SouthGobi Resources

TSX: SGQ HKEx: 1878

INTERIM REPORT 2011

SouthGobi Resources Ltd.

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

June 30, 2011

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

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SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Comprehensive Income

(Unaudited)

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

	Notes	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Revenue		**$ 47,336**	$ 17,668	**$ 67,494**	$ 31,585
Cost of sales	4	**(37,592)**	(13,268)	**(50,060)**	(25,998)
Income from mine operations		**9,744**	4,400	**17,434**	5,587
Administration expenses	5	**(9,832)**	(8,336)	**(16,551)**	(14,370)
Evaluation and exploration expenses	6	**(4,356)**	(6,659)	**(6,347)**	(8,310)
Operating loss from continuing operations		**(4,444)**	(10,595)	**(5,464)**	(17,093)
Finance costs	7	**(2,378)**	(5,033)	**(7,054)**	(165,983)
Finance income	7	**74,406**	68,326	**33,935**	66,844
Income / (loss) before tax		**67,584**	52,698	**21,417**	(116,232)
Current income tax expense		**(1,722)**	(368)	**(3,475)**	(378)
Deferred income tax recovery		**1,461**	971	**2,779**	1,642
Net income / (loss) for the period attributable to equity holders of the Company		**67,323**	53,301	**20,721**	(114,968)
OTHER COMPREHENSIVE INCOME					
Gain / (loss) on available-for-sale assets, net of tax	11	**(39,573)**	-	**11,175**	-
Net comprehensive income / (loss) attributable to equity holders of the Company		**$ 27,750**	$ 53,301	**$ 31,896**	$ (114,968)
BASIC INCOME / (LOSS) PER SHARE	8	**$ 0.37**	$ 0.29	**$ 0.11**	$ (0.68)
DILUTED INCOME / (LOSS) PER SHARE	8	**$ 0.00**	$ (0.07) (i)	**$ (0.03)**	$ (0.68) (i)

(i) For further details on the diluted loss per share for the three and six months ended June 30, 2010 refer to Note 8.2

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

SOUTHGOBI RESOURCES LTD.

Condensed Consolidated Interim Statement of Financial Position

(Unaudited)
(Expressed in thousands of U.S. Dollars)

	Notes	As at June 30, 2011	As at December 31, 2010
ASSETS			
Current assets			
Cash and cash equivalents	9	**$ 282,733**	$ 492,038
Trade and other receivables	10	**67,705**	30,246
Short term investments	11	**15,003**	17,529
Inventories	12	**45,211**	26,160
Prepaid expenses and deposits		**15,679**	10,026
Total current assets		**426,331**	575,999
Non-current assets			
Property, plant and equipment	13	**390,865**	266,771
Deferred income tax assets		**14,221**	11,442
Long term investments	11	**135,196**	107,416
Other receivables		**238**	238
Total non-current assets		**540,520**	385,867
Total assets		**$ 966,851**	$ 961,866
EQUITY AND LIABILITIES			
Current liabilities			
Trade and other payables	14	**$ 32,369**	$ 24,137
Amounts due under line of credit facility	15	**1,666**	-
Current portion of convertible debenture	16	**4,285**	6,312
Total current liabilities		**38,320**	30,449
Non-current liabilities			
Convertible debenture	16	**211,892**	245,498
Deferred income tax liabilities		**5,562**	3,966
Decommissioning liability		**3,761**	3,063
Total non-current liabilities		**221,215**	252,527
Total liabilities		**259,535**	282,976
Shareholders' equity			
Common shares	17	**1,063,995**	1,061,560
Share option reserve	19	**36,102**	32,360
Investment revaluation reserve	19	**38,936**	27,761
Accumulated deficit	20	**(431,717)**	(442,791)
Total shareholders' equity		**707,316**	678,890
Total shareholders' equity and liabilities		**$ 966,851**	$ 961,866
Net current assets		**$ 388,011**	$ 545,550
Total assets less current liabilities		**$ 928,531**	$ 931,417

Commitments for expenditure (Note 23)
Contingencies (Note 24)

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

APPROVED BY THE BOARD:

"Andre Deepwell" — Director

"Pierre Lebel" — Director

SOUTHGOBI RESOURCES LTD.
Condensed Consolidated Interim Statement of Changes in Equity
(Unaudited)
(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, 2010	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	557	4,319	(1,674)	-	-	2,645
Share-based compensation charged to operations	-	-	5,726	-	-	5,726
Net loss and comprehensive loss for the period	-	-	-	-	(114,968)	(114,968)
Balances, June 30, 2010	183,863	$ 1,063,747	$ 26,352	$ -	$ (436,479)	$ 653,620
Balances, January 1, 2011	**183,485**	**$1,061,560**	**$ 32,360**	**$ 27,761**	**$ (442,791)**	**$ 678,890**
Shares issued for:						
Interest settlement on convertible debenture	**375**	**4,011**	**-**	**-**	**-**	**4,011**
Exercise of share options	**646**	**7,010**	**(2,323)**	**-**	**-**	**4,687**
Share-based compensation charged to operations	**-**	**-**	**6,065**	**-**	**-**	**6,065**
Common shares repurchased and cancelled	**(1,470)**	**(8,532)**	**-**	**-**	**(9,647)**	**(18,179)**
Share buy-back costs	**-**	**(54)**	**-**	**-**	**-**	**(54)**
Net income and comprehensive income for the period	**-**	**-**	**-**	**11,175**	**20,721**	**31,896**
Balances, June 30, 2011	**183,036**	**$1,063,995**	**$ 36,102**	**$ 38,936**	**$ (431,717)**	**$ 707,316**

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

SOUTHGOBI RESOURCES LTD.
Condensed Consolidated Interim Statement of Cash Flows
(Unaudited)
(Expressed in thousands of U.S. Dollars)

	Notes	Six months ended June 30, 2011	2010
OPERATING ACTIVITIES			
Income/(loss) for the period before tax		**$ 21,417**	$ (116,232)
Adjustments for:			
Depreciation and depletion		**10,493**	4,884
Share-based compensation	18	**6,065**	5,726
Fair value change on embedded derivative	16	**(33,641)**	(70,861)
Mark to market adjustment on investments		**488**	5,241
Interest income		**(782)**	(1,224)
Accrued interest expense		**6,970**	14,597
Interest paid		**(8,220)**	(13,816)
Income taxes paid		**(1,890)**	-
Loss on partial conversion of convertible debenture	16	**-**	151,353
Unrealized foreign exchange gain		**(730)**	(750)
Loss on disposal of property, plant and equipment		**704**	1,037
Accretion of decommissioning liability		**84**	33
Operating cash flows before movements in working capital		**958**	(20,012)
Increase in inventories		**(17,500)**	(9,044)
Increase in trade and other receivables		**(36,021)**	(5,008)
Increase in prepaid expenses and deposits		**(5,653)**	(2,732)
Increase in trade and other payables		**7,248**	1,661
Cash used in operating activities		**$ (50,968)**	$ (35,135)
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		**$ (135,778)**	$ (62,021)
Interest received		**822**	1,119
Proceeds from disposal of property, plant and equipment		**1,289**	-
Maturity of short term investments		**2,490**	15,000
Purchase of long term investments		**(45,461)**	(30,000)
Maturity of long term investments		**30,000**	-
Increase in other receivables		**-**	(13)
Cash used in investing activities		**$ (146,638)**	$ (75,915)
FINANCING ACTIVITIES			
Proceeds from issuance of common shares and exercise of stock options, net of issue costs		**$ 4,687**	$ 421,140
Repurchase of common shares, including transaction costs		**(18,233)**	-
Drawings under line of credit facilities		**102,216**	23,100
Repayments of line of credit facilities		**(100,489)**	(23,400)
Cash (used in)/generated from financing activities		**$ (11,819)**	$ 420,840
Effect of foreign exchange rate changes on cash		**120**	72
(Decrease)/increase in cash and cash equivalents		**(209,305)**	309,862
Cash and cash equivalents, beginning of period		**492,038**	357,342
Cash and cash equivalents, end of period		**$ 282,733**	$ 667,204
COMPRISED OF:			
Cash		**$ 257,707**	$ 637,087
Money market instruments		**25,026**	30,117
Total cash and cash equivalents		**$ 282,733**	$ 667,204

Supplemental cash flow information (Note 22)

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

1. CORPORATE INFORMATION

SouthGobi 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 condensed consolidated interim 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

These condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with International Accounting Standards ("IAS") 34 'Interim Financial Reporting' ("IAS 34") using accounting policies consistent with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC").

2.2 Basis of presentation

These condensed consolidated interim financial statements have been prepared on the basis of accounting policies and methods of computation consistent with those applied in the Company's December 31, 2010 consolidated annual financial statements.

2. BASIS OF PREPARATION (Continued)

2.3 Significant accounting judgments and estimates

The preparation of these condensed consolidated interim 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.

2. BASIS OF PREPARATION (Continued)

2.4 Adoption of new and revised standards and interpretations

The following new standards, amendments to standards and interpretations have been issued but are not effective during the year ended December 31, 2011:

- IFRS 7 (Amendment) — Enhanced disclosure on transfer of financial assets (i)
- IFRS 9 — New financial instruments standard that replaces IAS 39 for classification and measurement of financial assets (iv)
- IFRS 10 — New standard to establish principles for the presentation and preparation of consolidated financial statements when an entity controls multiple entities (ii)
- IFRS 11 — New standard to account for the rights and obligations in accordance with a joint agreement (ii)
- IFRS 12 — New standard for the disclosure of interests in other entities not within the scope of IFRS 9/IAS 39 (ii)
- IFRS 13 — New standard on the measurement and disclosure of fair value (ii)
- IAS 1 (Amendment) — Presentation of other comprehensive income (iii)
- IAS 28 (Amendment) — New standard issued that supercedes IAS 28 (2003) to prescribe the accounting for investments in associates and joint ventures (ii)

(i) Effective for annual periods beginning on or after July 1, 2011
(ii) Effective for annual periods beginning on or after January 1, 2013
(iii) Effective for annual periods beginning on or after July 1, 2012
(iv) Effective for annual periods beginning on or after January 1, 2013, current proposal to delay until 2015

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. SEGMENTED INFORMATION

The basis of segmentation, basis of measurement of segment profit or loss and geographical segmentation is consistent with those applied in the Company's December 31, 2010 consolidated annual financial statements.

At June 30, 2011, the Company has one reportable operating segment, being the Mongolian Coal Division, which had seven active customers with the largest customer accounting for 45% of trade receivables and the other customers accounting for the remaining 55% of trade receivables. For the six months ended June 30, 2011, the largest customer accounted for 42% of revenues, the second largest customer accounted for 25% of revenue, the third largest customer accounted for 20% of revenue and the other customers accounted for the remaining 13% of revenue.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

3. SEGMENTED INFORMATION (Continued)

The following is an analysis of the carrying amounts of segment assets, segment liabilities and reported segment profit or loss and revenues analyzed by operating segment and reconciled to the Company's condensed consolidated interim financial statements:

	Mongolian Coal Division	Unallocated (i)	Consolidated Total
Segment assets			
As at June 30, 2011	**$ 528,763**	**$ 438,088**	**$ 966,851**
As at December 31, 2010	342,591	619,275	961,866
Segment liabilities			
As at June 30, 2011	**$ 36,617**	**$ 222,918**	**$ 259,535**
As at December 31, 2010	25,408	257,568	282,976
Segment income / (loss)			
For the three months ended June 30, 2011	**$ 1,633**	**$ 65,690**	**$ 67,323**
For the three months ended June 30, 2010	(3,478)	56,779	53,301
For the six months ended June 30, 2011	**5,263**	**15,458**	**20,721**
For the six months ended June 30, 2010	(4,904)	(110,064)	(114,968)
Segment revenues			
For the three months ended June 30, 2011	**$ 47,336**	**$ -**	**$ 47,336**
For the three months ended June 30, 2010	17,668	-	17,668
For the six months ended June 30, 2011	**67,494**	**-**	**67,494**
For the six months ended June 30, 2010	31,585	-	31,585

(i) The unallocated amount contains all amounts associated with the Corporate Division

The following is an analysis of the revenues and non-current assets by geographical area and reconciled to the Company's condensed consolidated interim financial statements:

	Mongolia	Hong Kong	Canada	Consolidated Total
Revenues				
For the three months ended June 30, 2011	**$ 47,336**	**$ -**	**$ -**	**$ 47,336**
For the three months ended June 30, 2010	17,668	-	-	17,668
For the six months ended June 30, 2011	**67,494**	**-**	**-**	**67,494**
For the six months ended June 30, 2010	31,585	-	-	31,585
Non-current assets				
As at June 30, 2011	**$ 400,868**	**$ 342**	**$ 139,310**	**$ 540,520**
As at December 31, 2010	$ 277,201	$ 401	$ 108,265	$ 385,867

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

4. COST OF SALES

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Operating expenses	**$ 29,939**	$ 10,964	**$ 39,708**	$ 21,171
Depreciation and depletion	**7,653**	2,304	**10,352**	4,827
Cost of sales	**$ 37,592**	$ 13,268	**$ 50,060**	$ 25,998

5. ADMINISTRATION EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Corporate administration	**$ 1,634**	$ 1,821	**$ 3,387**	$ 2,938
Legal	**457**	320	**680**	519
Professional fees	**842**	1,043	**1,165**	1,356
Salaries and benefits	**3,834**	3,251	**6,797**	6,606
Sustainability and community relations	**145**	105	**480**	261
Public infrastructure	**3,202**	1,603	**3,938**	2,076
Depreciation	**41**	7	**116**	13
Foreign exchange (gain)/loss	**(323)**	186	**(12)**	601
Administration expenses	**$ 9,832**	$ 8,336	**$ 16,551**	$ 14,370

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

6. EVALUATION AND EXPLORATION EXPENSES

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Drilling and trenching	**$ 3,093**	$ 5,071	**$ 3,905**	$ 5,785
Geological	**21**	173	**21**	268
Geophysics	**99**	596	**99**	667
License fees	**231**	309	**489**	601
Depreciation	**13**	9	**25**	21
Salaries	**274**	170	**503**	346
Overhead and other	**625**	331	**1,305**	622
Evaluation and exploration expenses	**$ 4,356**	$ 6,659	**$ 6,347**	$ 8,310

7. FINANCE COSTS AND INCOME

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Loss on partial conversion of convertible debenture (Note 16)	**$ -**	$ -	**$ -**	$ 151,353
Interest expense on convertible debenture (Note 16)	**2,177**	4,982	**6,684**	14,508
Interest expense on line of credit facility (Note 15)	**156**	32	**286**	89
Accretion of decommissioning liability	**45**	19	**84**	33
Finance costs	**$ 2,378**	$ 5,033	**$ 7,054**	$ 165,983

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

7. FINANCE COSTS AND INCOME (Continued)

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Fair value gain on embedded derivatives in convertible debenture (Note 16)	**$ 70,422**	$ 72,232	**$ 33,641**	$ 70,861
Mark to market gain/(loss) on investments (Note 11)	**3,629**	(4,555)	**(488)**	(5,241)
Interest income	**355**	649	**782**	1,224
Finance income	**$ 74,406**	$ 68,326	**$ 33,935**	$ 66,844

8. EARNINGS PER SHARE ("EPS")

8.1 Basic EPS

The basic EPS is computed by dividing the net income/(loss) in the period by the weighted average number of common shares outstanding during the period.

The calculation of basic EPS for the three and six months ended June 30, 2011 and 2010, is based on the following data:

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Net income/(loss) for the period	**$ 67,323**	$ 53,301	**$ 20,721**	$ (114,968)
Weighted average number of shares	**183,745**	183,777	**183,746**	168,955
Basic income/(loss) per share	**$ 0.37**	$ 0.29	**$ 0.11**	$ (0.68)

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

8. EARNINGS PER SHARE (Continued)

8.2 Diluted EPS

The diluted EPS reflects the potential dilution of common share equivalents, such as outstanding stock options and convertible debt, in the weighted average number of common shares outstanding during the period, if dilutive.

The calculation of diluted EPS for the three and six months ended June 30, 2011, includes the following adjustments:

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Earnings				
Net income/(loss) for the period	**$ 67,323**	$ 53,301	**$ 20,721**	$ (114,968)
Interest on convertible debenture	**2,177**	5,001	**6,684**	- (i)
Fair value gain on convertible debenture	**(70,422)**	(72,232)	**(33,641)**	- (i)
Diluted net income/(loss) for the period	**$ (922)**	$ (13,930)	**$ (6,236)**	$ (114,968)
Number of shares				
Weighted average number of shares	**183,745**	183,777	**183,746**	168,955
Convertible debenture	**20,264**	21,323	**20,931**	- (i)
Stock options issues by the Company	**1,215**	2,122	**2,098**	- (i)
Diluted weighted average number of shares	**205,224**	207,222	**206,775**	168,955
Diluted income/(loss) per share	**$ 0.00**	$ (0.07) (ii)	**$ (0.03)**	$ (0.68) (ii)

(i) All of the stock options and the convertible debenture were anti-dilutive for this period
(ii) The previously reported diluted earnings per share for the three months ended June 30, 2010 of $0.28 per share was restated to reflect all amounts relating to the convertible debenture, including the change in fair value of the embedded derivative in the convertible debenture for the period. For the six months ended June 30, 2010, the CIC convertible debenture was anti-dilutive and no change was required.

Potentially dilutive items not included in the calculation of diluted EPS for the three months ended June 30, 2011, were 5,172 (2010: 2,488) stock options that were anti-dilutive.

Potentially dilutive items not included in the calculation of diluted EPS for the six months ended June 30, 2011, were 1,266 (2010: 6,839) stock options that were anti-dilutive.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

9. 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 maturities of three months or less. The Company's cash and cash equivalents are denominated in the following currencies:

	As at June 30, 2011	As at December 31, 2010
Denominated in U.S. dollars	**$ 278,549**	$ 486,404
Denominated in Hong Kong dollars	**2,133**	3,666
Denominated in Canadian dollars	**1,695**	1,182
Others	**356**	786
Cash and cash equivalents	**$ 282,733**	$ 492,038

10. 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 taxes ("VAT") and goods and services taxes ("GST") due from various government authorities. These are broken down as follows:

	As at June 30, 2011	As at December 31, 2010
Trade receivables	**$ 50,173**	$ 15,297
VAT/GST receivable	**13,651**	14,541
Other receivables	**3,881**	408
Total trade and other receivables	**$ 67,705**	$ 30,246

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

	As at June 30, 2011	As at December 31, 2010
Less than 1 month	**$ 48,147**	$ 15,604
1 to 3 months	**3,809**	1,869
3 to 6 months	**2,036**	2,600
Over 6 months	**13,713**	10,173
Total trade and other receivables	**$ 67,705**	$ 30,246

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

10. TRADE AND OTHER RECEIVABLES (Continued)

At June 30, 2011, 70% of the trade and other receivables that were outstanding over one month are VAT/GST receivables and 99% of 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 Company holds no collateral for any receivable amounts outstanding as at June 30, 2011.

Included in trade and other receivables are amounts due from related parties which are disclosed in Note 21. The amounts are unsecured, interest free and repayable upon written notice given from the Company.

11. INVESTMENTS

The Company's investments are broken down as follows:

	As at	
	June 30, 2011	December 31, 2010
Short term investments		
Money market investments (i)	**$ 15,003**	$ 17,529
Long term investments		
Investment in Kangaroo Resources Ltd. (iii)	**9,926**	10,235
Investment in Aspire Mining Ltd. (iv)	**65,239**	52,008
Money market investments (ii)	**60,031**	45,173
	135,196	107,416
Total short and long term investments	**$ 150,199**	$ 124,945

(i) Money market investments with original maturities greater than three months and less than one year
(ii) Money market investments with original maturities greater than one year
(iii) At June 30, 2011, the Company owned 1.5% of Kangaroo's issued and outstanding shares
(iv) At June 30, 2011, the Company owned 19.8% of Aspire's issued and outstanding shares

11. INVESTMENTS (Continued)

11.1 Investment in Kangaroo

The Company classifies its investment in Kangaroo as Fair Value Through Profit and Loss ("FVTPL") with any change in value being recognized through profit and loss. During the three months ended June 30, 2011, the Company recognized an unrealized mark to market gain of $3,453 related to its investment in Kangaroo (2010: loss of $4,509). During the six months ended June 30, 2011, the Company recognized an unrealized mark to market loss of $309 related to its investment in Kangaroo (2010: $5,211).

11.2 Investment in Aspire

On December 23, 2010, the Company announced it had completed a private placement with Aspire Mining Limited ("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. Pursuant to this right, in the six months ended June 30, 2011, the Company purchased an additional 798 shares for $462, bringing the Company's total ownership in Aspire at 106,658 shares, approximately 19.8% of the issued and outstanding shares.

The Company classifies 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 as it does not have the ability to influence the operating and financial decisions of Aspire and it is neither a subsidiary nor a joint venture. During the three months ended June 30, 2011, the Company recognized an unrealized loss of $39,573, net of tax, in other comprehensive income related to its investment in Aspire (2010: $nil). During the six months ended June 30, 2011, the Company recognized an unrealized gain of $11,175, net of tax, in other comprehensive income related to its investment in Aspire (2010: $nil).

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

12. INVENTORIES

The Company's inventories are broken down as follows:

	As at June 30, 2011	As at December 31, 2010
Stockpiles [(i)]	**$ 12,430**	$ 2,395
Materials and supplies	**32,781**	23,765
Total inventories	**$ 45,211**	$ 26,160

(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 three months ended June 30, 2011, is $34,574 (2010: $12,568). The cost of inventories recognized as an expense during the six months ended June 30, 2011, is $44,860 (2010: $24,743).

As at June 30, 2011, the Company anticipates the entire stockpiles balance of $12,430 will be realized within twelve months.

13. 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 December 31, 2010	$ 217,433	$ 865	$ 1,350	$ 5,049	$ 14,249	$ 38,054	$ 16,138	$ 293,138
Additions	**79,498**	**294**	**30**	**1,563**	**231**	**29,204**	**33,587**	**144,407**
Disposals	**(6,481)**	**-**	**-**	**-**	**-**	**-**	**-**	**(6,481)**
Reclassifications	**-**	**-**	**-**	**-**	**204**	**-**	**(204)**	**-**
As at June 30, 2011	**$290,450**	**$ 1,159**	**$ 1,380**	**$ 6,612**	**$ 14,684**	**$ 67,258**	**$ 49,521**	**$ 431,064**
Accumulated depreciation and impairment								
As at December 31, 2010	$ (20,915)	$ (418)	$ (258)	$ (1,376)	$ (2,673)	$ (727)	$ -	$ (26,367)
Charge for the period	**(15,553)**	**(89)**	**(172)**	**(442)**	**(961)**	**(883)**	**-**	**(18,100)**
Eliminated on disposals	**4,268**	**-**	**-**	**-**	**-**	**-**	**-**	**4,268**
As at June 30, 2011	**$ (32,200)**	**$ (507)**	**$ (430)**	**$ (1,818)**	**$ (3,634)**	**$ (1,610)**	**$ -**	**$ (40,199)**
Net book value								
As at December 31, 2010	$ 196,518	$ 447	$ 1,092	$ 3,673	$ 11,576	$ 37,327	$ 16,138	$ 266,771
As at June 30, 2011	**$258,250**	**$ 652**	**$ 950**	**$ 4,794**	**$ 11,050**	**$ 65,648**	**$ 49,521**	**$ 390,865**

In the three months ended June 30, 2011, the Company capitalized interest of $2,827 (2010: $22) into construction in progress. In the six months ended June 30, 2011, the Company capitalized interest of $3,269 (2010: $274) into construction in progress.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

14. 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	
	June 30, 2011	December 31, 2010
Less than 1 month	$ 32,260	$ 24,006
1 to 3 months	18	33
3 to 6 months	6	72
Over 6 months	85	26
Total trade and other payables	$ 32,369	$ 24,137

Included in trade and other payables are amounts due to related parties which are disclosed in Note 21.

15. 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 $6,800) 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.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

15. LINE OF CREDIT FACILITY (Continued)

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

	As at	
	June 30, 2011	**December 31, 2010**
Principal amount	**$ 1,665**	$ -
Interest payable	**1**	-
Amounts due under line of credit facility	**$ 1,666**	$ -

16. 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% per annum (6.4% payable semi-annually in cash and 1.6% payable annually in the Company's shares) and with a maximum term of 30 years.

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 three months ended March 31, 2010.

Based on the Company's valuations as at June 30, 2011, the fair value of the embedded derivatives decreased by $70,422 compared to March 31, 2011 (2010: $72,232). This decrease was recorded in finance income for the three months ended June 30, 2011. The fair value of the embedded derivatives decreased by $33,641 compared to December 31, 2010 (2010: $70,861). This decrease was recorded in finance income for the six months ended June 30, 2011.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

16. CONVERTIBLE DEBENTURE (Continued)

In the three months ended June 30, 2011, the Company also recorded an interest expense of $5,005 (2010: $5,001) related to the convertible debenture. In the six months ended June 30, 2011, the Company recorded an interest expense of $9,953 (2010: $14,782) 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%.

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Balance, beginning of period	**$ 289,529**	$ 360,490	**$ 251,810**	$ 547,063
Interest expense on convertible debenture	**5,005**	5,001	**9,953**	14,782
Decline in fair value of embedded derivatives	**(70,422)**	(72,232)	**(33,641)**	(70,861)
Loss on conversion of convertible debenture	**-**	-	**-**	151,353
Conversion of convertible debenture	**-**	-	**-**	(347,643)
Interest paid	**(7,935)**	(13,721)	**(11,945)**	(15,156)
Balance, end of the period	**$216,177**	$ 279,538	**$216,177**	$ 279,538

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

	As at June 30, 2011	As at December 31, 2010
Debt host	**$ 90,656**	$ 90,621
Fair value of embedded derivatives	**121,236**	154,877
Interest payable	**4,285**	6,312
Convertible debenture	**$ 216,177**	$ 251,810
FINANCIAL STATEMENT PRESENTATION		
Current liabilities		
Current portion of convertible debenture	**$ 4,285**	$ 6,312
Non-current liabilities		
Convertible debenture	**211,892**	245,498
Convertible debenture	**$ 216,177**	$ 251,810

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

16. CONVERTIBLE DEBENTURE (Continued)

The assumptions used in the Company's valuation models as at June 30, 2011 and December 31, 2010 are as follows:

	As at	
	June 30, 2011	**December 31, 2010**
Floor conversion price	**Cdn$8.88**	Cdn$8.88
Ceiling conversion price	**Cdn$11.88**	Cdn$11.88
Historical volatility	**72%**	73%
Risk free rate of return	**3.49%**	3.48%
Foreign exchange spot rate (U.S.$ to Cdn$)	**1.04**	1.01
Forward foreign exchange rate curve (U.S.$ to Cdn$)	**1.00 - 1.13**	0.97 - 1.14

17. SHARE CAPITAL

The Company has authorized an unlimited number of common and preferred shares with no par value. At June 30, 2011, the Company had 183,136 common shares outstanding (2010: 183,863) and no preferred shares outstanding (2010: nil).

During the six months ended June 30, 2011, the Company repurchased 1,470 common shares on the Toronto Stock Exchange and Hong Kong Stock Exchange (2010: nil) for an average price of $12.37 per share. As at June 30, 2011, the Company had cancelled 1,370 of the 1,470 repurchased common shares. The remaining 100 common shares were cancelled in July 2011.

The weighted average share price during the six months ended June 30, 2011 was Cdn$13.95 (2010: Cdn$15.28).

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

18. SHARE-BASED PAYMENTS

18.1 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 17, 2011, 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.

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 six months ended June 30, 2011, were granted with a weighted average maximum exercise period of 5.00 years (2010: 5.00 years) and a weighted average vesting period of 2.01 years (2010: 2.01 years).

During the six months ended June 30, 2011, the Company granted 1,020 stock options (2010: 200) to officers, employees, directors and other eligible persons at exercise prices ranging from Cdn$10.79 to Cdn$14.09 (2010: Cdn$15.09) and expiry dates ranging from January 8, 2016 to May 30, 2016 (2010: February 8, 2015). The weighted average fair value of the options granted in the six months ended June 30, 2011, was estimated at $7.01 (Cdn$6.84) (2010: $7.54, Cdn$8.06) per option at the grant date using the Black-Scholes option pricing model. The weighted average assumptions used for the calculation were:

	Six months ended June 30,	
	2011	**2010**
Risk free interest rate	**2.34%**	2.19%
Expected life	**3.5 years**	3.5 years
Expected volatility (i)	**68.76%**	74.78%
Expected dividend per share	**$nil**	$nil

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

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

18. SHARE-BASED PAYMENTS (Continued)

18.1 Stock option plan (continued)

A share-based compensation cost of $6,680 for the options granted in the six months ended June 30, 2011 (2010: $1,492) will be amortized over the vesting period, of which $1,125 was recognized in the six months ended June 30, 2011 (2010: $345).

The total share-based compensation calculated for the three months ended June 30, 2011 was $3,350 (2010: $2,754). Share-based compensation of $2,848 (2010: $2,297) has been allocated to Administration expenses, $300 (2010: $282) has been allocated to Cost of sales and $202 (2010: $175) has been allocated to Evaluation and exploration expenses.

The total share-based compensation calculated for the six months ended June 30, 2011 was $6,065 (2010: $5,726). Share-based compensation of $4,934 (2010: $4,824) has been allocated to Administration expenses, $685 (2010: $556) has been allocated to Cost of sales and $446 (2010: $346) has been allocated to Evaluation and exploration expenses.

18.2 Outstanding stock options

The following is a summary of stock option transactions under the Company's stock option plan:

	Six months ended June 30, 2011		Year ended December 31, 2010	
	Number of options	**Weighted average exercise price (Cdn$)**	**Number of options**	**Weighted average exercise price (Cdn$)**
Balance, beginning of period	**9,276**	**$ 10.82**	7,254	$ 9.11
Options granted	**1,020**	**13.13**	3,446	12.48
Options exercised	**(643)**	**7.08**	(1,099)	4.04
Options forfeited	**(1,038)**	**12.99**	(325)	13.31
Balance, end of period	**8,615**	**$ 11.11**	9,276	$ 10.82

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

18. SHARE-BASED PAYMENTS (Continued)

18.2 Outstanding stock options (continued)

The following table summarizes information about stock options outstanding and exercisable as at June 30, 2011:

Exercise price (Cdn$)	Options Outstanding: Options outstanding	Options Outstanding: Weighted-average exercise price (Cdn$)	Options Outstanding: Weighted-average remaining contractual life (years)	Options Exercisable: Options outstanding and exercisable	Options Exercisable: Weighted-average exercise price (Cdn$)	Options Exercisable: Weighted-average remaining contractual life (years)
$4.81 - $6.00	**1,637**	**$ 5.56**	**1.62**	**1,340**	**$ 5.66**	**1.45**
$7.16 - $11.24	**1,805**	**9.25**	**3.95**	**950**	**8.57**	**3.60**
$11.46 - $14.25	**4,172**	**12.80**	**3.76**	**695**	**12.90**	**2.24**
$15.07 - $18.86	**1,001**	**16.44**	**2.39**	**622**	**16.59**	**2.24**
	8,615	**$ 11.11**	**3.23**	**3,607**	**$ 9.71**	**2.30**

19. RESERVES

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

	As at June 30, 2011	As at December 31, 2010
Share option reserve	**$ 36,102**	$ 32,360
Investment revaluation reserve	**38,936**	27,761
Total reserves	**$ 75,038**	$ 60,121

19.1 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 18. The following is an analysis of movement in the share option reserve:

	Six months ended June 30, 2011	Six months ended June 30, 2010
Balance, beginning of period	**$ 32,360**	$ 22,300
Share-based compensation charged to operations	**6,065**	5,726
Exercise of share options	**(2,323)**	(1,674)
Balance, end of period	**$ 36,102**	$ 26,352

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

19. RESERVES (Continued)

19.2 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 movement in the investment revaluation reserve:

	Six months ended June 30, 2011	Six months ended June 30, 2010
Balance, beginning of period	$ 27,761	$ -
Gain arising on revaluation of available-for-sale financial assets (Note 11)	12,771	-
Income tax relating to gain arising on revaluation of available-for-sale financial assets	(1,596)	-
Balance, end of period	**$ 38,936**	$ -

20. ACCUMULATED DEFICIT AND DIVIDENDS

The Company has incurred losses since inception and at June 30, 2011, the Company has accumulated a deficit of $431,717 (December 31, 2010: $442,791).

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

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

21. RELATED PARTY TRANSACTIONS

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

		% equity interest	
	Country of	As at June 30,	
Name	**incorporation**	**2011**	**2010**
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%

For the six months ended June 30, 2011 and 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's parent company and at June 30, 2011 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.
- 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.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

21. RELATED PARTY TRANSACTIONS (Continued)

21.1 Related party expenses

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Corporate administration	**$ 580**	$ 912	**$ 923**	$ 1,521
Salaries and benefits	**357**	320	**625**	1,128
Total related party expenses	**$ 937**	$ 1,232	**$ 1,548**	$ 2,649

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
GMM	**$ 593**	$ 466	**$ 987**	$ 1,447
Ivanhoe Mines	**14**	-	**70**	-
Ivanhoe Aviation	**-**	524	**-**	824
I2MS	**330**	242	**491**	378
Total related party expenses	**$ 937**	$ 1,232	**$ 1,548**	$ 2,649

21.2 Related party expense recoveries

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Corporate administration	**$ 116**	$ -	**$ 233**	$ -

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

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Ivanhoe Mines	**$ 78**	$ -	**$ 156**	$ -
Ivanhoe Energy	**38**	-	**77**	-
Total related party expense recoveries	**$ 116**	$ -	**$ 233**	$ -

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

21. RELATED PARTY TRANSACTIONS (Continued)

21.3 Related party assets

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

	As at	
	June 30, 2011	**December 31, 2010**
Amounts due from GMM	**$ 238**	$ 238
Amounts due from Ivanhoe Mines	**311**	156
Amounts due from Ivanhoe Energy	**13**	38
Total assets due from related parties	**$ 562**	$ 432

21.4 Related party liabilities

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

	As at	
	June 30, 2011	**December 31, 2010**
Amounts payable to GMM	**$ 159**	$ 549
Amounts payable to Ivanhoe Mines	**8**	1
Amounts payable to I2MS	**330**	367
Total liabilities due to related parties	**$ 497**	$ 917

22. SUPPLEMENTAL CASH FLOW INFORMATION

22.1 Non-cash financing and investing activities

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

	Six months ended June 30,	
	2011	**2010**
Conversion of convertible debenture	**$ -**	$ 347,643
Interest settlement on convertible debenture	**4,011**	1,436
Transfer of share option reserve upon exercise of options	**2,323**	1,674
Total non-cash financing and investing activities	**$ 6,334**	$ 350,753

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

22. SUPPLEMENTAL CASH FLOW INFORMATION (Continued)

22.2 Cash payments for interest and taxes

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

	Six months ended June 30, 2011	Six months ended June 30, 2010
Interest paid	**$ 8,220**	$ 13,816
Taxes paid	**1,890**	-
Total cash payments	**$ 10,110**	$ 13,816

23. COMMITMENTS FOR EXPENDITURE

As at June 30, 2011, the Company had the following commitments that have not been disclosed elsewhere in these condensed consolidated interim financial statements:

	As at June 30, 2011			
	Within 1 year	**2-3 years**	**Over 3 years**	**Total**
Capital expenditure commitments	**$161,366**	**$ 13,528**	**$ -**	**$174,894**
Minimum rental and lease payments	**2,051**	**1,770**	**-**	**3,821**
Commitments	**$163,417**	**$ 15,298**	**$ -**	**$178,715**

24. 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 condensed consolidated interim financial statements of the Company.

25. APPROVAL OF THE FINANCIAL STATEMENTS

The condensed consolidated interim financial statements of SouthGobi Resources Ltd. for the six months ended June 30, 2011 were reviewed by the Audit Committee and approved and authorized for issue by the Board of Directors on August 10, 2011.

(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 in the half-year interim report and not shown elsewhere in this report is as follows:

A1. TAXATION ON PROFITS

	Six months ended June 30, 2011	Six months ended June 30, 2010
Current tax expense for period in:		
Canada	**$ -**	$ -
Hong Kong	**-**	-
Mongolia	**3,475**	378
Other jurisdictions	**-**	-
Deferred tax recovery for period	**(2,779)**	(1,642)
Tax recovery attributable to the Company and its subsidiaries	**$ 696**	$ (1,264)

The Company and its subsidiaries in Canada are subject to Canadian federal and provincial tax for the estimated assessable profit at a rate of 26.5%. The Company had no assessable profit in Canada for the six months ended June 30, 2011.

The Company's subsidiaries in Hong Kong are subject to Hong Kong profits tax 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 for the six months ended June 30, 2011.

The Company's subsidiaries in Mongolia are subject to Mongolian income tax at a rate of 25%. In the six months ended June 30, 2011 the Company recorded a current income tax charge of $3,475 (2010: $378) related to assessable profit derived from Mongolia.

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

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

A2. SHARE REPURCHASE

During the six months ended June 30, 2011, the Company repurchased its own common 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
January 2011	**372**	**14.69**	**12.32**	**$ 5,294**
February 2011	**223**	**16.02**	**14.51**	**3,474**
May 2011	**239**	**11.89**	**11.47**	**2,777**
June 2011	**636**	**11.25**	**10.10**	**6,649**
	1,470			**$ 18,194**

As at June 30, 2011, the Company had cancelled 1,370 of the 1,470 common shares repurchased and the remaining 100 common shares were cancelled in July 2011. None of the Company's subsidiaries repurchased, sold or redeemed any of the Company's shares during the six months ended June 30, 2011.

A3. COMPLIANCE WITH CORPORATE GOVERNANCE

The Company has, throughout the six months ended June 30, 2011, applied the principles and complied with the requirements of its corporate governance practices as defined by the Board of Directors and all applicable statutory, regulatory and stock exchange listings standards.

A4. COMPLIANCE WITH MODEL CODE

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

The Board of Directors confirms that all of the Directors of the Company have complied with the required policies in the Company's Corporate Disclosure, Confidentiality and Securities Trading policy throughout the six months ended June 30, 2011.

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

A5. DIRECTORS' AND CHIEF EXECUTIVES' INTEREST IN SHARES AND SHARE OPTIONS

At June 30, 2011, the interests of the directors, Mr. Curt Church, the Chief Operating Officer of the Company and Terry Krepiakevich, the Chief Financial Officer of the Company, 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.	N/A	nil	nil
Alexander Molyneux	SouthGobi Resources Ltd.	Personal	20	0.011%
	Ivanhoe Mines Ltd.	N/A	nil	nil
Pierre Lebel	SouthGobi Resources Ltd.	Personal	5	0.003%
	Ivanhoe Mines Ltd.	N/A	nil	nil
André Deepwell	SouthGobi Resources Ltd.	Personal	2	0.001%
	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	23	0.012%
	Ivanhoe Mines Ltd.	N/A	nil	nil
John Macken	SouthGobi Resources Ltd.	N/A	nil	nil
	Ivanhoe Mines Ltd.	Personal	219	0.031%
R. Edward Flood	SouthGobi Resources Ltd.	N/A	nil	nil
	Ivanhoe Mines Ltd.	Personal	34	0.005%
Gordon Lancaster	SouthGobi Resources Ltd.	N/A	nil	nil
	Ivanhoe Mines Ltd.	N/A	nil	nil
Curt Church	SouthGobi Resources Ltd.	Personal	6	0.001%
	Ivanhoe Mines Ltd.	N/A	nil	nil
Terry Krepiakevich	SouthGobi Resources Ltd.	Personal	1	0.001%
	Ivanhoe Mines Ltd.	N/A	nil	nil

(Expressed in thousands of U.S. Dollars and shares in thousands, unless otherwise indicated)

A5. DIRECTORS' AND CHIEF EXECUTIVES' INTEREST IN SHARES AND SHARE OPTIONS (Continued)

Options

Name	Name of company	Number of options held
Peter Meredith	SouthGobi Resources Ltd.	685
	Ivanhoe Mines Ltd.	2,382
Alexander Molyneux	SouthGobi Resources Ltd.	950
	Ivanhoe Mines Ltd.	29
Pierre Lebel	SouthGobi Resources Ltd.	190
	Ivanhoe Mines Ltd.	nil
André Deepwell	SouthGobi Resources Ltd.	165
	Ivanhoe Mines Ltd.	nil
R. Stuart (Tookie) Angus	SouthGobi Resources Ltd.	115
	Ivanhoe Mines Ltd.	nil
Robert Hanson	SouthGobi Resources Ltd.	115
	Ivanhoe Mines Ltd.	83
John Macken	SouthGobi Resources Ltd.	411
	Ivanhoe Mines Ltd.	5,551
R. Edward Flood	SouthGobi Resources Ltd.	115
	Ivanhoe Mines Ltd.	125
Gordon Lancaster	SouthGobi Resources Ltd.	150
	Ivanhoe Mines Ltd.	nil
Curt Church	SouthGobi Resources Ltd.	595
	Ivanhoe Mines Ltd.	nil
Terry Krepiakevich	SouthGobi Resources Ltd.	400
	Ivanhoe Mines Ltd.	22

SouthGobi Resources Ltd.

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

June 30, 2011
(Unaudited)
(Expressed in U.S. dollars)

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

1. OVERVIEW

SouthGobi Resources Ltd., (which, together with its subsidiaries, is collectively referred to as the "Company" or "SouthGobi") is an integrated 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.

SouthGobi's common shares trade on the Toronto Stock Exchange ("TSX") under the symbol SGQ and on the Hong Kong Stock Exchange ("HKEX") 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 Mongolia-China border, is the Company's flagship producing asset. SouthGobi 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 together with raw medium and higher-ash coals, which can be washed into semi-soft coking coal. From the commencement of production in late 2008 until June 30, 2011, the Company has sold approximately 5.48 million tonnes of coal from the Ovoot Tolgoi Mine. During the second quarter of 2011, the Company sold approximately 1.05 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. On June 3, 2011, the Company announced it had successfully registered the resource associated with the Soumber Deposit with the Mineral Resource Authority of Mongolia ("MRAM"). Further, on July 6, 2011, the Company announced that MRAM had issued the Company a mining license pertaining to the Soumber Deposit. The new 10,993 ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions.

1. OVERVIEW (Continued)

The Company has conducted substantial exploration activities at the Ovoot Tolgoi Underground Deposit and has delineated mineral resources at this project. The Ovoot Tolgoi Underground Deposit is covered by the existing Ovoot Tolgoi Mining License.

In addition, the Company owns the Tsagaan Tolgoi Deposit in Mongolia, which has a mining license.

SouthGobi owns 19.8% 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 August 1, 2011, SouthGobi's interest in Aspire had a market value of approximately $65.7 million.

1.1 Corporate Developments

Ovoot Tolgoi Complex

Total sales for the quarter ended June 30, 2011 were 1.05 million tonnes with an average realized selling price of $54 per tonne. Total sales for the quarter ended June 30, 2010 were 0.45 million tonnes with an average realized selling price of $43 per tonne. Total sales for the first half of 2011 were 1.50 million tonnes at an average realized price of $53 per tonne.

Coal shipments from the Ovoot Tolgoi Mine commenced in late September 2008. Since then, SouthGobi continued coordinating efforts with the Mongolian Government and various agencies to improve border crossing capacity for coal shipments. Four designated coal truck entry points have now been constructed on the Chinese side of the Shivee Khuren-Ceke border crossing together with an additional four separate points for empty trucks to exit China for Mongolia. The Company has taken the initiative to undertake the road works required on the Mongolian side of the border with the aim of having the parallel coal dedicated border crossing points open during 2011.

1. OVERVIEW (Continued)

SouthGobi continues to ramp up production at the Ovoot Tolgoi Mine. Additional fourth and fifth fleets of equipment have been ordered for delivery in 2011. Furthermore, in 2011, the Company upgraded its first mining fleet by replacing the Liebherr 994 hydraulic shovel with a newer, more productive Liebherr R9250 hydraulic excavator that will work primarily 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.

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.

The coal rank at the Ovoot Tolgoi Complex 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.

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. The facility is expected be operational at the end of 2011.

1. OVERVIEW (Continued)

On July 5, 2011, the Company entered into an agreement with Ejinaqi Jinda Coal Industry Co. Ltd ("Ejin Jinda"), a subsidiary of China Mongolia Coal Co. Ltd. ("CMC"), to toll wash coal from the Ovoot Tolgoi Mine. The agreement has a duration of 5-years from commencement (expected in early 2012) and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input raw coal. Raw higher-ash and medium-ash coals from the Ovoot Tolgoi Mine will be washed at this facility. Washed coal will generally meet semi-soft coking coal specifications.

Ejin Jinda's wet washing facility is located approximately 10km inside China from the Mongolia-China border crossing (i.e., approximately 50km from the Ovoot Tolgoi Mine). Medium and higher-ash coals with only basic processing through Ovoot Tolgoi's on-site dry coal handling facility will be transported from the Ovoot Tolgoi Mine to the facility under a separate transport agreement. Based on preliminary samples, the Company expects these coals can then be washed to produce coals with ash in the range of 8% to 11% at a yield of 85% to 90%. Ejin Jinda will charge the Company a single toll washing fee which will cover their expenses, capital recovery and profit.

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 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.

On June 3, 2011, the Company announced it had successfully registered the resource associated with the Soumber Deposit with MRAM. Further, on July 6, 2011, the Company announced that MRAM had issued the Company a mining license pertaining to the Soumber Deposit. The new 10,993 ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions.

1. OVERVIEW (Continued)

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.

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 April 6, 2011, Aspire announced that it had received the raw coal quality sample analyses from its 2010 drilling programme. 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 – 26.5%, Sulphur – 1.2%, Crucible Swelling Index – 7.7 and Energy – 6,668 kcal/kg. Data results are on an air dried basis for raw coal samples. Based on the samples tested, it is expected that the Ovoot Coking Coal Project washed product will be a high fluidity, high volatile B bituminous coking coal.

1.2 Corporate Activity

On March 30, 2011, the Company announced updated NI 43-101 compliant coal Resources and Reserves for its Ovoot Tolgoi Complex. Measured plus indicated increased by 7% to 266.2 million tonnes and inferred increased by 190% to 97.1 million tonnes.

On March 30, 2011, SouthGobi announced effective April 1, 2011, Curt Church, previously Vice President, Mining operations had been appointed Chief Operating Officer.

On May 10, 2011, SouthGobi made an announcement regarding fuel supply issues in Mongolia and their impact on the Company's operations. As a result of the fuel supply issues, the Company faced a reduction in supply leading to a decrease in operational efficiency and an increase in per liter fuel prices.

On June 3, 2011, SouthGobi announced the resource associated with the Soumber Deposit was officially registered with the Government of Mongolia.

1. OVERVIEW (Continued)

On June 8, 2011, SouthGobi announced the renewal of its share re-purchase program. The Board of Directors authorized the Company to purchase up to a total of 3.2 million common shares of the Company on either of the TSX or the HKEX, representing approximately 1.7% of the current outstanding common shares of the Company. The share re-purchase program commenced on June 15, 2011, and will remain until June 14, 2012, or until the purchases are complete or the program is terminated by the Company.

On June 28, 2011, SouthGobi announced effective July 1, 2011, Matthew O'Kane, previously Vice President, Commercial Operations, had been appointed Chief Financial Officer. Matthew O'Kane replaces Terry Krepiakevich who will remain as a Senior Advisor to the Company.

On July 5, 2011 the Company entered into an agreement with Ejin Jinda, a subsidiary of CMC, to toll wash coal from the Ovoot Tolgoi Mine at Ceke.

On July 6, 2011, SouthGobi announced that MRAM had issued a mining license pertaining to the Soumber Deposit. The new 10,993 ha mining license is granted for an initial term of 30 years with an option for two 20 year extensions.

As of August 10, 2011, Ivanhoe Mines Ltd. ("Ivanhoe") directly owned 104.8 million 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 Senior Engineer. Mr. Bartel is a "qualified person" for the purposes of National Instrument 43-101 of the Canadian Administrators ("NI 43-101").

3.2 Mongolia Exploration and Mining Licenses

In May 2007, 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 19 exploration licenses with coal potential, and with the additional 35 licenses, a total of 54 licenses covering an area of approximately 2.1 million ha were then available for coal exploration.

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

As at July 6, 2011, the Company held 15 licenses, including three mining licenses, which in total cover an area of approximately 541,000 ha.

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. In February 2011, the potential forest and waste areas were updated. 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.

3. MINERAL PROPERTIES (Continued)

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 owns 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.

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.

3. MINERAL PROPERTIES (Continued)

Current products from the Ovoot Tolgoi Mine include coals with coking (or metallurgical) applications primarily a raw semi-soft coking coal together with raw medium and 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. Commissioning of the rotary breaker is anticipated before the end of 2011. Completion of the dry air separation modules is scheduled for mid-2012. Prior to the commissioning of the rotary breaker, temporary screening operations are being conducted at the Ovoot Tolgoi Mine. The temporary screening performs a similar function to the rotary breaker, namely rejecting oversize ash and sizing the coal to a maximum size of 50 millimeters, however at a higher cost and with lower capacity.

The Company entered into an agreement with Ejin Jinda, a subsidiary of CMC, to toll wash coal from the Ovoot Tolgoi Mine. The agreement has a duration of 5-years from commencement (expected in early 2012) and provides for an annual wet washing capacity of approximately 3.5 million tonnes of input raw coal. Raw higher-ash and medium-ash coals from the Ovoot Tolgoi Mine will be washed at this facility. Washed coal will generally meet semi-soft coking coal specifications.

Ejin Jinda's wet washing facility is located approximately 10km inside China from the Mongolia-China border crossing (i.e., approximately 50km from the Ovoot Tolgoi Mine). Medium and high-ash coals with only basic processing through Ovoot Tolgoi's on-site dry coal handling facility will be transported from the Ovoot Tolgoi Mine to the facility under a separate transport agreement. Based on preliminary studies the Company expects these coals can then be washed to produce coals with ash in the range of 8% to 11% at a yield of 85% to 90%. Ejin Jinda will charge the Company a single toll washing fee which will cover their expenses, capital recovery and profit.

In the second quarter of 2011, coal sales were approximately 1.05 million tonnes compared to total sales in the second quarter of 2010 of approximately 0.45 million tonnes. Total sales since the mine commenced production are approximately 5.48 million tonnes.

3. MINERAL PROPERTIES (Continued)

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. Four designated coal truck entry points have now been constructed on the Chinese side of the Shivee Khuren-Ceke border crossing together with an additional four separate points for empty trucks to exit China for Mongolia. SouthGobi has taken the initiative to undertake the road works required on the Mongolian side of the border with the aim of having the parallel coal dedicated border crossing points open during 2011.

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. On August 2, 2011, the State Property Committee of Mongolia awarded the tender to construct a paved highway from Ovoot Tolgoi to the Mongolia-China border to consortium partners NTB LLC and the Company's Mongolian operating subsidiary, SouthGobi Sands LLC ("NTB-SGS"). NTB-SGS now has the right to conclude a 15-year build, operate and transfer ("BOT") contract under the Mongolian Law on Concessions. NTB-SGS intends to commence construction this year of the paved highway with an intended carrying capacity upon completion of in excess of 20 million tonnes of coal per year.

A north-south railway line currently connects Ceke with Jiayuguan City in Gansu Province and with the interior of China. Another east-west railway line connects Ceke to Linhe, an industrial city in eastern Inner Mongolia. This line has a stated initial transportation capacity of approximately 15 million tonnes per year, with a planned increase to 25 million tonnes per year.

SouthGobi Sands LLC, a wholly owned Mongolian subsidiary of SouthGobi, employed 628 employees as at June 30, 2011. Of the 628 employees, 54, including expatriates, are employed in the Ulaanbaatar office, 6 in outlying smaller offices, including the Ceke border point, and 566 employees at the mine site. Of the total 628 employees based in Mongolia, 610 (97%) are Mongolian nationals and of those, 239 (38%) are residents of the local Gurvantes and Noyon Soums.

The Company's current shovel and truck fleet consists of a Liebherr 996 hydraulic shovel (34m^3), a Liebherr 996 hydraulic excavator (34m^3), two Liebherr R9250 hydraulic excavator (15m^3), nine Terex MT4400 (218-tonne capacity) trucks, seven Terex TR100 (91-tonne capacity) trucks and various auxiliary equipment.

3. MINERAL PROPERTIES (Continued)

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.

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. Three 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. The R9250 hydraulic excavator from the fifth fleet was commissioned in the second quarter of 2011 and is currently being used to supplement the capacity of the Company's existing fleets.

Throughout the quarter ended June 30, 2011, the Company continued to develop its coal markets in China. Total sales in the quarter ended June 30, 2011 were 1.05 million tonnes consisting of raw semi-soft coking coal and raw higher-ash coal.

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. The 2010 drilling included a series of open-holes and core holes including over 109,600 m of total drilling within the Soumber Deposit.

3. MINERAL PROPERTIES (Continued)

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.

On June 3, 2011, the Company announced it had successfully registered the resource associated with the Soumber Deposit with MRAM. Further, on July 6, 2011, the Company announced that MRAM had issued the Company a mining license pertaining to the Soumber Deposit. The new 10,993 ha mining license was granted for an initial term of 30 years with an option for two 20 year extensions.

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. Environmental baseline studies have been completed and general environmental impact assessments have been approved. 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.

<u>Ovoot Tolgoi Underground Deposit</u>

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.

The coal rank at the Ovoot Tolgoi Underground Deposit 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.

3. MINERAL PROPERTIES (Continued)

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 150m. 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)

Exploration Program

A number of the exploration licenses are associated with the broader Ovoot Tolgoi Complex and the Soumber Deposit. The Company considers some of these to be prospective exploration properties.

The exploration program in 2011 will include drilling, trenching and geological reconnaissance.

Key exploration targets for 2011 include additional drilling at the Soumber Deposit and the fields surrounding the Soumber Deposit and additional areas within the Ovoot Tolgoi Complex mining licenses that have not been fully explored.

4. SUMMARY OF QUARTERLY RESULTS

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

	2011		2010				2009	
QUARTER ENDED	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Revenue	**$ 47,336**	$ 20,158	$ 41,595	$ 6,597	$ 17,668	$ 13,917	$ 9,960	$ 11,871
Income/(loss) from mine operations	**9,744**	7,690	3,376	(6,674)	4,400	1,187	1,524	3,234
Margin on revenue	***21%***	*38%*	*8%*	*-101%*	*25%*	*9%*	*15%*	*27%*
Evaluation and exploration expenses	**(4,356)**	(1,991)	(4,144)	(6,314)	(6,659)	(1,651)	(739)	(2,150)
Operating loss from continuing operations	**(4,444)**	(1,020)	(8,914)	(20,969)	(10,595)	(6,498)	(6,948)	(5,031)
Net interest expense	**(2,023)**	(4,251)	(4,191)	(4,385)	(4,384)	(9,024)	(8,243)	(642)
Net income/(loss)	**67,323**	(46,602)	(28,720)	27,495	53,301	(168,271)	(69,153)	(23,782)
Basic income/(loss) per share	**0.37**	(0.25)	(0.16)	0.15	0.29	(1.09)	(0.52)	(0.17)

	2011		2010				2009	
QUARTER ENDED	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Net income/(loss)	**$ 67,323**	$ (46,602)	$ (28,720)	$ 27,495	$ 53,301	$ (168,271)	$ (69,153)	$ (23,782)
Excluding								
Gain/(loss) on value change of embedded derivatives in CIC debenture	**70,422**	(36,780)	(19,995)	49,772	72,232	(1,372)	(44,980)	-
Loss on partial conversion of CIC debenture	**-**	-	-	-	-	(151,353)	-	-
Mark to market gain/(loss) in value of investment in Kangaroo	**3,453**	(3,762)	4,209	1,363	(4,509)	(703)	1,099	-
Income/(loss) from discontinued operations	**-**	-	-	-	-	-	1,034	(26,006)
Net income/(loss) excluding specified items	**(6,552)**	(6,060)	(12,934)	(23,640)	(14,422)	(14,843)	(26,306)	2,224

	2011		2010				2009	
QUARTER ENDED	**30-Jun**	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep
Volumes and prices								
Raw semi-soft coking coal								
Raw coal production *(millions of tonnes)*	**0.52**	0.48	0.41	0.18	0.39	0.21	0.16	0.35
Coal sales *(millions of tonnes)*	**0.60**	0.34	0.35	0.11	0.42	0.40	0.36	0.46
Average realized sales price *(per tonne)*	**$ 65.96**	$ 56.50	$ 47.08	$ 46.04	$ 44.10	$ 36.62	$ 29.55	$ 27.82
Raw higher-ash coal								
Raw coal production *(millions of tonnes)*	**0.35**	0.63	0.97	0.39	0.23	0.01	-	0.01
Coal sales *(millions of tonnes)*	**0.45**	0.11	1.12	0.08	0.03	0.03	-	-
Average realized sales price *(per tonne)*	**$ 38.32**	$ 31.68	$ 26.75	$ 25.34	$ 18.82	$ 21.24	$ -	$ -
Total								
Raw coal production *(millions of tonnes)*	**0.87**	1.11	1.38	0.57	0.62	0.22	0.16	0.36
Coal sales *(millions of tonnes)*	**1.05**	0.45	1.47	0.19	0.45	0.43	0.36	0.46
Average realized sales price *(per tonne)*	**$ 54.06**	$ 50.29	$ 31.56	$ 37.15	$ 42.63	$ 35.52	$ 29.55	$ 27.82
Costs								
Direct cash costs of product sold *(per tonne)*	**$ 26.77**	$ 18.91	$ 18.53	$ 18.59	$ 21.37	$ 22.25	$ 16.97	$ 11.16
Total cash costs of product sold *(per tonne)*	**$ 27.61**	$ 20.61	$ 19.25	$ 22.04	$ 22.30	$ 23.32	$ 18.29	$ 13.41
Waste movement and stripping ratio								
Ovoot Tolgoi Mine - Sunset Pit								
Total waste material moved *(millions of bank cubic meters)*	**4.08**	3.85	3.56	2.90	1.73	1.50	0.87	1.06
Strip ratio *(bank cubic meters of waste rock per tonne of coal produced)*	**4.74**	3.47	2.58	5.09	2.79	6.79	5.38	2.98
Ovoot Tolgoi Mine - Sunrise Pit								
Total waste material moved *(millions of bank cubic meters)*	**0.80**	0.49	0.73	0.43	0.02	-	-	-
Other operating capacity statistics								
Capacity								
Number of mining shovels/excavators available at period end	**4**	3	3	2	2	2	1	1
Total combined stated mining shovel/excavator capacity at period end *(cubic meters)*	**98**	83	82	48	48	48	14	14
Number of haul trucks available at period end	**16**	16	15	12	11	9	7	7
Total combined stated haul truck capacity at period end *(tonnes)*	**2,599**	2,599	2,254	1,727	1,509	1,073	637	637
Employees and safety								
Employees at period end	**658**	600	544	472	421	388	334	308
Lost time injury frequency rate *(per 100,000 man hours)*	**1.2**	0.9	0.8	0.9	1.0	0.6	n/a (i)	n/a (i)

(i) Lost time injury frequency data for all periods in 2009 is not available.

4. SUMMARY OF QUARTERLY RESULTS (Continued)

The changes in comparative results of operations on a quarter over quarter basis are due primarily to fluctuations in the following areas:

The Company recorded net income for the three months ended June 30, 2011 of $67.3 million compared to a net loss of $46.6 million for the three months ended March 31, 2011 and net income of $53.3 million for the three months ended June 30, 2010. The net income in the second quarter of 2011 is due primarily to the $70.4 million gain on the fair value change of the embedded derivatives in the CIC convertible debenture. This compares to a loss of $36.8 million in the first quarter of 2011 and a gain of $72.2 million in the second quarter of 2010 on the fair value change of the embedded derivative in the CIC convertible debenture.

Coal production decreased in the second quarter of 2011 compared to the first quarter of 2011. Production in the second quarter of 2011 was impacted by the fuel shortages in Mongolia announced by the Company in the press release dated May 10, 2011. The diesel fuel shortage impacted the Ovoot Tolgoi Mine in two ways. Firstly, there was some curtailment of mining to varying degrees during May and June of 2011, which made equipment generally less efficient. Secondly, the Company paid a higher price to secure diesel fuel supplies. The average price paid for diesel fuel in the second quarter of 2011 was $1.37 per liter, 25% higher than in the first quarter of 2011.

In addition to the specific diesel fuel issue, the waste-to-coal ratio (strip ratio) was higher for the second quarter of 2011 compared to the first quarter meaning that a higher proportion of material movement capacity was allocated to waste movement as opposed to coal production. The higher allocation of waste material movement per tonne of coal production further increased direct cash cost per tonne in the period.

Sales volume in the second quarter of 2011 increased compared to the first quarter of 2011 due to significant contracts signed for the second quarter and the fact that shipping capacity is generally substantially lower in the first quarter of each year due to the seasonal holidays of Chinese New Year and Mongolian Tsagaan Tsar, which result in extended border closures. The Company sold 1.05 million tonnes at an average realized price of $54 per tonne compared to 0.45 million tonnes at an average realized price of $50 per tonne in the first quarter of 2011 and 0.45 million tonnes sold in the second quarter of 2010 at an average realized price of $43 per tonne. The average realized price has increased quarter over quarter due to increasing selling prices partially offset by the mix of product sold. Selling prices in the second quarter of 2011 for individual coal types increased by between 17% and 21% compared to the first quarter of 2011.

4. SUMMARY OF QUARTERLY RESULTS (Continued)

Revenue was $47.3 million in the second quarter of 2011 which represented record quarterly revenue since operations commenced. It compared to $20.2 million in the first quarter of 2011 and $17.7 million in the second quarter of 2010. Revenue was negatively impacted by an increase in the average proportional royalty payable. The 'effective royalty' rose from 9% in the first quarter of 2011 to 14% in the second quarter of 2011 due to the methodology being applied to royalties basing fees on benchmark price levels set by the Mongolian government.

Income from mine operations increased to a record level of $9.7 million in the second quarter of 2011 from $7.7 million in the first quarter of 2011 and $4.4 million in the second quarter of 2010. Income from mine operations will vary by quarter depending on sales volume, sales price, production and unit costs. The increase in income from mine operations relates primarily to the higher average selling price and the higher sales volume, partially offset by the higher direct cash cost per tonne of product sold associated with diesel fuel issues and higher royalties.

The net loss excluding specified items was $6.6 million in the second quarter of 2011, compared to a loss of $6.1 million in the first quarter of 2011 and a loss of $14.4 million in the second quarter of 2010. In the second quarter of 2011, net loss excluding specified items excludes a gain of $70.4 million on the fair value change of the embedded derivatives in the convertible debenture and a $3.5 million mark to market gain on the Company's investment in Kangaroo Resources Ltd. ("Kangaroo"). In the first quarter of 2010, net loss excluding specified items excludes a loss of $36.8 million on the fair value change of the embedded derivatives in the convertible debenture and a loss of $3.8 million on the Company's investment in Kangaroo.

Contributions to public road maintenance, which appears in administration expenses, increased in the second quarter of 2011 to $3.2 million compared to $0.7 million in the first quarter of 2011. The primary reason for the increase is the extra work being carried out where the road approaches the border area to allow access to the new parallel dedicated coal border crossing gates. A large volume of crushed rock is being hauled down to that area to create a more stable road base for large trucks to move over.

Exploration costs for the second quarter of 2011, were $4.4 million compared to $2.0 million in the first quarter of 2011 and $6.7 million for the second quarter of 2010. Exploration costs will vary from quarter to quarter depending on the number of projects and the related seasonality of the exploration programs.

5. RESULTS OF OPERATIONS

	Three months ended June 30,		Six months ended June 30,	
	2011	**2010**	**2011**	**2010**
Volumes, Prices and Costs				
Raw coal production *(millions of tonnes)*	**0.87**	0.62	**1.98**	0.84
Coal sales *(millions of tonnes)*	**1.05**	0.45	**1.50**	0.87
Average realized sales price *(per tonne)*	**$ 54.06**	$ 42.63	**$ 52.92**	$ 39.17
Direct cash costs of product sold *(per tonne)*	**$ 26.77**	$ 21.37	**$ 24.39**	$ 21.81
Total cash costs of product sold *(per tonne)*	**$ 27.61**	$ 22.30	**$ 25.49**	$ 22.80
Operating Statistics				
Ovoot Tolgoi Mine - Sunset Pit				
Total waste material moved *(millions of bank cubic meters)*	**4.08**	1.73	**7.93**	3.22
Strip ratio *(bank cubic meters of waste rock per tonne of coal produced)*	**4.74**	2.79	**4.03**	3.84
Ovoot Tolgoi Mine - Sunrise Pit				
Total waste material moved *(millions of bank cubic meters)*	**0.80**	0.02	**1.28**	0.02
Operating Results *(thousands of dollars)*				
Revenue	**$ 47,336**	$ 17,668	**$ 67,494**	$ 31,585
Cost of sales	**(37,592)**	(13,268)	**(50,060)**	(25,998)
Income from mine operations	**9,744**	4,400	**17,434**	5,587
Administration expenses (i)	**(9,832)**	(8,336)	**(16,551)**	(14,370)
Evaluation and exploration expenses	**(4,356)**	(6,659)	**(6,347)**	(8,310)
Operating loss	**$ (4,444)**	$ (10,595)	**$ (5,464)**	$ (17,093)

(i) Administration costs for the three months ended June 30, 2011 include $3.2 million in public infrastructure costs (2010: $1.6 million) and the six months ended June 30, 2011 include $3.9 million in public infrastructure costs (2010: $2.1 million).

5.1 Three Months Ended June 30, 2011 and 2010

In the three months ended June 30, 2011, 0.87 million tonnes of raw coal was produced with a strip ratio of 4.74 compared to 0.62 million tonnes of raw coal produced in the three months ended June 30, 2010 with a strip ratio of 2.79. Waste removal continued during the second quarter of 2011 at the Sunrise pit and costs associated with the 0.80 million bank cubic meters ("BCM") were capitalized as deferred stripping. Stripping of the Sunrise pit began in the second quarter of 2010.

The Company incurred an operating loss for the three months ended June 30, 2011 of $4.4 million compared to a $10.6 million loss for the three months ended June 30, 2010. The decrease in the operating loss is due to the factors discussed below.

5. RESULTS OF OPERATIONS (Continued)

In the three months ended June 30, 2011, the Company sold approximately 1.05 million tonnes of coal at an average realized selling price of approximately $54 per tonne. This compares to 0.45 million tonnes of coal sold in the three months ended June 30, 2010 at an average realized selling price of approximately $43 per tonne. Revenue increased from $17.7 million in the three months ended June 30, 2010 to a quarterly record of $47.3 million in the three months ended June 30, 2011 due to selling prices for individual coal types increasing by between 50% and 104%. Revenues are net of royalties and selling fees. The Company is subject to a 5% royalty on all coal sold based on a set reference price per tonne published monthly by the Government of Mongolia. Effective January 1, 2011, the Company is also subject to a sliding scale additional royalty of up to 5% based on the set reference price of coal. Based on the reference price for the second quarter of 2011, the Company was subject to an average 8% royalty based on a weighted average reference price of $95 per tonne. The Company's effective royalty rate for the three months ended June 30, 2011, based on the Company's realized sales price of $54 per tonne was 14%

Cost of sales was $37.6 million in the three months ended June 30, 2011 compared to $13.3 million for the three months ended June 30, 2010. Cost of sales has increased in the second quarter of 2011 compared to the second quarter of 2010 due to higher sales volumes and higher unit costs. Cost of sales comprise the direct cash cost of products sold, mine administration costs, equipment depreciation, depletion of stripping costs, and share-based compensation.

Direct cash costs of product sold were $26.77 per tonne in the three months ended June 30, 2011 compared to $21.37 per tonne in the three months ended June 30, 2010. Direct cash costs have increased due to higher fuel costs, screening costs and the increased strip ratio. The Company only began screening its raw higher-ash coals in the third quarter of 2010.

Mine administration costs per tonne decreased to $0.84 per tonne for the three months ended June 30, 2011 compared to $0.93 per tonne for the three months ended June 30, 2010 due to the increased sales volume in the second quarter of 2011.

Exploration expenses for the three months ended June 30, 2011 were $4.4 million compared to $6.7 million for the three months ended June 30, 2010. Exploration was still in the process of mobilization during the second quarter of 2011. Drilling in 2010 related to the Soumber Deposit and additional greenfield targets.

Administration expense consists of corporate administration, legal fees, professional fees, salaries and benefits, sustainability and community relations costs, public infrastructure costs, depreciation and foreign exchange gains/losses (see Note 5 of the condensed consolidated interim financial statements).

5. RESULTS OF OPERATIONS (Continued)

Administration expenses for the three months ended June 30, 2011, were $1.5 million higher compared to the three months ended June 30, 2010. This increase is related primarily to the following three items. Salaries and benefits were $0.6 million higher for the three months ended June 30, 2011 as compared to same period in 2010, due primarily to an increase in share-based compensation expense. Public infrastructure costs were $1.6 million higher for the three months ended June 30, 2011 as compared to the same period in 2010. These costs relate to maintenance and upgrading of public transportation infrastructure used to transport coal from the Ovoot Tolgoi Mine to the Chinese border and also to work completed on the Mongolian side of the border to facilitate the future opening of the dedicated coal border crossing channels. Finally, foreign exchange gains/losses were $0.5 million lower for the three months ended June 30, 2011 compared to 2010. Foreign exchange gains/losses are primarily the result of changes of the U.S. to Canadian dollar ("Cdn$"), and the U.S. dollar to Mongolian Tugrik exchange rates.

5.2 Six Months Ended June 30, 2011 and 2010

The Company incurred an operating loss for the six months ended June 30, 2011 of $5.5 million compared to $17.1 million for the same period in 2010. This variance is due to the factors discussed below.

In the six month period ended June 30, 2011, the Company sold approximately 1.50 million tonnes at an average realized selling price of approximately $53 per tonne compared to 0.87 million tonnes at an average realized selling price of approximately $39 per tonne in the six month period ended June 30, 2010. Revenues are net of royalties and selling fees. The royalties are based on a set reference price per tonne published monthly by the Government of Mongolia. The weighted average reference price for the six month period ended June 30, 2011 was $86 per tonne.

Cost of sales was $50.1 million in the six months ended June 30, 2011, which includes the direct cash cost of products sold, mine administration costs, equipment depreciation, depletion of stripping costs and share-based compensation. Cost of sales was $26.0 million for the six months ended June 30, 2010. The increase in cost of sales for the six months ended June 30, 2011 is due to the higher sales volumes and higher unit costs.

Direct cash costs of product sold were $24.39 per tonne for the six months ended June 30, 2011 compared to $21.81 per tonne for the same period in 2010. The increase in direct cash costs is due primarily to increased fuel costs, screening costs and the higher strip ratio in 2011. The Company began screening its higher-ash coal in the third quarter of 2010.

5. RESULTS OF OPERATIONS (Continued)

Mine administration costs per tonne increased to $1.10 per tonne for the six months ended June 30, 2011, compared to $0.99 per tonne for the six months ended June 30, 2010. The increase per tonne is due to the general increase in mine administration costs in 2011.

Exploration expenses for the six months ended June 30, 2011, were $2.0 million lower than the six months ended June 30, 2010. The exploration program began later in 2011 and therefore costs in 2011 are lower compared to 2010. Exploration expense in 2010 relates to drilling at the Soumber Deposit and other greenfield targets.

Administration expenses for the six months ended June 30, 2011, were $2.2 million higher compared to the six months ended June 30, 2010. This increase is related primarily to public infrastructure costs which were $1.9 million higher for the six months ended June 30, 2011 as compared to the same period in 2010. These costs relate to the upgrading of transportation infrastructure from the Ovoot Tolgoi Mine to the Chinese border.

6. 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.

	Three months ended June 30		Six months ended June 30	
	2011	**2010**	**2011**	**2010**
Cash costs				
Cost of sales per financial statements	**$ 37,592**	$ 13,268	**$ 50,060**	$ 25,998
Less non-cash adjustments	**(8,724)**	(3,263)	**(11,830)**	(6,060)
Total cash costs	**28,868**	10,005	**38,230**	19,938
Coal sales *(000's of tonnes)*	**1,046**	449	**1,500**	874
Total cash costs of product sold *(per tonne)*	**$ 27.61**	$ 22.30	**$ 25.49**	$ 22.80

	Three months ended June 30		Six months ended June 30	
	2011	**2010**	**2011**	**2010**
Cash costs				
Direct cash costs of product sold *(per tonne)*	**$ 26.77**	$ 21.37	**$ 24.39**	$ 21.81
Mine administration cash costs of product sold *(per tonne)*	**0.84**	0.93	**1.10**	0.99
Total cash costs of product sold *(per tonne)*	**$ 27.61**	$ 22.30	**$ 25.49**	$ 22.80

7. EXPLORATION COSTS

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 exploration expenditures for the six months ended June 30, 2011 were $6.3 million compared to $8.3 million for the six months ended June 30, 2010. Key exploration targets for 2011 will include additional drilling at the Soumber Deposit and the fields surrounding the Soumber Deposit and additional areas within the Ovoot Tolgoi mining licenses that have not been fully explored. Exploration activities include drilling, trenching, water exploration and geological reconnaissance. The exploration program in 2011 started later in the year than 2010 due to delays in receiving required government approvals.

8. FINANCE INCOME / (COSTS)

($ in thousands)

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Fair value gain on embedded derivatives in convertible debenture	**$ 70,422**	$ 72,232	**$ 33,641**	$ 70,861
Loss on partial conversion of convertible debenture	**-**	-	**-**	(151,353)
Interest expense on convertible debenture	**(2,177)**	(4,982)	**(6,684)**	(14,508)
Interest expense on line of credit facilities	**(156)**	(32)	**(286)**	(89)
Mark to market gain/(loss) on investments	**3,629**	(4,555)	**(488)**	(5,241)
Accretion of decommissioning liability	**(45)**	(19)	**(84)**	(33)
Interest income	**355**	649	**782**	1,224
	$ 72,028	$ 63,293	**$ 26,881**	$ (99,139)

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 21.5 million 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 0.1 million 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.

8. FINANCE INCOME / (COSTS) (Continued)

For the three months ended June 30, 2011, the fair value change on the embedded derivative was a gain of $70.4 million, compared with a gain of $72.2 million for the three months ended June 30, 2010. The fair value of the embedded derivatives is driven by many factors including, share price, foreign exchange rates and share price volatility. The share price decreased from Cdn$14.29 at March 31, 2011 to Cdn$10.66 at June 30, 2011 resulting in a significant decrease in the fair value of the embedded derivative which resulted in a gain of $70.4 million. Finance costs for the six months ended June 30, 2011 include a gain of $33.6 million on the fair value change on the embedded derivative (2010: $70.9 million). The finance costs for the six months ended June 30, 2010 also include a $151.4 million loss on partial conversion of the convertible debenture.

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 Bank line of credit facility is used by the Company's Mongolian subsidiaries as part of their working capital management. The Company incurred interest expense related to the line of credit of $0.2 million for the three months ended June 30, 2011 (2010: $0.03 million) and $0.3 million for the six months ended June 30, 2011 (2010: $0.1 million).

The Company recorded a mark to market gain of $3.6 million for the three months ended June 30, 2011, compared to a loss of $4.6 million in the same period in 2010. For the six months ended June 30, 2011, the Company incurred a loss of $0.5 million compared to a loss of $5.2 million in the same period in 2010. Included in the mark to market gain/loss is the mark to market adjustment on the Company's investment in Kangaroo and certain money market instruments.

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 was lower in the three and six months ended June 30, 2011 compared to the same periods in 2010, due to lower cash balances. The current economic climate has also resulted in very low interest rates especially for US$ denominated investments.

9. TAXES

In the three and six months ended June 30, 2011, the Company recorded current income tax expense of $1.7 million and $3.5 million, respectively, related to its Mongolian operations compared to $0.4 million in each of the same periods in 2010. The Company has recorded a deferred income tax recovery related to deductible temporary differences and the carry forward of unused tax losses of $1.5 million and $2.8 million for the three and six months ended June 30, 2011. A deferred income tax recovery of $1.0 million and $1.6 million was recorded for the three and six month period ended June 30, 2010.

10. LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Highlights
($ in thousands)

	Six months ended June 30, 2011	Six months ended June 30, 2010
Cash used in operating activities	**$ (50,968)**	$ (35,135)
Cash used in investing activities	**(146,638)**	(75,915)
Cash (used)/generated by financing activities	**(11,819)**	420,840
Effect of foreign exchange rate changes on cash	**120**	72
(Decrease)/increase in cash for the period	**(209,305)**	309,862
Cash balance, beginning of the period	**492,038**	357,342
Cash balance, end of the period	**$ 282,733**	$ 667,204

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. 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 June 30, 2011, the Company had cash resources of $282.7 million compared to cash resources of $492.0 million at December 31, 2010. At June 30, 2011, the Company also had short and long term money market investments of $75.0 million for a total of $357.7 million in cash and cash equivalents and money market investments.

10. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Cash used in operations for the six months ended June 30, 2011 was $51.0 million compared to $35.1 million for the six months ended June 30, 2010. The increased outflows in 2011 primarily relates to the increase in coal stockpiles and the increased materials and supplies as the mine expands and more mobile equipment is brought on-site.

The Company recorded net income before tax of $21.4 million for the six months ended June 30, 2011 compared to a net loss before tax of $116.2 million for the six months ended June 30, 2010. The net loss before tax for the six months ended June 30, 2010 includes the non-cash loss on partial conversion of the convertible debenture of $151.4 million. In the six months ended June 30, 2011, the Company recorded revenue of $67.5 million compared to $31.6 million for the six months ended June 30, 2010. With the increased activities at the Ovoot Tolgoi site and the operations in Mongolia, inventory, and accounts payable increased during the six months ended June 30, 2011.

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.

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 the law was prospective and any amounts that were accumulated until November 9, 2010, are refundable to the Company. 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. The annual verification by the Mongolian Government Taxation Authority of the collectability of the VAT receivable has been completed and as at June 30, 2011, any outstanding VAT receivable amounts accumulated prior to November 10, 2010, will be available to the Company to offset future taxes and royalties or will be refunded by the Mongolian Government Taxation Authority.

10. LIQUIDITY AND CAPITAL RESOURCES (Continued)

When the Company completes the 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 fully commissioned by mid 2012.

The Company is also closely monitoring collectability of outstanding accounts receivable for current coal sales. The Company expects to collect all outstanding receivables. However, unforeseen unfavorable market conditions could have an impact on future collectability.

Prepaid balances and deposits have increased during the six months ended June 30, 2011. The increase primarily relates to advances for materials and supplies inventory.

Coal and supplies inventory have increased to $45.2 million at June 30, 2011 from $26.2 million at December 31, 2010 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 $12.4 million at June 30, 2011 compared to $2.4 million at December 31, 2010. 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 0.39 million tonnes of coal inventory at June 30, 2011 and 0.16 million tonnes at December 31, 2010.

Accounts payable have increased during the six months ended June 30, 2011 due mainly to increased royalties.

Cash used for investing activities

Cash used for investing activities was $146.6 million for the six months ended June 30, 2011 compared to $75.9 million for the six months ended June 30, 2010.

The Company's investment in property, plant and equipment was higher during the six months ended June 30, 2011 as the Company incurred expenditures for mobile and mining equipment, construction projects, and deferred stripping in Mongolia. The Company began deferred stripping at the Sunrise pit in the second quarter of 2010.

10. LIQUIDITY AND CAPITAL RESOURCES (Continued)

In the first quarter of 2011, certain longer term money market instruments matured and the Company re-invested the cash in new longer term money market instruments. In the second quarter of 2011 certain short term money market investments matured and were not re-invested.

During the first quarter of 2011, the Company purchased additional shares of Aspire for $0.5 million. The Company now owns 106.7 million shares and after giving effect to the additional purchases, the Company holds approximately 19.8% of Aspire.

Interest income will increase or decrease depending on the cash position and interest rates. Interest income was lower for the six months ended June 30, 2011 compared to the six months ended June 30, 2010 due to lower cash balances. The current economic climate has resulted in very low interest rates especially for US$ denominated investments.

Cash provided by financing activities

The Company received approximately $4.7 million from the exercise of share options during the six months ended June 30, 2011.

On January 18, 2011, the Company signed a new revolving line of credit facility with Golomt Bank for a twelve month period. 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 SouthGobi Sands LLC as part of its working capital management. Under the 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. During the six months ended June 30, 2011, the Company had drawings of $102.2 million and repayments of $100.5 million. The principal balance outstanding as at June 30, 2011 was $1.7 million.

10. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Liquidity, Financing and Working Capital Resources

The Company is an integrated coal exploration, development and production company. The Company has sufficient capital to go beyond its current obligations and does not anticipate raising new capital 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 21.5 million shares at a conversion price of $11.64 (Cdn$11.88). At June 30, 2011, CIC owned through its indirect wholly owned subsidiary approximately 13.7% of the Company.

On January 29, 2010, the Company announced that it had closed the global equity offering of 27.0 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 exercise of the over-allotment option and issued an additional 0.2 million common shares of the Company at a price of Cdn$17.00 per share for gross proceeds of $3.7 million.

At the time of the financing, the Company planned 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 at the time of the financing.

10. LIQUIDITY AND CAPITAL RESOURCES (Continued)

On June 8, 2010, the Company announced that its Board of Directors authorized a share repurchase program to purchase up to 2.5 million common shares of the Company on each or either of the TSX and the HKEX, in aggregate representing up to 5.0 million common shares of the Company. On June 8, 2011, the Company announced the renewal of its share re-purchase program. The share re-purchase program commenced on June 15, 2011, and will remain until June 14, 2012, or until the purchases are complete or the program is terminated by the Company. As of August 10, 2011, the Company had repurchased 0.9 million shares on the HKEX and 1.5 million shares on the TSX for a total of 2.4 million common shares. The Company cancels all shares after they are repurchased.

As at June 30, 2011, the Company's gearing ratio was 0.23 (December 31, 2010: 0.26) which was calculated based on the Company's long term liabilities to total assets.

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 Kangaroo, Aspire and its money market investments are determined using this methodology. The Company's investment in shares of Kangaroo 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.

10. LIQUIDITY AND CAPITAL RESOURCES (Continued)

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 June 30, 2011	As at December 31, 2010
Financial assets *($ in thousands)*		
Loans-and-receivables		
Cash and cash equivalents	**$ 282,733**	$ 492,038
Trade and other receivables	**67,705**	30,246
Other receivables	**238**	238
Available-for-sale		
Investment in Aspire	**65,239**	52,008
Fair value through profit and loss (FVTPL)		
Investment in Kangaroo	**9,926**	10,235
Money market investments	**75,034**	62,702
Total financial assets	**$ 500,875**	$ 647,467
Financial liabilities *($ in thousands)*		
Fair value through profit and loss (FVTPL)		
Convertible debenture - embedded derivatives	**$ 121,236**	$ 154,877
Other-financial-liabilities		
Trade and other payables	**32,369**	24,137
Amounts due under line of credit facilities	**1,666**	-
Convertible debenture - debt host	**94,941**	96,933
Total financial liabilities	**$ 250,212**	$ 275,947

The net gain for the six months ended June 30, 2011 and June 30, 2010 included the following amounts of unrealized gains/(losses) from the fair value adjustments to certain financial instruments which are classified as FVTPL:

($ in thousands)	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Unrealized gains/(losses) on investments	**$ 3,629**	$ (4,555)	**$ (488)**	$ (5,241)
Fair value gain/(loss) of embedded derivatives	**70,422**	72,232	**33,641**	70,861

The other comprehensive income includes an unrealized after tax loss of $39.6 million and an after tax gain of $11.2 million for the three and six months ended June 30, 2011 and $nil for the three and the six months ended June 30, 2010.

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

11. 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 June 30, 2011, the Company recognized a liability of $3.8 million. The fair value of the decommissioning liability is estimated using a present value method 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)	Six months ended June 30, 2011	Six months ended June 30, 2010
Assumption		
Undiscounted costs	**$ 7,161**	$ 2,953
Country specific risk free rate	**8.0%**	10.8%
Inflation rate	**2.8%**	2.8%
Average years to reclamation	**14**	15

12. 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 June 30, 2011 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 2010 to facilitate the global equity offering. The contract with Ivanhoe Aviation was terminated in the fourth quarter of 2010 and the Company did not incur any costs in 2011.

- 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.

12. RELATED PARTY TRANSACTIONS (Continued)

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

($ in thousands)	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
Corporate administration	**$ 580**	$ 912	**$ 923**	$ 1,521
Salaries and benefits	**357**	320	**625**	1,128
Total related party expenses	**$ 937**	$ 1,232	**$ 1,548**	$ 2,649

($ in thousands)	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010
GMM	**$ 593**	$ 466	**$ 987**	$ 1,447
Ivanhoe Mines	**14**	-	**70**	-
Ivanhoe Capital Aviation	**-**	524	**-**	824
I2MS	**330**	242	**491**	378
Total related party expenses	**$ 937**	$ 1,232	**$ 1,548**	$ 2,649

The Company also recorded recoveries of $0.1 million and $0.2 million for the three and six months ended June 30, 2011 compared to $nil for the three and six months ended June 30, 2010 for administration expenses with Ivanhoe Mines and Ivanhoe Energy.

The Company had accounts receivable of $0.6 million at June 30, 2011 ($0.4 million at December 31, 2010) and accounts payable of $0.5 million at June 30, 2011 ($0.9 million at December 31, 2010) with related parties.

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.

12. RELATED PARTY TRANSACTIONS (Continued)

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 has also adopted a share option plan as incentive to directors and eligible employees. Details of the plan are set out in Note 18 of the Condensed Consolidated Interim Financial Statements.

As at June 30, 2011, the Company employed 658 employees.

13. OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value. As at August 10, 2011, 183.0 million common shares were issued and outstanding. There are also incentive share options outstanding that are exercisable to acquire 8.6 million unissued common shares. There are no preferred shares outstanding.

As at August 10, 2011, Ivanhoe directly owned 104.8 million common shares representing approximately 57% of the issued and outstanding common shares of the Company.

14. INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

15. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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.

15. 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.

15. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)

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.

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.

15. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)

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.

15. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)

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

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

Property, plant and equipment ("PPE")

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.

15. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)

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.

16. RISK FACTORS

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

Material risks and uncertainties affecting SouthGobi, their potential impact and the Company's principal risk management strategies are substantially unchanged from those disclosed in the Company's MD&A for the year ended December 31, 2010, which is available at www.sedar.com.

17. OUTLOOK

SouthGobi substantially proliferated its customer base during the first half of 2011 and raised prices for individual products.

To date the Company has signed seven major customers to purchase coal in the third quarter of 2011. Pricing for the raw semi-soft coking coal product and raw higher-ash coal product should be similar to those prices of the second quarter of 2011 at approximately $65 per tonne and $40 per tonne respectively because SouthGobi has pursued a strategy to substantially expand volume for the third quarter. A new product will also be introduced being a raw medium-ash coal. Initial contracts have been signed reflecting pricing of approximately $47 per tonne for that product. With the three products, SouthGobi anticipates the overall average realized sales price in the third quarter of 2011 should be similar to that achieved in the second quarter and in the range of $50 per tonne to $55 per tonne.

Assuming various contracts are performed and the Mongolia-China border remains efficient, the Company anticipates sales volumes for the third quarter of 2011 to be in the range of 1.2 million tonnes to 1.6 million tonnes.

The country-wide shortage of diesel fuel that caused a large abnormal increase in direct cash cost per tonne of coal produced has currently been resolved. Assuming no recurrence of the issue, nor an increase in waste-to-coal ratio (strip ratio) substantially above the long-term mine plan level of approximately 4 bank cubic meters of waste per tonne, SouthGobi anticipates direct cash costs will return to recent trend levels over the balance of the year.

Based on the Company's current expectation for volumes, pricing and costs, SouthGobi anticipates a further expansion of its normalized income from mine operations in the third quarter of 2011 when compared to the second quarter of 2011.

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;
- 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.

17. OUTLOOK (Continued)

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 year ended December 31, 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 is part of a consortium awarded the tender to construct a paved highway from Ovoot Tolgoi to the Mongolia-China border. The consortium intends to commence construction this year of the highway that is expected upon completion to have a carrying capacity in excess of 20 million tonnes of coal per year.
- **Advancing the Soumber deposit** – SouthGobi intends to further define the deposit with continued exploration work while also substantially advancing the feasibility and planning 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.

August 10, 2011