SouthGobi Resources Ltd.

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

December 31, 2010

(Unaudited)

(Expressed in U.S. dollars)

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

1. OVERVIEW

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

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

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

The Ovoot Tolgoi Mine, strategically located approximately 40 kilometers ("km") from the China-Mongolia border, is the Company's flagship producing asset. The Company commenced mining at Ovoot Tolgoi's Sunset Pit in April 2008 and commenced coal sales in September 2008. Current products from the Ovoot Tolgoi Mine include coals with coking (or metallurgical) applications primarily a raw semi-soft coking coal and raw higher-ash coals, which can be washed into semi-soft coking coal. From the commencement of production in late 2008 until December 31, 2010, the Company has sold approximately 4.0 million tonnes of coal from the Ovoot Tolgoi Mine. During the year ended December 31, 2010, the Company sold approximately 2.5 million tonnes of coal. The Ovoot Tolgoi Mine is covered by a single 9,308 hectare ("ha") mining license and a corresponding permit to mine.

The Soumber Deposit comprises the Soumber Field and the Biluut Field and is located approximately 20km to the east of the Ovoot Tolgoi Mine, which could allow the operations to share existing infrastructure in the event a mine is developed there. Exploration results show potential for thick seams of coking coal, and a resource has been established confirming the deposit. Preparatory work for a formal license application for the Soumber Deposit continues.

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

1.1 Corporate Developments

Ovoot Tolgoi Complex

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

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

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

1. OVERVIEW (Continued)

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

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

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

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

To further enhance the value of our products, the Company commenced construction of a coal-handling facility in June 2010, including dry air separators and blending capability and is expected be operational at the end of 2011.

1. OVERVIEW (Continued)

Soumber Deposit

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

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

Regional Infrastructure

In October 2010, the Company entered into a contract for $48 million to design and construct a coal-haul highway. The 45 km highway will link the Ovoot Tolgoi Mine with Ceke, a major coal terminal on the China side of the border with rail connections to key coal markets in China. The new coal-haul highway will be 22 meters ("m") wide and will consist of four fully paved lanes, with a central median in order to provide capacity well in excess of 20 million tonnes of coal per year. The new highway is scheduled to be completed by the end of 2012. It will be constructed with a concession granted by the Mongolian Government as per the country's Concession Law. Final approval for the contract is subject to a formal review from the Mongolian Government.

Aspire Investment

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

1. OVERVIEW (Continued)

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

1.2 Corporate Activity

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

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

On February 10, 2010, the Mongolian National Chamber of Commerce and Industry selected SouthGobi Sands LLC, a wholly-owned subsidiary of SouthGobi, as the "Local Job Creator of the Year" for 2009. The purpose of this commemorative prize is to encourage and support the hiring of local residents in remote areas of Mongolia. Also during the year, the Company received awards for safety, partner of the year with Habitat for Humanity Mongolia and for tangible contributions for soum economic and social development and regional development through investments and creation of jobs.

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

1. OVERVIEW (Continued)

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

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

On June 8, 2010, the Company announced that its Board of Directors authorized a share repurchase program to purchase up to 2.5 million common shares of the Company on each or either of the Toronto Stock Exchange and the Hong Kong Stock Exchange, in aggregate representing up to 5 million common shares of the Company. As of March 30, 2011, the Company had repurchased 250,750 shares on the Hong Kong Stock Exchange and 1,255,550 shares on the Toronto Stock Exchange for a total of 1,506,300 common shares at a total cost of approximately $19.0 million. The Company cancels all shares after they are repurchased.

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

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

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

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

As of March 30, 2011, Ivanhoe Mines Ltd. ("Ivanhoe") directly owned 104,807,155 common shares representing approximately 57% of the issued and outstanding common shares of SouthGobi.

2. FORWARD-LOOKING STATEMENTS

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

3. MINERAL PROPERTIES

3.1 Qualified Persons

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

3.2 Mongolia Exploration and Mining Licenses

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

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

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

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

3. MINERAL PROPERTIES (Continued)

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

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

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

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

3.3 Properties in Mongolia

Ovoot Tolgoi Mine

The Ovoot Tolgoi Mine is located in the southwest corner of the Umnugobi Aimag (South Gobi Province) of Mongolia. The deposit is within the administrative unit of Gurvantes Soum, 270km southwest of the provincial capital of Dalanzadgad and 700km southwest of the nation's capital of Ulaanbaatar.

Ivanhoe first initiated coal exploration in the Ovoot Tolgoi area in October 2004 and extensive exploration programs were also carried out in 2005, 2006 and 2007. Mining operations at the Ovoot Tolgoi property are found in two distinct areas, referred to as the Sunset Pit to the west and the Sunrise Pit to the east.

3. MINERAL PROPERTIES (Continued)

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

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

The coal rank at the Ovoot Tolgoi Mine is high volatile B to A bituminous based on the ASTM D388 standard. High volatile B produces between 7,212 to 7,785 kcal/kg and high volatile A produces greater than 7,785 kcal/kg heat output.

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

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

To further enhance product value, the Company commenced construction of a coal-handling facility in June 2010. The coal-handling facility will include a 300-tonne–capacity dump hopper, which will receive run-of-mine coal from the Ovoot Tolgoi Mine and feed a coal rotary breaker that will size coal to a maximum of 50 millimeters and reject oversize ash. The facility will also include dry air separation as an additional stage through the insertion of dry air separation modules. Completion is estimated at the end of 2011. Prior to the operation of the permanent coal handling facility, temporary screening operations have commenced at Ovoot Tolgoi. The screening performs a similar function to the coal-handling facility, namely rejecting oversize ash and sizing the coal to a maximum size of 50 millimeters.

3. MINERAL PROPERTIES (Continued)

In the fourth quarter of 2010, coal sales were approximately 1.5 million tonnes compared to total sales in the fourth quarter of 2009 of approximately 0.36 million tonnes. Total sales since the mine commenced production are approximately 4.0 million tonnes.

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

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

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

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

3. MINERAL PROPERTIES (Continued)

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

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

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

In October 2010, the Company approved the purchase of additional equipment including one Liebherr R9250 hydraulic excavator (17 m^3), which will replace the current Liebherr 994 hydraulic shovel ($13.5m^3$), and an additional Terex MT4400 (218-tonne capacity) truck. This will provide better fleet flexibility as the Liebherr R9250 hydraulic excavator will be in a back-hoe configuration and can load both the larger MT4400 (218-tonne capacity) trucks and the smaller TR100 (91-tonne capacity) trucks as well as mine the thinner seams more cleanly. The new Liebherr R9250 was commissioned at the end of January 2011. An additional fifth fleet has also been approved including one Liebherr R9250 hydraulic excavator and two MT4400 (218-tonne capacity) trucks. This additional equipment is expected to accelerate production. Two additional MT4400 (218-tonne capacity) trucks have also been approved to maintain capacity as cycle times will increase when the coal handling facility is operating.

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

3. MINERAL PROPERTIES (Continued)

Soumber Deposit

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

Exploration and drilling programs at Soumber first started in 2005 in the western field. Sixty-two holes were drilled during 2005 and 2006 that confirmed the potential for a significant coal deposit in the area. Between 2007 and 2008, over 121 drill holes, totaling 24,512m of drilling were completed. In 2009, the Company conducted geotechnical and hydrological programs in the Soumber central field. Exploration programs were conducted on the Biluut field in 2005 and 2008 when over 29 drill holes totaling approximately 6,549m were completed. Exploration at the Biluut field was expanded in 2010 with 67 drill holes totaling 20,507m being completed. The exploration geology fieldwork included reconnaissance mapping, trenching, geologic descriptions of drilling returns, geotechnical data, field logs and database development.

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

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

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

3. MINERAL PROPERTIES (Continued)

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

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

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

Ovoot Tolgoi Underground Deposit

The Ovoot Tolgoi Underground Deposit is contiguous to, and located directly below, the surface mine development. The entire extension of the coal at depth from 300m to 600m that is designated for potential underground development is located inside the existing Ovoot Tolgoi mining license.

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

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 150 m. Details of the assumptions and parameters used to calculate these coal resources and coal quality estimates are set out in the Technical Report entitled, "Coal Geology and Resources – Tsagaan Tolgoi Property" dated March 25, 2008, and available at www.sedar.com.

Effective August 12, 2009, the Mongolian Government issued a mining license for the Tsagaan Tolgoi coal field. The Technical and Economic Study has been completed, and was approved by the Mongolian Government on March 4, 2010. The Detailed Environmental Impact Assessment was approved on April 9, 2010.

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

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

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

3. MINERAL PROPERTIES (Continued)

Exploration Program

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

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

Substantive physical exploration for 2010 commenced in March. For the year ended December 31, 2010, $18.8 million has been spent, including 60,646m^3 of trenching and over 109,600m of drilling (both core and reverse circulation). Key targets so far have been the Soumber Deposit and the fields surrounding the Soumber Deposit and a target approximately 6km to the south-west of the Ovoot Tolgoi Complex known as the SW target. For the year ended December 31, 2010, $8.3 million has been spent on the Soumber Deposit and surrounding area.

The 2010 drilling program focused primarily on further definition of known coal occurrences with the intention to bring them to a NI 43-101 compliant resource definition stage and to allow for registration with the Mongolian Government as the next step toward expanding the Company's mining license holdings.

Regional Infrastructure

The Company entered into a contract for $48 million to design and construct a coal-haul highway. The 45 km highway will link the Ovoot Tolgoi Mine with Ceke, a major coal terminal on the China side of the border with rail connections to key coal markets in China. The new coal-hauling highway will be 22m wide and will consist of four fully paved lanes, with a central median in order to provide capacity well in excess of 20 million tonnes of coal per year. The new highway is scheduled to be completed by the end of 2012. It will be constructed with a concession granted by the Mongolian Government as per the country's recently passed Concession Law. Final approval for the contract is subject to a formal review from the Mongolian Government.

4. SELECTED ANNUAL INFORMATION

($ in thousands, except per share information)

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

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

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

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

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

4. SELECTED ANNUAL INFORMATION (Continued)

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

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

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

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

5. SUMMARY OF QUARTERLY RESULTS

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

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

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

The changes in comparative results of operations on a quarter over quarter basis are due primarily to significant fluctuations in the following areas: revenue, exploration expenses, foreign exchange gains and losses, interest expense, impairments, loss on partial conversion of the convertible debenture and fair value change of embedded derivatives in convertible debt. These latter two items are described in Notes 9 and 20 of the Consolidated Financial Statements.

5. SUMMARY OF QUARTERLY RESULTS (Continued)

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

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

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

The cost of sales was $38.2 million in the fourth quarter of 2010 compared to $8.4 million in the fourth quarter of 2009. Cost of sales will vary depending on sales volume, production and unit costs, which directly affects income from mine operations. Cost of sales is comprised of three main components, direct cash costs of products sold, mine administration costs and non-cash items. Non-cash items include depreciation, depletion of stripping costs, impairments and share-based compensation. The increase in cost of sales in the fourth quarter of 2010 compared to the fourth quarter of 2009 and the third quarter of 2010 relates primarily to the increased sales volume.

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

5. SUMMARY OF QUARTERLY RESULTS (Continued)

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

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

In the fourth quarter of 2010, other finance income/(costs) includes a loss of $20.0 million on the fair value change of the embedded derivative and a mark to market gain of $4.4 million mainly related to the Company's investment in KRL. This compares to a $45.0 million loss on the fair value change of the embedded derivative in the fourth quarter of 2009. In the third quarter of 2010, other finance income/(costs) included a gain of $49.8 million on the fair value change of the embedded derivatives in the convertible debenture and a $1.7 million mark to market gain on investments. The finance income/(costs) in the first quarter of 2010 included a $151.4 million loss on partial conversion of the convertible debenture.

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

6. RESULTS OF OPERATIONS

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

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

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

6. RESULTS OF OPERATIONS (Continued)

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

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

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

In addition to the impact of the pit realignment, costs for the year ended December 31, 2010 were adversely impacted by fleet issues. Delayed commissioning of the final two Terex MT4400 (218-tonne) haul trucks from the second mining fleet meant the Liebherr 996 hydraulic shovel ($34m^3$) was not operating efficiently in the second quarter of 2010. Furthermore, the Company's Terex TR100 (91-tonne capacity) haul trucks from the first mining fleet experienced poor equipment availability ratios in the second quarter of 2010.

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

In the third quarter of 2010, the Company introduced screening of its raw higher-ash coals (currently consisting of Sunset Pit No. 8/9/10 seams coal). Screening increases the direct cash cost of those coals impacted.

6. RESULTS OF OPERATIONS (Continued)

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

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

Cost of sales was $77.5 million in the year ended December 31, 2010, compared to $29.4 million for the year ended December 31, 2009. The increase in cost of sales is due to the increased sales volume, increased cash costs as well as the impairment of the raw higher-ash coal stockpiles and the Liebherr 994 shovel and related supplies recorded in the third quarter of 2010. Cost of sales comprise the direct cash cost of products sold, mine administration costs, equipment depreciation, depletion of stripping costs, impairment of inventory and fixed assets and share-based compensation.

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

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

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

6. RESULTS OF OPERATIONS (Continued)

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

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

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

Corporate administration fees increased in the year ended December 31, 2010 compared to the year ended December 31, 2009. The increase predominantly relates to additional administration costs incurred through the continued expansion of the Company's employee base, higher regulatory and filing fees, investor relations costs, travel expenses and administration support costs.

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

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

Sustainability and community relations are costs incurred in Mongolia. Sustainability and community relations expenses were $0.7 million in the year ended December 31, 2010 compared to $nil in the year ended December 31, 2009. The Company is committed to contributing to communities in Mongolia and developing and maintaining a positive relationship with the various communities in which the Company operates.

6. RESULTS OF OPERATIONS (Continued)

Public infrastructure costs were $6.0 million for the year ended December 31, 2010 compared to $nil for the year ended December 31, 2009. These costs relate to maintenance and upgrading of public transportation infrastructure used to transport coal from the Ovoot Tolgoi Mine to the Chinese border.

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

Listing fees consist of legal, accounting and professional fees incurred for a secondary listing on the Hong Kong stock exchange. On January 29, 2010 the Company closed a global equity offering and commenced trading on the Main Board of the Hong Kong Stock Exchange. Listing fees incurred in 2010 were capitalized as share issue costs. In 2009, listing costs of $2.5 million were expensed and listing costs of $4.6 million were capitalized. In October 2009 the Company achieved milestones that strongly indicated that the secondary listing application would lead to an equity financing and all listing costs subsequent to that date were capitalized.

7. NON-IFRS FINANCIAL MEASURES

($ in thousands, unless otherwise stated)

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

Cash costs is the term used by the Company to describe the cash production costs and consists of cost of product, which includes direct and indirect costs of production. Non-cash adjustments include share-based compensation costs, depreciation, depletion and impairments. The figures disclosed below are for cash cost of product sold and may differ from cash cost of product produced depending on stockpile inventory turnover.

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

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

8. EXPLORATION COSTS AND DISCONTINUED OPERATIONS BY DIVISION

($ in thousands)

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

Mongolian Coal Division

Exploration costs are charged to operations until such time as it has been determined that a property has economically recoverable reserves, in which case the subsequent costs incurred to develop a property are capitalized. Exploration expenditures include geological consulting, drilling, license fees, office costs and salaries and benefits.

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

The exploration expenditures for the year ended December 31, 2010 were $18.8 million compared to $5.4 million for the year ended December 31, 2009. Exploration activities include drilling, trenching and geological reconnaissance. The Soumber exploration program and the Greenfields exploration program accounts for the majority of the exploration expenditures and involves reverse circulation work, core diamond drilling, hole logging as well as a water and a geotechnical study program.

Indonesian Coal Division – Discontinued Operations

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

9. FINANCE INCOME/(COSTS)

($ in thousands)

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

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

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

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

9. FINANCE INCOME/(COSTS) (Continued)

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

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

On December 18, 2009, the Company established a line of credit facility with Golomt Bank in Mongolia ("Bank line of credit"). The Bank line of credit was a twelve month revolving line of credit facility with a maximum draw-down available of $3.0 million. The Bank line of credit facility was used by the Company's Mongolian subsidiaries as part of their working capital management. On December 18, 2010 the line of credit facility was extended to January 18, 2011. On January 18, 2011, the Company signed a new revolving line of credit facility with Golomt Bank for a twelve month period. Under the new agreement the maximum draw-down available is $3.5 million and MNT8.1 Billion (approximately $6.5 million) and bears interest at 11% for any U.S. Dollar amounts outstanding and 12% for any Mongolia Tugrik amounts outstanding. The Company incurred interest expense of $0.13 million for the year ended December 31, 2010 related to the line of credit.

9. FINANCE INCOME/(COSTS) (Continued)

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

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

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

10. TAXES

For the year ended December 31, 2010, the Company recorded current income tax expense of $1.8 million related to its Mongolian operations compared to $0.5 million for the year ended December 31, 2009. The Company believes profitable operations in Mongolia are probable and has therefore recorded a deferred income tax recovery related to deductible temporary differences and the carry forward of unused tax losses of $4.5 million for the year ended December 31, 2010 (2009: $6.9 million).

11. LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Highlights
($ in thousands)

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

General market conditions

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

Cash used in operating activities

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

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

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

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

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

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

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

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

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

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Coal and supplies inventory have increased to $26.2 million at December 31, 2010 from $16.4 million at December 31, 2009 due to increased activity and more mobile equipment on-site. Coal and supplies inventory is valued at the lower of cost and net realizable value. Coal inventory cost is $2.4 million at December 31, 2010 compared to $9.6 million at December 31, 2009. Coal inventory cost includes direct and indirect labour, operating materials and supplies, transportation costs and an appropriate portion of fixed and variable overhead expenses including depreciation and depletion. Supplies inventory consists of consumable parts and supplies.

The Company had a stockpile of approximately 0.16 million tonnes of coal inventory at December 31, 2010 and 0.39 million tonnes at December 31, 2009. Coal stockpiles at December 31, 2010 were all semi-soft coking coal.

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

Cash used for investing activities

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

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

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

Interest income will increase or decrease depending on the cash position and interest rates. Interest income was higher in the year ended December 31, 2010 compared to the year ended December 31, 2009 due to higher cash balances which relate directly to the completion of the equity financings and the proceeds from the CIC convertible debenture. The current economic climate has resulted in very low interest rates especially for US$ denominated investments.

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Cash provided by financing activities

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

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

On December 18, 2009, the Company established a line of credit facility with Golomt Bank in Mongolia. The bank line of credit facility was a twelve month revolving line of credit facility with a maximum draw-down available of $3.0 million. The line of credit facility is secured by a charge over certain equipment held by SouthGobi Sands LLC. The line of credit facility is used by the Company's Mongolian subsidiaries as part of their working capital management. On December 18, 2010 the line of credit facility was extended to January 18, 2011. On January 18, 2011, the Company signed a new revolving line of credit facility with Golomt Bank for a twelve month period. Under the new agreement the maximum draw-down available is $3.5 million and MNT8.1 Billion (approximately $6.5 million) and bears interest at 11% for any U.S. Dollar amounts outstanding and 12% for any Mongolia Tugrik amounts outstanding. In 2010, the Company had drawings of $46.7 million and repayments of $49.7 million. The principal balance outstanding as at December 31, 2010 was $nil.

Contractual Obligations and Guarantees
($ in thousands)

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

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

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

Liquidity, Financing and Working Capital Resources

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

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

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

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

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

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

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

11. LIQUIDITY AND CAPITAL RESOURCES (Continued)

On June 8, 2010, the Company announced that its Board of Directors authorized a share repurchase program to purchase up to 2.5 million common shares of the Company on each or either of the Toronto Stock Exchange and the Hong Kong Stock Exchange, in aggregate representing up to 5 million common shares of the Company. As of March 30, 2011, the Company had repurchased 250,750 shares on the Hong Kong Stock Exchange and 1,255,550 shares on the Toronto Stock Exchange for a total of 1,506,300 common shares. The Company cancels all shares after they are repurchased.

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

Financial instruments

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

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

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

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

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

	Year ended December 31,		
($ in thousands)	**2010**	**2009**	**2008**
Unrealized gains/(losses) on long term investments	**$ 870**	$ 843	$ -
Fair value gain/(loss) of embedded derivatives	**100,637**	(44,980)	(7,223)

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

12. ENVIRONMENT

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

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

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

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

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

12. ENVIRONMENT (Continued)

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

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

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

($ in thousands)	Year ended December 31,		
	2010	**2009**	**2008**
Assumption			
Undiscounted costs	**$ 5,982**	$ 2,270	$ 1,087
Country specific risk free rate	**8.0%**	10.8%	11.0%
Inflation rate	**2.8%**	2.8%	3.5%
Average years to reclamation	**14**	15	16

13. RELATED PARTY TRANSACTIONS

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

- Ivanhoe Mines is the Company's parent company and at December 31, 2010 owned approximately 57% of the outstanding common shares of the Company. Ivanhoe Mines provides various administrative services to the Company on a cost-recovery basis. The Company also provides some office services to Ivanhoe Mines in the Company's Hong Kong Office and recovers the costs for those services on a cost-recovery basis.

- Global Mining Management ("GMM") is a private Company owned equally by seven companies, two of which include the Company and Ivanhoe Mines. GMM provides administration, accounting and other office services to the Company on a cost-recovery basis.

- I2MS.NET Pte. Ltd. ("I2MS") is a private company 100% owned by Ivanhoe Mines. 12MS provides information technology and other related services to the Company on a cost-recovery basis.

- Ivanhoe Capital Aviation LLC ("Ivanhoe Aviation") is a private company 100% owned by Ivanhoe's Executive Chairman. Ivanhoe Aviation operates aircrafts which was rented by the Company on a cost-recovery basis for a portion of the year to facilitate the global equity offering. The contract with Ivanhoe Aviation was terminated in the fourth quarter of 2010.

- Ivanhoe Energy Inc. ("Ivanhoe Energy") is a publicly listed company with two directors in common with the Company. The Company provides some office services to Ivanhoe Energy in the Company's Hong Kong office and recovers the costs for those services on a cost-recovery basis.

13. RELATED PARTY TRANSACTIONS (Continued)

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

($ in thousands)	Year ended December 31,		
	2010	**2009**	**2008**
Corporate administration	**$ 3,832**	$ 1,176	$ 1,893
Salaries and benefits	**2,120**	1,321	1,824
Interest	**-**	1,642	134
Total related party expenses	**$ 5,952**	$ 4,139	$ 3,851

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

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

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

On December 31, 2008, the Company announced the sale of the Metals Division to Ivanhoe for $3.0 million and other non-cash consideration. As part of the sale transaction, the Company obtained a one year credit facility from Ivanhoe, which allowed the Company to receive loan advances from Ivanhoe to an aggregate maximum of $30.0 million which was later increased to $60.0 million. In November 2009, the Company after receiving the financing from CIC repaid the $50.0 million in principal plus $1.6 million in accrued interest.

14. OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares without par value and an unlimited number of preferred shares without par value. As at March 30, 2011, 183,726,811 common shares were issued and outstanding. There are also incentive share options outstanding that are exercisable to acquire 8,546,491 unissued common shares. There are no preferred shares outstanding.

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

15. DISCLOSURE CONTROLS AND PROCEDURES

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

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

Internal controls over financial reporting

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

15. DISCLOSURE CONTROLS AND PROCEDURES (Continued)

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

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

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

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

16. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

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

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

A detailed summary of all of the Company's significant accounting policies is included in Note 3 to the annual Consolidated Financial Statements for the year ended December 31, 2010.

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

Mineral properties

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

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

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

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

16. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (Continued)

Decommissioning, restoration and similar liabilities

The Company recognizes a provision for statutory, contractual, constructive or legal obligations, including those associated with the reclamation of mineral properties and mineral assets under PPE, when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, a provision for a decommissioning liability (also referred to as an asset retirement obligation) is recognized as its present value in the period in which it is incurred. Upon initial recognition of the liability, a corresponding amount is added to the carrying amount of the related asset and the cost is amortized as an expense over the economic life of the asset using either the unit-of-production method or the straight-line method, as appropriate. Following the initial recognition of the decommissioning liability, the carrying amount of the liability is increased for the passage of time and adjusted for changes to the current market-based discount rate, amount or timing of the underlying cash flows needed to settle the obligation. Because the estimate of obligations is based on future expectations in the determination of closure provisions, management makes a number of assumptions and judgments. The main factors that can cause expected cash flow changes are changes to laws and legislation, construction of new facilities and changes in the reserve estimate and the resulting amendment to the life of the mine. In general, as the life of a mine ends, the expected cash flows become more reliable. The estimate of a decommissioning liability at the beginning of the mine life, is subject to greater uncertainty due to the amount of time before decommissioning activities begin. (see Environmental section for detailed assumptions).

Inventory valuation

Coal inventories are stated at lower of production cost and net realizable value. Production costs include direct and indirect labour, operating materials and supplies, transportation costs and an appropriate portion of fixed and variable overhead expenses, including depreciation and depletion. Net realizable value represents the estimated selling price, based on current and future contracts less all estimated costs of completion and costs necessary to make the sale which are based on current operations and forecasts. The estimates and assumptions used in the measurement of the coal stockpiles include volume, quality and density. If these estimates or assumptions prove to be inaccurate, it could impact management's valuation of the coal inventory stockpiles.

16. 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.

16. 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.

16. 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.

16. 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.

17. RISK FACTORS

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

Risks Relating to the Company's Business and Industry

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

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

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

17. RISK FACTORS (Continued)

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

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

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

17. RISK FACTORS (Continued)

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

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

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

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

17. RISK FACTORS (Continued)

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

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

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

17. RISK FACTORS (Continued)

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

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

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

17. RISK FACTORS (Continued)

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

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

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

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

17. RISK FACTORS (Continued)

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

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

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

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

17. RISK FACTORS (Continued)

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

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

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

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

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

17. RISK FACTORS (Continued)

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

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

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

17. RISK FACTORS (Continued)

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

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

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

17. RISK FACTORS (Continued)

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

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

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

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

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

17. RISK FACTORS (Continued)

Foreign currency fluctuations could affect expenses and any future earnings.

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

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

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

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

17. RISK FACTORS (Continued)

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

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

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

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

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

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

17. RISK FACTORS (Continued)

Future stock market conditions may change.

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

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

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

17. RISK FACTORS (Continued)

Risks Relating to the Company's Projects in Mongolia

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

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

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

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

17. RISK FACTORS (Continued)

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

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

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

17. RISK FACTORS (Continued)

The Mineral Resources Authority of Mongolia ("MRAM") has prepared a draft list of licenses that overlap with the prohibited areas described in the new law – based on information submitted by water authority agencies, forest authority agencies and local authorities – for submission to the Mongolian Ministry of Mineral Resources and Energy (the "MMRE"). Subsequent to the MMRE's approval of this preliminary list, the Mongolian Government must still give its final approval before the final list can be published. During the MMRE's and the Mongolian Government's review of the draft list of licenses prepared by MRAM, licenses may be added or subtracted to the list at any time prior to approval and publication of the final list.

Six of the Company's exploration licenses and the Tsagaan Tolgoi mining license– included on MRAM's draft list of licenses – may be included on the final list published by the Mongolian Government, potentially affecting the status of those licenses under the Mining Prohibition in Specified Areas Law. Activities being carried out on these properties include drilling, trenching and geological reconnaissance. The Company has no immovable company assets located in any of the potentially affected areas and the loss of any or all of the potentially affected properties would not materially and adversely affect its existing operations. The loss of the Tsagaan Tolgoi mining licenses would however impact the Company's resources.

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

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

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

17. RISK FACTORS (Continued)

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

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

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

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

Importance or to accurately determine whether or not any given license area is within, or overlaps a Mineral Deposit of Strategic Importance.

17. RISK FACTORS (Continued)

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

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

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

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

18. OUTLOOK

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

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

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

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

18. OUTLOOK (Continued)

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

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

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

Overview and Objectives

The Company continues to focus its efforts on mining, development and exploration of coking and raw coal products in Mongolia for supply of quality products to customers in China. As the Company looks forward through 2011, the Company is encouraged by the overall long term demand for our products. There are many positive developments in Mongolia, which provide further support that the mining sector will develop its resource base for long term growth. The Company is making progress with its sales and marketing efforts, continuing to focus on efficiency and prudent financial management and intends to manage production levels to meet anticipated demand for the Company's products.

18. OUTLOOK (Continued)

The Company's objectives for 2011 remain unchanged from the third quarter of 2010 and are as follows:

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

March 30, 2011