive directors					
Alexander Molyneux	**$ —**	**$ 802**	**$ 994**	**$ 2**	**$ 1,798**
Non-executive directors					
Peter Meredith	**$ —**	**$ 98**	**$ 659**	**$ —**	**$ 757**
John Macken	**—**	**—**	**296**	**—**	**296**
Pierre Lebel	**104**	**—**	**139**	**2**	**245**
André Deepwell	**86**	**—**	**139**	**2**	**227**
R. Edward Flood	**34**	**—**	**139**	**1**	**174**
R. Stuart (Tookie) Angus	**65**	**—**	**139**	**2**	**206**
Robert Hanson	**57**	**—**	**139**	**—**	**196**
Gordon Lancaster	**31**	**—**	**306**	**1**	**338**
	$ 377	**$ 98**	**$ 1,956**	**$ 8**	**$ 2,439**
	$ 377	**$ 900**	**$ 2,950**	**$ 10**	**$ 4,237**

YEAR ENDED DECEMBER 31, 2009

Name of Director	Directors' fees	Salaries and other benefits	Stock-based compensation	Retirement benefit contribution	Total
Executive directors					
Alexander Molyneux[(i)]	$ —	$ 181	$ 522	$ —	$ 703
Non-executive directors					
Peter Meredith	$ —	$ 191	$ 661	$ —	$ 852
John Macken	—	—	332	—	332
Pierre Lebel	104	—	229	2	335
André Deepwell	77	—	225	2	304
R. Edward Flood	29	—	228	1	258
R. Stuart (Tookie) Angus	61	—	218	2	281
Robert Hanson	59	—	218	1	278
	$ 330	$ 191	$ 2,111	$ 8	$ 2,640
	$ 330	$ 372	$ 2,633	$ 8	$ 3,343

(i) Alexander Molyneux was appointed as a director and the CEO of the Company on October 11, 2009

A2. DIRECTOR AND EMPLOYEE EMOLUMENTS CONTINUED

Five highest paid individuals

The five highest paid individuals included one director of the Company for the year ended December 31, 2010 and two directors for the year ended December 31, 2009. The emoluments of the remaining four and three highest paid individuals for the years ended December 31, 2010 and 2009, respectively are as follows:

	YEAR ENDED DECEMBER 31, 2010	2009
Salaries and other benefits	**$ 1,511**	$ 695
Retirement benefit contribution	**2**	2
Stock-based compensation	**2,813**	1,738
Total emoluments	**$ 4,326**	$ 2,435

Their emoluments were within the following bands:

	YEAR ENDED DECEMBER 31, 2010	2009
HK$ 5,000,001 to HK$ 5,500,000	**—**	1
HK$ 6,000,001 to HK$ 6,500,000	**1**	1
HK$ 7,500,001 to HK$ 8,000,000	**—**	1
HK$ 8,500,001 to HK$ 9,000,000	**1**	—
HK$ 9,000,001 to HK$ 9,500,000	**2**	—
	4	3

During the years ended December 31, 2010 and 2009, no emoluments were paid by the Company to the directors or the five highest paid individuals as an inducement to join or upon joining the Company or as compensation for loss of office. None of the directors of the Company has waived any emoluments during the years ended December 31, 2010 and 2009.

APPENDIX TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010
(expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

A3. FIVE YEAR SUMMARY

Below is a five year summary of the Company's results, assets and liabilities:

	YEAR ENDED DECEMBER 31				
	2010	2009	2008	2007	2006
Revenue	$ 79,777	$ 36,038	$ 3,126	$ —	$ —
Income from mine operations	2,289	6,613	949	—	—
Net loss and comprehensive loss attributable to equity holders of the Company	$ (88,434)	$ (110,805)	$ (69,576)	$ (96,736)	$ (21,729)
Basic and diluted loss per share from continuing and discontinued operations	(0.66)	(0.83)	(0.54)	(1.89)	(1.31)

	AS AT DECEMBER 31				
	2010	2009	2008	2007	2006
Total assets	$ 961,866	$ 560,684	$ 99,948	$ 5,610	$ 2,315
Less: Total liabilities	(282,976)	(563,476)	(10,984)	(107,441)	(6,287)
Total net (liabilities)/assets	$ 678,890	$ (2,792)	$ 88,964	$ (101,831)	$ (3,972)

A4. SHARE REPURCHASE

During the year ended December 31, 2010, the Company repurchased its own shares through the Toronto Stock Exchange and Hong Kong Stock Exchange as follows:

Month of repurchase	Shares repurchased	Price per share Highest	Price per share Lowest	Aggregate consideration paid
August 2010	49	10.51	10.29	$ 509
September 2010	203	10.46	9.44	2,011
October 2010	9	10.03	10.03	85
November 2010	227	11.69	10.60	2,540
December 2010	423	13.86	11.67	5,212
	911			$ 10,357

As at December 31, 2010, the Company had cancelled 792 of the 911 shares repurchased and the remaining 119 common shares were cancelled in January 2011. None of the Company's subsidiaries repurchased, sold or redeemed any of the Company's shares during the year.

CORPORATE INFORMATION

DIRECTORS

Executive Directors:
Mr. Alexander Molyneux

Non-Executive Directors:
Mr. Peter Meredith (CHAIRMAN)
Mr. John Macken

Independent Non-Executive Directors:
Mr. Pierre Lebel (LEAD DIRECTOR)
Mr. André Deepwell
Mr. R. Stuart (Tookie) Angus
Mr. Robert Hanson
Mr. R. Edward Flood
Mr. W. Gordon Lancaster

AUDIT COMMITTEE
Mr. André Deepwell (CHAIR)
Mr. Pierre Lebel
Mr. W. Gordon Lancaster

NOMINATING AND CORPORATE GOVERNANCE COMMITTEE
Mr. Robert Hanson (CHAIR)
Mr. R. Stuart (Tookie) Angus
Mr. André Deepwell
Mr. Pierre Lebel
Mr. W. Gordon Lancaster

COMPENSATION AND BENEFITS COMMITTEE
Mr. R. Stuart (Tookie) Angus (CHAIR)
Mr. André Deepwell
Mr. Pierre Lebel
Mr. W. Gordon Lancaster
Mr. R. Edward Flood

SAFETY, HEALTH AND ENVIRONMENT COMMITTEE
Mr. Robert Hanson (CHAIR)
Mr. John Macken
Mr. Alexander Molyneux

MERGERS AND ACQUISITIONS COMMITTEE
Mr. Pierre Lebel (CHAIR)
Mr. R. Stuart (Tookie) Angus
Mr. R. Edward Flood

COMPANY SECRETARY
Beverly Ann Bartlett

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Hong Kong:
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