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MONGOLIAN MINING CORPORATION

(Incorporated in the Cayman Islands with Limited Liability)

(Stock Code: 975)

PROPOSED ISSUE OF GUARANTEED SENIOR NOTES

The Company proposes to issue U.S. dollar denominated guaranteed senior notes due 2017. The Notes will be guaranteed by the Subsidiary Guarantors. The proposed issue of the Notes will be arranged by ING Bank N.V., Singapore Branch, J.P. Morgan Securities Ltd. and Merrill Lynch International as Joint Bookrunners, and together with Standard Bank Plc and Standard Chartered Bank as Joint Lead Managers. Approval in-principle has been received for the listing and quotation of the Notes on the Official List of the SGX-ST.

As no binding agreement in relation to the proposed issue of the Notes has been entered into, the proposed issue of the Notes may or may not materialize. Potential investors and shareholders of the Company are urged to exercise caution when dealing in the securities of the Company.

PROPOSED ISSUE OF THE NOTES

Introduction

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Once the terms and conditions of the Notes have been finalised, the Company will enter into a purchase agreement with the Joint Lead Managers. The Company will make further announcement should the purchase agreement be signed. **As no binding agreement in relation to the proposed issue of the Notes has been entered into, the proposed issue of the Notes may or may not materialise. Potential investors and shareholders of the Company are urged to exercise caution when dealing in the securities of the Company.**

In connection with the proposed issue of the Notes, the Company will provide certain institutional investors with recent corporate, technical, regulatory and financial information of the Company, some of which has not been previously disclosed to the public. An extract of such updated information is set in the section “Extract of updated information” in the announcement, and can also be available at the Company’s website at <http://www.mmc.mn>.

The completion of the proposed issue of the Notes is subject to market conditions and investor interest. The Notes will not be registered under the Securities Act and may not be offered or sold within the United States, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. None of the Notes will be offered to the public in Hong Kong.

Reasons for the proposed issue of the Notes

The proposed issue of the Notes is intended for the following purposes:

- for financing transportation infrastructure improvement and development projects, including, without limitation, for our UHG-GS railway project;
- for working capital and other general corporate purposes, including, without limitation, for exploration and debt refinancing.

We may reallocate the use of proceeds in response to changing market conditions or circumstances and other factors, including, without limitation, the timing of our UHG-GS railway project. For example, if there is a change in the timing of our UHG-GS railway project, we may decide not allocate proceeds to our UHG-GS railway project and instead we may refinance our existing debt or allocate proceeds for other purposes.

Listing

Approval in-principle has been received for the listing and quotation of the Notes on the Official List of the SGX-ST. Admission to the Official List of the SGX-ST and quotation of the Notes on the SGX-ST is not to be taken as an indication of the merits of the Company or the Notes. No listing of the Notes has been sought in Hong Kong.

Extract of updated information

RISK FACTORS

In addition to other information in this offering memorandum, you should carefully consider the following risk factors before making any investment decision in relation to the Notes. If any of the events described below occurs, our business, prospects, financial condition and results of operations could be materially and adversely affected and the market price of the Notes could decline. See “Definitions” and “Glossary” for specific or specialized vocabulary used in this section.

Risks Relating to our Business and Industry

The Government of Mongolia could determine that any one or more of our projects in Mongolia is a Mineral Deposit of Strategic Importance and could take an equity, production, profit sharing or other interest in any of our projects.

Pursuant to the 2006 Minerals Law, the Parliament has wide discretion to designate mineral deposits to be Mineral Deposits of Strategic Importance. The Government of Mongolia is entitled 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 Government of Mongolia and such license holder. Details of any minerals reserves must be filed by the relevant license holder with the Government of Mongolia, 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 and the additional Tier 2 Deposits List, the Parliament may at any time designate other deposits not yet currently on either list 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 Government of Mongolia will take an interest in such deposit. While the Government of Mongolia 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 with a Mineral Deposit of Strategic Importance.

Under the 2006 Minerals Law, the size of the Government of Mongolia’s participation is determined largely by the level of state funding which has been provided for the exploration of any deposit, with the Government of Mongolia entitled to participate up to 50% in the event that there has been state funding. However, the 2006 Minerals Law is vague as to the details and method by which the Government of Mongolia will take its interest and the final arrangements in respect of the Government of Mongolia’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 Government of Mongolia’s interest are subject to negotiation between the Government of Mongolia and the license holder. In the past, state funds were used to conduct some of the exploration activities of our deposit. On September 12, 2008, we entered into an agreement with the MRAM and agreed to repay US\$1.18 million of state funds used in the historical exploration activities associated with our UHG mine on June 11, 2010. 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 be enforced 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 Government of Mongolia’s participating interest in excess of 50%. While the 2006

Minerals Law provides that the interest of the Government of Mongolia 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 Government of Mongolia. There can be no assurance that legislation will not be enacted which further strengthens the Government of Mongolia's right to participate in privately held mineral resources in Mongolia.

In February 2007, the Parliament declared the six mining licenses originally held by us to be Mineral Deposits of Strategic Importance under the 2006 Minerals Law. After taking into consideration the economic development policies of Mongolia, we decided to sign the Minerals License Transfer Agreement, pursuant to which we agreed to transfer five of our six mining licenses to the Government of Mongolia. We assumed no liability after these five mining licenses were transferred to the Government of Mongolia. We received no cash consideration for the transfer of five of the six mining licenses to the Government of Mongolia. Our UHG deposit was on the list of Mineral Deposits of Strategic Importance, but having entered into the Minerals License Transfer Agreement with the Government of Mongolia, the Government of Mongolia guaranteed that our mining license would not be terminated or amended by requiring state equity participation on the development. Our Mongolian counsel, Economic & Legal Consultancy LLC, has confirmed that the Minerals License Transfer Agreement is valid, binding and enforceable in accordance with its terms and is binding on the Government of Mongolia. Economic & Legal Consultancy LLC has also confirmed that the Government of Mongolia has under the Minerals License Transfer Agreement waived its right under the 2006 Minerals Law to participate jointly with us (by compulsorily taking a 50% or other ownership interest in ER LLC or the relevant minerals) in the exploitation of the minerals deposit covered by Mining License MV-11952, or withhold any further permits or licenses or access to infrastructure necessary for such exploitation provided that we apply for the same in accordance with relevant rules. However, no assurance can be made that the Government will not take an equity or other interest in our UHG mine.

As of the date of this offering memorandum, our BN mine has not been designated as a Mineral Deposit of Strategic Importance or included on the Strategic Deposit List or the Tier 2 Deposits List as delineated in the Mongolian Parliamentary Resolution No. 27 dated February 6, 2007. However, there can be no assurance that our BN mine will not be designated as a Mineral Deposit of Strategic Importance or included on either list.

Our licenses are subject to termination, renewal and other uncertainties.

Our most significant licenses are the license covering our UHG deposit located in the Tavan Tolgoi coal formation located in South Gobi Province, which gives us the right to mine coal within the licensed area through August 29, 2036, and our BN mine license covering our BN deposit located in Umnugobi Aimag in South Gobi, which gives us the right to mine coal within the licensed area through December 1, 2038, both of which are extendable twice, each for an additional 20 years, subject to certain conditions. The Government of Mongolia could revoke either of our licenses if we fail to satisfy our obligations, including payment of royalties and taxes to the Government of Mongolia and the satisfaction of certain mining, environmental, health and safety requirements. As we conduct operations through contractors, any failure by these contractors to perform under their operating agreements may result in our failure to satisfy our obligations under our licenses. As a result, our mining licenses could be terminated by the Government of Mongolia, which will materially and adversely affect our business, prospects, financial condition and results of operations. In addition, we will require additional licenses or permits to conduct our mining or exploration operations in Mongolia. There can be no assurance that we will be able to obtain and maintain such licenses or permits on terms favorable to us, or at all, for our future intended mining or exploration targets in Mongolia, or that such terms would not be subject to various changes.

Coking coal prices are cyclical and subject to significant fluctuation.

Our results of operations are highly dependent on world coal prices, which tend to be highly cyclical and subject to significant fluctuations. The world coal markets are sensitive to changes in coal mining capacity and output levels, patterns of demand and consumption of coal from the steel industry and other industries, for which coal is the principal raw material, and changes in the world economy. Improved distribution of Australian coking coal, an economic downturn in China, India or Asia in general or a change in Chinese government policy restricting coking coal imports could reduce world coal prices from current levels. The occurrence of any of these events can have a significant impact on selling prices for our coal. Although we have entered into supply agreements with terms ranging from one to ten years with several of our customers, most of these agreements provide that the price of coal sold is determined quarterly based on market prices and therefore do not protect against declines in world coal prices. An extended or substantial decline in world coal prices or the price for our coal may materially and adversely affect our business, prospects, financial condition and results of operations.

Historically, the Chinese coking coal and coal-related product markets have at times experienced alternating periods of increased demand that caused production capacity, volumes, prices and margins to increase, followed by periods of excess supply that caused prices and margins to decline. For example, due to floods in the state of Queensland in Australia in 2008, which negatively impacted the coking coal supply, and the high demand for coking coal products from Chinese state-owned steel manufacturing companies, the selling prices of washed coal and coke reached historically high levels in the first half of 2008. The average selling prices of washed coal and coke dropped significantly by the end of 2008 due to the effects of the global credit crisis and economic slowdown. In an effort to tackle the global financial crisis, China launched a stimulus package aiming at further expanding domestic demand and promoting economic growth which led to heightened domestic structural steel consumption. In 2010, China's urbanization continued to be one of the key growth drivers for construction steel, and by the end of 2010, washed coal and coke prices rebounded significantly. In 2011, the robust demand and tight supply of coking coal in China offset the effects of a slowdown in world economic growth, which resulted in a stabilized trend in the prices of washed coal and coke.

During the past 20 years, a growing world coal market and increased demand for coal worldwide have attracted new investors to the coal industry, spurred the development of new mines and expansion of existing mines in various countries, including Mongolia, Indonesia, China, Australia and Colombia, and resulted in added production capacity throughout the world. Increases in coal prices could encourage new or existing international coal producers to expand their production capacity. Any oversupply of coal in the world markets could reduce world coal prices in the future and the selling prices of our coal products, which could materially and adversely affect our business, prospects, financial condition and results of operations.

There is no assurance that Chinese demand for coking coal and coal-related products will continue to grow, or that the Chinese coking coal and coal-related markets will not experience excess supply in the future. A significant increase in the supply of or decrease in the demand for coking coal and coal-related products may cause the average selling prices of our coal products to decrease and therefore would have a material adverse effect on our business, prospects, financial condition and results of operations.

The accuracy of our resources and reserves estimates is based on a number of assumptions and we may produce less coal than our current estimates.

Our resources and reserves estimates are based on a number of assumptions in accordance with the JORC Code. There can be no assurance that our resources and reserves will be recovered in the quantities, qualities or yields presented in this offering memorandum. Coal resources and reserves estimates are inherently prone to variability. They involve expressions of judgment with regard to the presence and quality of mineralization and the ability to extract and process the mineralization economically. These judgments are based on a variety of factors, such as knowledge, experience and industry practice. The accuracy of these estimates may be affected by many factors, including the quality of the results of drilling and sampling of the coal deposits and analysis of the coal samples and the procedures adopted and experience of the person(s) making the estimates. There are risks associated with such estimates, including that coal mined may be of a different or inferior quality, volume, overburden strip ratio or stripping cost from the resource estimates. Such estimates may also be revised following further exploration or analysis.

We may at any time commission a new report to estimate the resources and reserves of our deposits. We are currently obtaining a new reserve report for our BN deposit which we expect to be completed by the end of 2012.

If we encounter mineralization or geological or mining conditions different from those predicted by historical drilling, sampling and similar examinations, we may have to adjust our mining plans in a way that may materially and adversely affect our business, prospects, financial condition and results of operations and reduce the estimated amount of coal resources and reserves available for production and expansion plans.

You should not assume that the resources estimated are capable of being directly reclassified as reserves under the JORC Code. The inclusion of resources estimates should not be regarded as a representation that these amounts could be exploited economically. You are cautioned not to place undue reliance on resources and reserves estimates.

We have significant levels of indebtedness, which could adversely affect us or the holders of the Notes.

As of December 31, 2011, we had US\$561.7 million in outstanding short-term and long-term borrowings, including indebtedness incurred under (i) our US\$180 million facility agreements with EBRD, FMO and DEG, (ii) our US\$400 million Existing Standard Bank Facilities Agreement, (iii) our US\$85 million QGX Convertible Bonds and (iv) our US\$13 million facility agreement with Khan Bank. In addition, on March 8, 2012, we entered into the New Standard Bank Facilities Agreement. See “Description of Other Material Indebtedness – New Standard Bank Facilities Agreement”. There can be no assurance that we will be able to obtain extensions of our credit facilities in the future as they mature or alternative sources of financing as our convertible bonds become due. In the event that we are unable to obtain extensions of these facilities, or if we are unable to obtain sufficient alternative funding at reasonable terms, we will have to repay these borrowings with cash generated by our operating activities. There can be no assurance that our business will generate sufficient cash flow from operations to repay these borrowings. In addition, repaying these borrowings with cash generated by our operating activities will divert our financial resources from the requirements of our ongoing operations and growth, and may have a material adverse effect on our business, prospects, financial condition and results of operations. Furthermore, we are subject to interest rate fluctuations on our financial indebtedness which may adversely impact our cash flow if prevailing interest rates increase.

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Quantitative and Qualitative Disclosures About Market Risk – Interest Rate Risk”.

Our credit facilities and convertible bonds contain covenants that restrict us and our subsidiaries from engaging in various transactions. Certain breaches, misrepresentations or defaults by, or an insolvency of, us or our subsidiaries could trigger an event of default under these financing agreements, which in turn would trigger an event of default under the Notes. This could materially and adversely affect us and the holders of the Notes. Any acceleration of indebtedness may cause defaults and cross defaults under our current and future financing agreements, and as well as significant reductions in our liquidity and may have a material adverse effect on our business, prospects, financial condition and results of operations. As of December 31, 2011, we had US\$561.7 million of outstanding bank borrowings and convertible bonds, all of which contained cross-default provisions. As of the date of this offering memorandum, the Subsidiary Guarantors have pledged certain accounts, our construction agreement with Sedgman for our CHPP, our coal mining agreement with Leighton, our offtake agreements, our CHPP, our water supply infrastructure assets, our 3x6 MW power plant and certain motor vehicles as collateral in connection with our EBRD, FMO and DEG Loan Agreements, our Existing Standard Bank Facilities Agreement and our Khan Bank Facility Agreement. In addition, ER LLC and we have granted a security interest in favor of Standard Bank over certain accounts, coal collateral and our rights under certain of our coal sales contracts to secure the New Standard Bank Facilities Agreement and, substantially simultaneous with the issuance of the Notes contemplated hereunder, the Collateral will be charged to secure both our obligations under the Notes and the New Standard Bank Facilities Agreement, on a pari passu basis. We may lose part or all of these pledged property and assets if we default on these secured borrowings, which would have a material adverse effect on our business, prospects, financial condition and results of operations. See “Description of Other Material Indebtedness”.

Coal markets are highly competitive and are affected by factors beyond our control.

We sell substantially all of the coal we produce into China. We compete with Chinese, Mongolian and other foreign coal producers (primarily from Australia) in the Chinese coal market. Competition in the Chinese coal market is based on many factors, including, among others, price, production capacity, coal quality and characteristics, transportation capability and costs, blending capability and brand name. Due to their location, some of our Chinese competitors may have lower transportation costs than we do. The Chinese coal market is highly fragmented and we face price competition from some small local coal producers that produce coal for significantly lower costs than we do, due to various factors, including their lower expenditure on safety and regulatory compliance. In addition, there was a slight decline in Chinese coal imports in 2011 due to a dramatic increase in the Chinese coking coal supply after the consolidation of the Chinese coal mining industry and high international coking coal prices. Some of our international competitors may have greater coal production capacity as well as greater financial, marketing, distribution and other resources than we do, and may benefit from more established brand names in international markets. As Mongolia is a landlocked country sharing borders only with China and Russia, we may be unable to access other markets if there is reduced demand for coal from China. Our inability to maintain our competitive position as a result of these or other factors could materially and adversely affect our business, prospects, financial condition and results of operation.

We may be adversely affected by future economic downturns that reduce the demand for steel, in particular, any economic downturn in China, including as a result of the financial crisis in Europe.

Any future economic downturn that reduces the demand for steel will have a negative impact on the demand for steel in China. While year-on-year growth rates in China’s demand for steel have

historically fluctuated dramatically, demand has continued to increase on an aggregate basis. Despite the Chinese government's recent efforts to cool down the overheating economy, particularly the real estate sector, China's apparent steel use in 2011 is still expected to have risen by approximately 7.5% year-on-year to 643.2 Mt according to the World Steel Association, mostly supported by growth in domestic infrastructure projects. As substantially all of our coking coal is currently sold to China and we believe is principally used in the manufacture of steel in China, a reduction in the demand for steel in China would directly reduce the demand for our coking coal. The financial crises in Europe could further weaken global demand for manufactured products and thereby indirectly weaken the Chinese economy and reduce the demand for steel in China. Construction has been one of the principal uses of steel in China, and any slowdown in the construction sector of the Chinese economy, whether as a result of falling housing prices or otherwise, could significantly reduce the demand for steel in China. As Mongolia is a landlocked country sharing borders only with China and Russia, we may be unable to access other markets if there is reduced demand for coal in China. This would have a material and adverse impact on our business, prospects, financial condition and results of operations.

Disruptions in transportation could adversely affect the demand for our coal.

Substantially all of our coal production is exported into China. Inadequate transportation infrastructure on both the Mongolia and Chinese sides of the border affects the pricing terms under which we sell our coal to customers and the willingness and ability of our customers to purchase coal from us. Our customers factor in any delays and the costs and availability of transportation in determining whether to purchase coal products from us and the prices they are willing to pay.

Our mining operations are highly dependent on road and rail services in Mongolia and in China. A bottleneck in the transportation of coal from our UHG mine to customers in China may arise if the road connecting our UHG mine to the GS 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 or delays or closures by governmental authorities for any reason. Our coal hauling operations on the road from the Tavan Tolgoi area to TKH were suspended for 23 days between April 21, 2011 to May 14, 2011 by the Inspector of the Umnugobi Aimag (South Gobi Province) Professional Inspection Agency to improve safety standards and reduce negative environmental impact on the area surrounding, what was at the time, a gravel road which was the cause of air pollution due to traffic-generated dust. While we began using our paved road with 18.0 Mtpa capacity of coal transportation from UHG mine to GS in October 2011 and we have significantly increased our trucking fleet to support our coal transport, there can be no assurance that our coal hauling operations on any part of our paved road will not be suspended in the future.

The hours of operation, the handling capacity and the potential closure of the GS border crossing also affect our ability to expedite the movement of our coal transportation. In January 2012, we together with Erdenes MGL, completed and commissioned an expansion of the GS border crossing to increase the throughput capacity and efficiency. However, there can be no assurance that the Mongolian and Chinese governments will continue to support further development and expansion of border-crossing handling capacity or that the respective customs authorities will handle our coal shipments in an efficient manner or in priority over other coal or freight being transported by other parties. In addition, the tariff for railway use may be set by the Government of Mongolia at a level that makes future railway transportation uneconomical when and if our UHG-GS railway is completed. There can be no assurance that, in such situations, there would be any other cost effective means of transporting the coal to our primary markets in China. As a result, our coal sales may be constrained and our results of operation adversely affected. See “– Our paved road connecting our UHG mine to the border crossing at GS is subject to a BOT license.”

In China, rail and road infrastructure and capacity have 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 events, or other new events will not occur in the future. In any of these circumstances, customers may not be able to take delivery of our coal, which may lead to delays in payment or refusal to pay for our coal and, as a result, our business, prospects, financial condition and results of operations could be materially and adversely affected.

Our UHG-GS railway is subject to various risks and uncertainties; we are not sure when we can commence and complete construction of the railway, what the actual cost of the project will be, or whether the project will be successful.

In order to lower our transportation costs and increase reliability and operational efficiency, we intend to commence construction of a railway directly from our UHG mine to GS in 2012. See “Business – Logistics and Transport – Railway”. We are not sure when we can commence construction of our UHG-GS railway or whether our investment in the railway project will be successful as a result of many factors, including:

- In June 2010, the Parliament passed Resolution No. 32 announcing its railway development policy. According to the policy, railway development will be conducted in three stages: (1) Tavan Tolgoi-Sainshand-Choibalsan railway, (2) our UHG-GS railway and other railways that go directly to the border of Mongolia and (3) railways going to western Mongolia from Tavan Tolgoi. The policy also specified that broad gauge rails would be used for crossing or connecting to existing railways, and use of standard gauge rails at the border will be discussed and decided by the Parliament at a later time. The policy left uncertain the starting time for construction and the gauge of those railways for the second stage. In June 2011, the Government of Mongolia announced that construction of second stage railways may proceed simultaneously with construction of the first stage. As of the date of this offering memorandum, the Government of Mongolia has not selected which gauge to use for our UHG-GS railway. While we expect the Parliament to support the construction of our UHG-GS railway, there can be no assurance that the Government of Mongolia will permit us to construct our UHG-GS railway in accordance with its railway development policy. We will not be able to begin constructing our UHG-GS railway until after the Government of Mongolia announces which rail gauge must be used for our UHG-GS railway.
- The Government of Mongolia issued Resolution 252 dated June 18, 2008 granting us the license to build our UHG-GS railway base infrastructure between UHG and GS for an initial three-year term beginning from January 19, 2009 and subsequently extended for three years beginning January 19, 2012. We entered into the license agreement for railway construction with the Railway Authority of Mongolia on September 5, 2008 and a detailed supplement to the license agreement on January 19, 2009. After the Government of Mongolia determines which gauge must be used in our UHG-GS railway, we plan to apply to the Railway Authority of Mongolia to amend the license agreement to comply with current Mongolian laws and policies. We will also be required to obtain a permit before we can commence and continue construction of our UHG-GS railway. There can be no assurance that we will be able to amend our license agreement or obtain the necessary construction permit on a timely basis or at all.
- There can be no assurance that we will own 100% of our UHG-GS railway as the Government of Mongolian and other third-parties may seek ownership stakes in the railway. In 2010, the Government of Mongolia announced its intention to develop one of its own deposits located in the Tavan Tolgoi coal formation and subsequently commenced production at the deposit in January 2011. While we do not expect this development to interfere with the construction of our UHG-GS railway, there can be no assurance that the

Government of Mongolia will not reevaluate our railway project in light of its decision to develop its own deposit in the Tavan Tolgoi coal formation.

- In the event that the Government of Mongolia or other parties develop an alternative railway project to connect the Tavan Tolgoi coal formation to the national railway network and beyond, we may decide to participate or be encouraged to participate in such alternative project or a portion thereof. One such alternative route would be a railway from Tavan Tolgoi to Sainshand and then to Choibalsan in eastern Mongolia. Any such investment or involvement may require significant capital investment and management resources. Even if we were to invest in any such alternative project, we may not have significant control or influence over the management of such project. There can be no assurance that our investment and involvement in such project, if any, would provide us with an economically attractive transportation route in a timely manner or at all or that our investment in such a project will not be lost.
- Pursuant to a feasibility study we conducted in 2009, we estimated the total cost of constructing our UHG-GS railway using standard gauge track will be approximately US\$700 million. The cost estimate does not include capitalized interests or working capital costs. In addition, we estimate that construction costs will be approximately US\$100 million higher if we use broad gauge rail. The actual total construction cost of the railway if we use broad gauge rail may be significantly higher than our estimates due to various factors, including delays, cost overruns, lack of financing, governmental policies, and many other factors. We cannot assure you that we will generate sufficient cash flows from operations or obtain the required financing on acceptable terms or at all to meet the capital expenditure requirements to construct our UHG-GS railway.
- We will engage third-party contractors to build our UHG-GS railway. There can be no assurance we will be able to contract with contractors on acceptable terms or at all. In addition, difficulties encountered by our contractors to fulfill their contractual obligations may require us to make alternative arrangements, cause delays and potentially increase costs.
- Our contractors may face difficulty in fulfilling their capital expenditure and operating plans, which are subject to risks, contingencies and other factors, some of which are beyond their control, such as increases in costs of equipment and materials and their ability to secure necessary approvals, recruit a sufficient number of qualified employees and obtain required financing on acceptable terms or at all.
- We expect that it will take approximately two to three years from the construction commencement date to complete construction of our UHG-GS railway. Various factors could substantially delay the construction of our UHG-GS railway, including inclement weather, shipping delays, safety issues and equipment and machinery malfunctions once operations commence.
- We have no experience constructing or operating a railway and may not be able to acquire, or contract with contractors who have, sufficient experience operating railways.
- Our UHG-GS railway will be a single-line heavy-haul freight railway approximately 240 km in length and will be used to transport our coal. Based on the feasibility study conducted by Deutsche Bahn, we expect to use approximately 500 wagons and 20 locomotives on our UHG-GS railway and support up to 15.0 Mtpa of coal transportation. We cannot assure you that our UHG-GS railway will operate up to our planned specifications.

- We currently transport our coal from our UHG mine to GM by truck. While we expect the opening of our UHG-GS railway will be more cost effective compared to our current transportation methods, there can be no assurance our transportation costs will decrease or not increase after we commission our UHG-GS railway.
- Mongolia's railways are mostly broad gauge and use Russian railway technology, while China's railways are standard gauge. We currently plan to construct our UHG-GS railway using standard gauge to allow easier connectivity with Chinese railways. However, the Government of Mongolia may require us to use broad gauge rail, in which case we would encounter greater difficulty connecting to the Chinese railway system.
- The Government of Mongolia will set a formula to determine the access fee (tariff) for use of our UHG-GS railway base infrastructure. The formula to be used to calculate the fee has not been set and there is no assurance that it will be set at a rate that makes use of our UHG-GS railway economical.
- Under the BOT license agreement, the Government of Mongolia may at any time take control of our UHG-GS railway. There can be no assurance that we would be adequately compensated or compensated at all if the Government of Mongolia took control of our UHG-GS railway or that we would be able to use an alternative transportation method to deliver our coal that is economical.
- An interconnecting railway to the Sino-Mongolian border from the Chinese side will be important to link our UHG-GS railway to the Chinese railway system, as our coking coal must pass through Baotou in order to reach the largest steel producing provinces of China. The Chinese Ministry of Railway has commenced construction of a railway connecting GM to Xixiaozhao that passes through Jinquan, Inner Mongolia. The Chinese Ministry of Railway already operates a railway between Xixiaozhao and Baotou. Completion of the GM-Xixiaozhao railway would allow our coal to travel from GM to Baotou using the Chinese Ministry of Railway's railway. Shenhua Group also has commenced construction of a railway connecting GM to Baotou. In order to use the Shenhua Group railway, we would need to obtain the consent of the Shenhua Group. There can be no assurance that the GM to Xixiaozhao railway will be completed or that we will obtain the consent of the Shenhua Group to use its railway, either of which could make the anticipated economic benefits of our UHG-GS railway unobtainable.

The factors described above or other factors could prevent or delay the construction of our UHG-GS railway, increase costs or result in our UHG-GS railway not achieving intended economic benefits, which could have a material adverse effect on our business, prospects, financial condition and results of operations.

We need additional capital to fund our operations and growth which we may not be able to obtain on acceptable terms, or at all.

We need capital to fund our current expansion and infrastructure development plans. There can be no assurance that we will generate sufficient cash flows for our intended expansion and infrastructure development plans. In the event that we are unable to generate sufficient operating cash flows from operating activities, we will need to obtain alternative financing.

Whether we will be able to obtain adequate financing on acceptable terms, or at all, will be subject to a variety of uncertainties, including, but not limited to:

- investor and lender perceptions of and appetite for securities and borrowings of companies engaged in the coal mining and production;

- conditions in the capital and financial markets in which we may seek to raise funds;
- our future results of operations, financial condition and cash flows;
- Mongolian regulation of foreign investment in companies engaged in the coal mining and production;
- economic, political and other conditions in Mongolia, China and the rest of the world;
- the amount of capital that other Mongolian entities may seek to raise in the foreign capital markets; and
- Mongolian government policies relating to foreign currency borrowings.

The terms of any future debt facilities may impose restrictive covenants that may limit our business and operations. In the event that we breach any of these covenants, we may not be able to obtain waivers from our lenders. Our inability to raise additional funds in a timely manner and on terms favorable to us, or at all, may have a material adverse effect on our business, prospects, financial condition and results of operations. See “– We have significant levels of indebtedness, which could adversely affect us or the holders of the Notes”.

We may have limited ability to obtain financing to fund our future growth plans. The global financial markets have experienced significant deterioration and volatility in the past few years, which may adversely affect our financial condition and results of operations.

Recent difficulties affecting the global financial sectors, adverse conditions and volatility in the United States and worldwide credit and financial markets, fluctuations in oil and commodity prices and the general weakness of the global economy have increased the uncertainty of global economic prospects in general. In 2007, credit markets in the United States began to experience difficult conditions and volatility that in turn affected worldwide financial markets. In 2008, liquidity and credit concerns and volatility in the global credit and financial markets increased significantly with the bankruptcy or acquisition of, and government assistance to, several major U.S. and European financial institutions. These developments resulted in reduced liquidity and greater volatility in the United States and global credit and financial markets. In 2009, these concerns and volatility were heightened by government assistance and incentives to several major non-financial U.S. and European companies, and additional requests for such assistance.

In addition, in 2010, a financial crisis emerged in Europe, triggered by high budget deficits and rising direct and contingent sovereign debt in Greece, Ireland, Italy, Portugal and Spain, which created concerns about the ability of these European nations to continue to service their sovereign debt obligations. These conditions impacted financial markets and resulted in high and volatile bond yields on the sovereign debt of many European nations. Certain European nations continue to experience varying degrees of financial stress, and yields on government-issued bonds in Greece, Ireland, Italy, Portugal and Spain have risen and remain volatile. Despite assistance packages to Greece, Ireland and Portugal, the creation of a joint European Union-IMF European Financial Stability Facility in May 2010, and other European Union actions aimed at addressing the financial challenges, uncertainty over the outcome of the European Union governments’ financial support programs and worries about sovereign finances persist.

As a result of these worldwide economic conditions, growth and demand for coking coal may diminish in China, our primary sales market. In addition, the credit tightening environment may affect our ability to obtain financing, or banks may even reduce the amount of or discontinue the banking facilities currently available to us. An environment of credit tightening can adversely affect our ability to secure sufficient financing to fund our projects. In the short to medium-term, we plan to expand our CHPP capacity, build a railway from our UHG mine to the GS border crossing and expand capacity at our water supply facility. These expansion and development projects are capital intensive and will require substantial expenditures. For further details regarding our capital expenditure plans, please see “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Capital Expenditures”. Any expansion of our capacity will be highly dependent upon our ability to obtain additional financing, which is subject to a variety of uncertainties, including:

- our future financial condition and credit rating;
- general market conditions for financing activities;
- our share price; and
- Government of Mongolia policies and regulations relating to coal mining enterprises and lending in general.

External financing may not be available in a timely manner, on acceptable terms, or at all. If we are unable to expand our capacity, we may be unable to grow our business and remain competitive, or provide services to companies with significant capacity requirements, which may have a material adverse effect on our ability to grow our revenue.

There can be no assurance that actions taken by international organizations and various governments will be effective in addressing the global financial and economic crisis. In the event that the recent financial crisis becomes more severe, or lasts longer than currently estimated, our business, liquidity, financial condition, results of operations and prospects could be materially and adversely affected.

Our mining activities are subject to operational risks, hazards and unexpected disruptions.

Our mining activities are subject to a number of operational risks and hazards, some of which are beyond our control, and could delay the production and delivery of our coal, increase our cost of mining or result in accidents in our mine. These risks and hazards include unexpected maintenance or technical problems, periodic interruptions due to inclement or hazardous weather conditions, natural disasters such as earthquakes, industrial accidents, power, water or fuel supply interruptions or increase in price of such supplies, critical equipment failure, malfunction and breakdowns of information management systems, fires, and unusual or unexpected variations in mineralization, geological or mining conditions. These risks and hazards may result in personal injury, damage to or destruction of properties or production facilities, environmental damage, business interruption, possible legal liability, damage to our business reputation and corporate image and, in severe cases, fatalities. In the years ended December 31, 2009, 2010 and 2011, there were 20 reported traffic accidents in connection with our coal transportation, which resulted in three traffic accident fatalities. As of December 31, 2011, none of these accidents resulted in a significant financial or operational impact to our operations. While we believe the opening of our UHG-GS railway, if constructed, will reduce accidents related to our coal trucking operations, there can be no assurance that accidents will not occur in the future. Such accidents may have a material adverse effect on our reputation, business, prospects, financial conditions and results of operations.

Our limited operating history may not serve as an adequate measure of our future prospects and results of operations.

We have only limited historical operating data and financial information available upon which you can base your evaluation of our business and prospects. We commenced mining operations in April 2009. As a result, we may not have sufficient experience to address the risks frequently encountered by companies with a limited operating history, including our potential failure to:

- increase our mining capacity significantly beyond current levels;
- maintain profitability;
- acquire and retain customers;
- attract, train, motivate and retain qualified personnel;
- keep up with evolving industry standards and market developments;
- manage our expanding operations, including the integration of any future acquisitions;
- anticipate and adapt to any changes in government regulation, mergers and acquisitions involving our competitors and other significant competitive and market dynamics;
- manage the logistics, utility and supply needs of our expanded operations; or
- maintain adequate control over our costs and expenses.

If we fail to address any of these risks, our business and financial results would be materially and adversely affected. Accordingly, you should consider our business and prospects in light of the risks, expenses and challenges that we will face as a company with limited operating history.

We are experiencing a period of rapid growth and may not be able to manage our growth effectively.

We are experiencing a period of rapid growth and expansion that has placed, and continues to place, significant constraints on our management personnel, systems and resources. For the years ended December 31, 2009, 2010 and 2011, we produced 1.8 Mt, 3.9 Mt and 7.1 Mt of ROM coal, respectively. We intend to increase our coal production capacity to approximately 15.2 Mtpa in the year ending December 31, 2014. In addition, we have completed the construction of and commissioned the first and second modules of our CHPP to produce high-quality washed coal. The first and second modules of our CHPP, each with ROM coal nameplate processing capacity of 5.0 Mtpa, have been in operation since June 2011 and February 2012, respectively. We began constructing the third module with ROM coal nameplate processing capacity of 5.0 Mtpa in August 2011 and expect to complete construction by the end of 2012. In connection with this expansion, we are expanding our water supply by another 100 liters per second to accommodate the increase of our coal processing capacity. In addition, we are planning to build a railway from our UHG mine to the GS border and we may participate in an alternative railway project led by the Government of Mongolia that connects the Tavan Tolgoi coal formation to the national railway network. To accommodate this growth, we anticipate that we will need to implement a variety of new and upgraded operational and financial systems, procedures and controls, including the improvement of our accounting and other internal management systems, all of which require substantial management effort and significant additional expenditures. There can be no assurance that we will be able to manage our growth effectively, and failure to do so may have a material adverse effect on our business, prospects, financial condition and results of operations.

We are dependent on future cash flows generated from our business and obtaining additional financing to support our business operations and expansion plans, and to continue as a going concern.

We have cash requirements for ongoing operating expenses, working capital, general corporate purposes and for interest and principal payments on our outstanding borrowings. As of December 31, 2011, we recorded net current liabilities of US\$158.7 million. If we are unable to generate sufficient revenue and cash flows from our operations or secure additional financing to meet our obligations, we may be forced to reduce expenditures or not be able to continue as a going concern. Reduction of expenditures could have a negative impact on our business and would make it more difficult for us to execute our strategy, including our expansion plans in accordance with our expectations. We may be required to make additional payments pursuant to the acquisition agreement for our BN mine, thereby impacting our cash requirements. See “– We may have to make additional payments under the acquisition agreement for our BN mine”.

In addition, our financial statements included in this offering memorandum have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Our ability to continue as a going concern is substantially dependent on our profits and cash flows from operations and our ability to obtain continued bank financing to meet our working capital and financing requirements. If there is an adverse change to our profits, cash flow or ability to obtain additional financing, our financial statements may need to be prepared on an alternative authoritative basis and adjustments relating to the recoverability and classification of recorded asset amounts or the classification of liabilities may need to be made.

We face risks under our expansion program.

We intend to expand our coal production capacity to approximately 15.2 Mtpa in the year ending December 31, 2014. Our contractors are responsible for obtaining any additional equipment required for them to increase the production capacity to comply with our expansion plans and their contractual obligations.

We may not be able to increase our coal production capacity as a result of many factors, including:

- the failure of equipment and machinery installed to perform according to specifications or our expectations;
- difficulties encountered by our contractors in obtaining or financing the purchase of machinery, equipment and spare parts, particularly coal hauling trucks, excavators and tires for such equipment, required to increase production, due to capacity and supply constraints in the world steel and rubber markets and high global demand for those materials and other mining equipment;
- the failure of any of our contractors to fulfill its contractual obligations, which would require us to make alternative arrangements, may cause delays and potentially increase the costs of our expansion plans;
- the failure of our contractors to fulfill their capital expenditure and operating plans, which are subject to risks, contingencies and other factors, some of which are and will be beyond their control, such as increases in costs of equipment and materials and their ability to secure necessary approvals, recruit a sufficient number of qualified employees and obtain required financing on acceptable terms or at all; and

- unforeseen conditions or developments that could substantially delay our planned expansion, including adverse weather conditions and equipment and machinery malfunctions once operations commence.

We may not be successful in developing and operating our BN mine.

We acquired our BN mine in June 2011 and commenced operations at our BN mine in February 2012. The development and operation of coal mines is subject to a broad range of operational, regulatory, geological and economic risks. There can be no assurance that we will be able to successfully develop and operate this mine or that the economics and scope of coal production from this mine will meet our expectations or be economical at all. We are currently engaged in owner mining at our BN mine. We have engaged contractors to mine coal at our UHG mine since its opening and therefore have no direct experience mining coal. We cannot assure you that we will be able to successfully conduct our own mining operations at our BN mine. In addition, while we may undertake a tendering process to engage a contractor for our coal mining operations at our BN mine, there can be no assurance that we would be able to engage a contractor on satisfactory terms, or at all. If we fail to successfully develop and operate our BN mine, we may have to write off all or a portion of the consideration paid in connection with the acquisition and capitalized exploration expenses, which amounted to US\$626 million as of December 31, 2011.

We may have to make additional payments under the acquisition agreement for our BN mine.

The total consideration was US\$464,465,000 for the acquisition of our BN mine in 2011, consisting of US\$100.0 million in cash, the promissory note of US\$279.5 million and the issuance of the QGX Convertible Bonds in the aggregate principal amount of US\$85 million. This consideration is subject to adjustments as a result of the total reserves of such mine exceeding 150 Mt or the production exceeding certain amounts as described in more detail in “Business – BN Mine-Consideration”. The maximum amount of additional consideration payable by us pursuant to such adjustments is US\$485.5 million, including up to US\$105.0 million for the reserve adjustment which will be determined by the results of a new reserve report that is expected to be completed by the end of 2012. To the extent that any such amounts become payable, particularly at a time when our BN mine does not contribute corresponding amounts of free cash flow to our business, payment of such amounts could adversely affect our financial condition. A failure to pay such amounts would constitute a default under the acquisition agreement and potentially cross defaults under our other existing and future contractual arrangements. See “Business – BN Mine”.

The development of any new technology or the use of alternative supply sources in the production of iron and steel may directly impact the demand for coking coal.

The demand for coking coal is directly correlated with the production of crude steel. As a result, any alternative energy source, such as PCI coal, or any heavy fuel oil injection into blast furnaces, or any new technology in steel production, such as electric arc furnace which omits coke from the steel production process, if adopted by steel manufacturers in China, would negatively affect the demand for coking coal. This could, in turn, materially and adversely affect our business, prospects, financial condition and results of operations.

We may not be successful in future acquisitions or may encounter difficulties in integrating and developing the acquired assets or businesses.

We plan to increase our mineral resources through acquisitions of companies with existing exploration rights and additional mining assets. In addition to mining licenses and mining assets, if we are presented with strategically attractive opportunities, we may acquire other businesses or assets that

are complementary to our business. We do not have specific timetables for these plans and there can be no assurance that we will be successful in these acquisitions. In addition, we must receive various regulatory approvals or permits in order to develop new reserves or businesses. Our inability to successfully acquire companies with existing exploration rights and additional mining assets, develop mineral resources or obtain necessary governmental approvals may have a material adverse effect on our business, prospects, financial condition and results of operations.

In June 2011, we completed the acquisition of our BN mine. While we believe the acquisition provides us with a unique opportunity to purchase a coking coal asset strategically located approximately 30 km to the southwest of our UHG mine in an advanced development stage and allows us to expand our existing footprint in Mongolia, there can be no assurance that we will be able to generate profits through the operation of our BN mine.

Future acquisitions may also expose us to potential risks and unforeseen operating difficulties and expenditures, including risks associated with the assimilation of new technologies, businesses and personnel, unforeseen or hidden liabilities, the diversion of management attention and resources from our existing business and the inability to generate sufficient revenues to offset the costs and expenses of an acquisition. Any difficulties encountered in the acquisition and integration process may have a material adverse effect on our business, prospects, financial condition and results of operations.

We may acquire and develop non-coal assets.

As part of our mineral resource expansion strategy, we are considering opportunities to acquire or invest in companies or assets in the steel industry supply chain. If an attractive opportunity presents itself, we may acquire and develop other resources. We have experience only in coal mining, and our experience with coking coal may not be directly relevant to the development of other non-coal resources. There can be no assurance that we will be successful in developing any non-coal assets. Failure to successfully develop non-coal assets, if acquired, could have a material adverse effect on our business, prospects, financial condition and results of operations.

We may dispose of our assets or sell majority or minority stakes in our subsidiaries.

We may dispose of some of our assets or sell majority or minority stakes in our subsidiaries, including our BN mine and our paved road from UHG to GS, if we are presented with strategically attractive opportunities or seek funding opportunities. If we take on joint venture partners, we will be subject to risk associated with jointly owning and managing projects. No assurance can be given that we will or will not engage in, or as to the timing of, for any such disposals or joint venture activities and there can be no assurance that we will be successful in these dispositions should they occur.

We currently rely on a single source of water for all of our operations.

Our operations currently depend on a single source of water in the Naimant Depression which is located approximately 20 kilometers north of our UHG mine. We have the right to extract water from the aquifer for 20 years, extendable by an additional five years subject to certain conditions, under the Water Use Agreement signed in May 2011 between the Governor of Tsogtsetsii soum and Ukhaa Khudag Water Supply LLC. Water is piped from the aquifer to our water supply plant at our UHG mine which can supply up to 117 liters per second. The majority of our water use is by our CHPP to wash coal.

We plan to expand capacity by approximately 100 liters per second in 2012 from a second water supply in Naimdain Khundii. We have conducted a survey of the Naimdain Khundii area and expect to extract approximately 25% of the water in the aquifer. There can be no assurance that these aquifers

will provide stable and uninterrupted sources of water in the future, and if these sources were interrupted temporarily or permanently for any reason, including regulatory or practical reasons, there can be no assurance that we would be able to source a sufficient amount of water from another location.

If we are unable to operate our CHPP due to a shortage of water, we would not be able to sell washed coal and would have to revert to selling raw coal, which may have less attractive economics or may not be economically viable.

Our mining operations are mainly concentrated at one mining site.

Our mining operations are currently mainly concentrated at our UHG mine. Though we commenced operations at our BN mine in February 2012, we expect operations at our UHG mine to continue to provide substantially all of our production in the near future while we expect to begin producing a small amount of raw coal from our mine. Therefore, all of our current operating cash flows and sales are derived from the sale of coal produced from a single mine. Any significant operational or other difficulties in the mining, processing, storing or transporting of coal at or from our UHG mine could reduce, disrupt or halt our coal production, which would materially and adversely affect our business, prospects, financial condition and results of operations.

We rely on our contractors to perform key aspects of our operations.

Currently, we cooperate with Leighton, our mining contractor, and work closely with them in all aspects of our coal mining operations at our UHG mine. We entered into a long-term contract with Leighton to undertake overburden removal, coal extraction and mine reclamation activities. Substantially all of the principal mining equipment used in our UHG mine is sourced through Leighton and their expatriate personnel supervise our mining operations. Actual mining activities are conducted by our employees who have been trained by Leighton personnel. In addition, Leighton has agreed to work with us to build out our coal production capacity to 15.0 Mtpa. See “Business – Mining Operation”.

We are currently engaged in owner mining at our BN mine. We may undertake a tendering process to engage a contractor for our coal mining operations at our BN mine.

We have contracted with Sedgman to engineer, procure the equipment for the building of, manage the construction of and train personnel to operate our CHPP, in order to produce washed coal products without the need to rely on coal traders and customers to wash our own coal. The first and second modules of our CHPP, each with ROM coal nameplate capacity of 5.0 Mtpa, began operations in June 2011 and February 2012, respectively. We began constructing the third module in August 2011 and expect to complete construction by the end of 2012. See “Business – Coal Handling and Preparation Plant”.

Failure by Leighton, Sedgman or any of our other contractors to perform their respective contractual obligations or the loss of their services could materially and adversely affect our business, prospects, financial condition and results of operations. If Leighton or Sedgman terminates their contracts with us, the amount of remedies we will be able to receive may not be sufficient to cover losses we may sustain. There can be no assurance that replacement contractors could be found in a timely manner or at all, or would be able to perform at the same levels, at the same prices or on the same terms as our current contractors if any of our contractors cease to perform their services or terminate their contracts with us. In addition, if we decide to terminate our agreement with Leighton, we will be required to pay a termination fee.

Our paved road connecting our UHG mine to the border crossing at GS is subject to a BOT license.

We constructed a 245 km paved road parallel to the existing coal transport gravel road from our UHG mine to GS which commenced operations in October 2011. The paved road was built under the license awarded to Gobi Road LLC, an indirect wholly owned subsidiary of us, by the Government of Mongolia under Government Resolution No. 83 of 2010 dated March 31, 2010 and subsequent Build-Operate-Transfer Agreement (the “BOT Agreement”) whereby Gobi Road LLC was granted a right to build, operate and use the paved road for a period of ten years after the date on which it is commissioned for service. All coal originated from our UHG mine is now being transported on the paved road. Upon the expiration of the BOT Agreement, we will transfer all of our rights and obligations with respect to the operation and maintenance of the paved road under the BOT Agreement to the Government of Mongolia for no consideration.

The Government of Mongolia may at any time take control of the road. If the Government of Mongolia takes control of the road prior to the expiration of the BOT Agreement or otherwise adversely affects our rights under the BOT Agreement, the Government of Mongolia is required, under the BOT Agreement, to compensate us for all costs and expenses incurred for the construction, operation and maintenance of the paved road. However, no assurance can be given that the Government will compensate us or that any such compensation will be adequate. While we expect to be able to continue to use the paved road by paying the tolls and tariffs determined by the Government of Mongolia until the expiration or early termination of the BOT Agreement and transfer of all the rights and responsibilities with respect to the operation and maintenance of the paved road to the Government of Mongolia, there can be no assurance that we would have access to enough capacity on the road to transport all of our current coal output, and any future increases, on the road. See “Business – Logistics and Transportation – Road Paving.”

In addition, on August 24, 2011, the Government of Mongolia passed Resolution No. 257 which assigned to Erdenes Tavan Tolgoi the right to build a parallel paved road from Tavan Tolgoi coal deposit to GS under a build and transfer arrangement. At the same time, the Government of Mongolia authorized the Minister of Road, Transportation, Construction and Urban Development, Minister for Environment and Tourism and Head of State Property Commission to determine public utilization tariffs, including the tariffs for the paved roads. As of the date of this offering memorandum, we still hold the right to define tariffs on our paved road in accordance with our BOT Agreement, but there can be no assurance that the Government will not interfere with our right to determine the tariffs for our paved road, which may impact our transportation cost in the future.

We may face delays or cost overruns in connection with our infrastructure projects.

In order to lower transportation costs and increase reliability and operational efficiency, we currently expect to commence construction of a railway in 2012. See “– We are not sure when we can commence construction of our UHG-GS railway or whether our investment in the railway project will be successful”. The opening of our UHG-GS railway is key to our production expansion and any delay in its completion will have a direct impact on the costs of transporting our coal to China. In addition, we are (i) constructing the third module of our CHPP (see “Business – Coal Handling and Preparation Plant”), (ii) constructing a road connecting our UHG and BN mines (see “Business – Logistics and Transport”) and (iii) expanding the supply capacity of our water supply facility by approximately 100 liters per second (see “Business – Water Supply Facility”). Any delay in the expansion of these facilities could delay or limit our ability to produce and sell washed coal. There can be no assurance that the actual costs of these projects will not exceed their original budgets. As a result of project delays, cost overruns or other reasons, we may not be able to achieve the intended economic benefits of these projects, which may materially and adversely affect our business, prospects, financial condition and results of operations.

Our dependence on our major customers may cause significant fluctuations or declines in our revenues.

Substantially all of our coal production is exported into China and we have a concentrated group of major customers. For the years ended December 31, 2009, 2010 and 2011, our sales to our five largest customers accounted for 100%, 95.0% and 87.9%, respectively, of our total sales. For the years ended December 31, 2009, 2010 and 2011, our sales to our single largest customer accounted for 39.0%, 37.9% and 34.1%, respectively, of our total sales. Although we are planning to expand our customer base, we anticipate that our dependence on our major customers will continue in the near future. There can be no assurance that we will be able to retain these customers or that they will maintain current level of business with us. If there is a reduction or cessation of orders from any of these customers for any reason, our business, prospects, financial condition and results of operations will be materially and adversely affected.

We extend credit (generally for periods not exceeding 90 days) to certain of our customers with whom we have long-term supply agreements. Our ability to receive payments for coal sold and delivered depends on the continued creditworthiness of our customers. Competition with other coal suppliers could force us to extend credit to customers and on terms that could increase the risk of payment default. The bankruptcy of any of our customers could materially and adversely affect our business, prospects, financial condition, and results of operations.

Our insurance may not be adequate to cover losses or liabilities that may arise.

We do not maintain adequate insurance against some operational and infrastructure risks and natural disasters. In particular, we do not have insurance coverage for acts or omissions of our contractors. Under the mining contracts, insurance against risks or loss to operations is provided by our mining contractors for each of the relevant mining areas. However, some of our contractors may not carry adequate liability coverage.

We have obtained insurance policies from global insurers including Zurich, Munich Re and Swiss Re covering property damage for our mining properties and business interruption. Such policies may not be adequate to cover all losses or liabilities that may be incurred by us or our contractors. Also, insurance may only be available at premium levels that are prohibitively expensive. As a result, losses incurred or payments we may be required to make may have a material adverse effect on our business, prospects, financial condition and results of operations to the extent such losses or payments are not insured or the insured amount is not adequate.

Increases in the costs, or our accessibility to sources, of fuel could negatively affect our operating costs or disrupt or delay production.

NIC supplies us with all of our fuel requirement. NIC is the largest oil product importer and retailer in Mongolia, sourcing substantially all of its fuel from Russia. While we have reserved the option to contract with other fuel suppliers, there is no assurance that we would be able to source the requisite amounts of fuel necessary to run our operations from other suppliers if there were an interruption in the fuel supply from Russia to Mongolia or from NIC to us.

In May and June 2011, Mongolia faced a shortage of Russian fuel supply, which provides more than 98% of the entire Mongolian fuel usage. We have agreed with NIC to increase the capacity of onsite fuel storage facilities at our UHG mine to 6 million liters by September 2012. However, there can be no assurance that Mongolia or we will not face a shortage of fuel in the future.

We directly bear the costs of fuel. We do not engage in any fuel hedging arrangements to cover our fuel price risk. Any significant increases in the price or shortage of fuel would cause a corresponding increase in our costs or limit our operations, either of which could result in termination of sales contracts by our customers and materially and adversely affect our business, prospects, financial condition and results of operations.

Issues with local communities may materially and adversely affect our business.

Issues with the local communities surrounding the areas where we operate might arise from the implementation of our business activities, including disputes related to settlement relocation. These issues may result in community protests, blocking of road and third party claims. The failure to successfully settle any local community issues could divert our management's attention and resources and have a material and adverse effect upon our business, reputation, prospects, financial condition and results of operations.

Our business depends substantially on the continuing efforts of our executive officers and our mining contractors and our ability and the ability of our mining contractors to attract and retain qualified technical personnel.

Our business depends substantially on the continued services of our executive officers and, to a significant extent, on our ability to attract, train and retain qualified technical personnel, particularly those with expertise in coal mining and production. There can be no assurance that we will be able to attract or retain qualified technical personnel. If one or more of our executive officers or key employees were unable or unwilling to continue their service with us, we might not be able to replace them with persons of equivalent expertise and experience within a reasonable period of time or at all. If any of our executive officers or key employees joins a competitor or forms a competing company, we may lose customers, suppliers, know-how and key personnel and staff members. If any dispute arises between such employees and us, there can be no assurance as to the extent to which any non-competition undertakings of such employees could be enforced in our favor or at all. These executive officers and key employees primarily include Mr. Odjargal Jambaljamts, Dr. Battsengel Gotov, Ms. Enkhzaya Nyamdorj, Ms. Ulemj Baskhuu, Mr. Enkhtuvshin Dashtseren, Mr. Oyunbat Lkhagvatsend, Ms. Uurtsaikh Dorjgotov, Mr. Davaakhuu Chultem, Ms. Ariunaa Baldandorj, Mr. Andrew Little, Mr. Gary Ballantine, Mr. Bayarbayasgalan Dorjderem, Ms. Baigalmaa Shurka and Mr. Batbold Khorloo. If we lose any of the foregoing executive officers and key employees, our business may be severely disrupted, our financial condition and results of operations may be materially and adversely affected, and we may incur additional expenses to recruit, train and retain personnel. Furthermore, some of our technical personnel are trained by our contractors. If our contractors cease to train our technical personnel, we may not be able to train or find qualified parties to train our technical personnel. In addition, we believe our future success will depend on our contractors' continued ability to attract and retain their own skilled and qualified personnel. Any difficulty in our contractors' ability to attract, recruit, train and retain skilled and qualified personnel could materially and adversely affect our operations. As our business has grown and is expected to continue to grow rapidly, our ability to train and integrate new employees into our operations may not meet the growing demands of our business.

The interests of our principal shareholder, MCS Holding, may differ from those of our other shareholders or of the holders of the Notes.

As of December 31, 2011, MCS Holding indirectly owned approximately 43.5% of our issued share capital. Accordingly, MCS Holding has substantial influence over our business, including decisions regarding mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions, timing and amount of our dividend

payments, and otherwise controls or influences actions that require the approval of our shareholders and may impact the holders of the Notes. These actions may be taken even if they are opposed by our other shareholders or are not in line with the interests of the holders of the Notes. We believe that third parties may be discouraged from making a tender offer or bid to acquire us because of this concentration of ownership. For further information on the ownership of the Shares, see the section headed “Corporate Structure” and “Principal Shareholders” in this offering memorandum.

Foreign currency fluctuations could affect expenses and any future earnings.

We are exposed to foreign exchange fluctuations with respect to the MNT, the RMB and the U.S. dollar. Our financial results are reported in U.S. dollars. The salaries for local laborers in Mongolia are paid in MNT. Sales of coal into China have been and may continue to be settled in RMB and U.S. dollars. Since our headquarters is in Ulaanbaatar, Mongolia, a portion of our expenses are in MNT. As a result, our financial position and results are impacted by the exchange rate fluctuations between the aforementioned currencies and the U.S. dollars. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Quantitative and Qualitative Disclosures About Market Risk – Foreign Currency Exchange Risk”.

Our results of operations are subject to economic, political and legal developments in China.

We expect that substantially all of our sales will be made to customers based in China. Accordingly, the economic, political and social conditions, as well as government policies, of China may affect our business. The Chinese 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 Chinese economy has been transitioning from a planned economy to a more market-oriented economy. For the past three decades, the Chinese government has implemented economic reform measures emphasizing the utilization of market forces in the development of the Chinese economy. Changes in Chinese political, economic and social conditions, laws, regulations and policies could materially and adversely affect our business, prospects, financial condition and results of operations.

The growth of the Chinese economy has been uneven across different geographic regions and different economic sectors. In order to stabilize national economic growth, the Chinese government may adopt macroeconomic policies that include measures to restrict excessive growth in specific sectors of the economy, such as the steel industry. We cannot predict future economic reforms or the effects that any such measure may have on our business, prospects, financial condition or results of operations. The Chinese government exercises significant control over the growth of the Chinese economy through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies as it deems fit. In the past, the Chinese government has implemented a number of measures, such as raising bank reserves against deposit rates to place additional limitations on the ability of commercial banks to make loans and raise interest rates, in order to suppress the growth of specific segments of the Chinese economy which it believed to be overheating. These actions, as well as future actions and policies of the Chinese government to exert influence over certain segments of the economy, could materially and adversely affect the level of overall economic activity and our Chinese customers’ liquidity and access to capital and hence, in turn, affect our ability to operate our business.

In addition, there can be no assurance that the Chinese economy will continue to grow, or that its growth will be steady or in geographic regions or economic sectors to our benefit. Since substantially all of our sales will be made into China, we depend heavily on general economic conditions in China for our continued growth. A downturn in China’s economic growth or a decline in its economic conditions may have a material adverse effect on our business, prospects, financial condition and results of operations.

The Chinese government may impose restrictions on the import of Mongolian coal or adopt policies favorable to Chinese coal producers.

As of the date of this offering memorandum, we believe that the Chinese government has not imposed restrictions on the import of Mongolian coal or adopted any preferential policies that favor Chinese coal producers over Mongolian producers. However, there can be no assurance that the Chinese government will not directly or indirectly implement any restrictions or adopt any preferential policies in the future. The Chinese government may do so for a number of reasons, including but not limited to, a policy to support domestic Chinese coking coal producers. If we are unable to sell our coal into China on commercially viable terms or at all, there can be no assurance that we will be able to sell our coal to customers in any other jurisdiction. Furthermore, as all our coal currently passes through China, any restriction on the transport of Mongolian coal through China will effectively prohibit our coal from reaching any of our Chinese customers or potential overseas customers.

Our mining operations are exposed to environmental risks.

All phases of our operations are subject to environmental regulations in the various jurisdictions in which we operate. For example, our UHG and BN mines are subject to a requirement to meet environmental protection obligations. We must complete an environmental protection plan for the Government of Mongolia's approval and complete a report prepared by an independent expert on environmental compliance every year.

Failure to comply with applicable laws, regulations and to obtain the necessary permits may result in enforcement actions, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in mining operations may be required to compensate those suffering loss or damage by reason of the mining activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

Environmental legislation is evolving in a manner which will likely 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. There can be no assurance that future changes in environmental regulation, if any, will not materially and adversely affect our business, prospects, financial condition and results of operations. The Government of Mongolia's approvals and permits are also often required in connection with various aspects of our operations. To the extent such approvals or permits are required and not obtained, we may be delayed or prevented from proceeding with planned exploration or development of our mineral properties.

In December 2011, the Government of Mongolia submitted to the Parliament eleven draft laws related to the renewal and moderation of the environmental legal framework, which include the imposition of new fees for water pollution and increases in other fees. Changes to the current laws, regulations and permits governing operations and activities of mining companies, including more stringent implementation or increases in or imposition of new fees, could have a material adverse impact on us including increases in our capital expenditures or production costs, reductions in our production and abandonment or delays in development of new mining properties.

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

Whether we ultimately implement the business plans described in this offering memorandum, and whether we achieve the objectives described in this offering memorandum, 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; availability of heavy equipment, supplies and personnel; success or failure of activities in areas similar to those in which our projects are situated; and changes in estimates of project completion costs. We will continue to gather information about our projects, and it is possible that additional information will cause us to alter our schedule or determine that a project should not be pursued at all. Accordingly, our plans and objectives may change from those described in this offering memorandum.

Inclement weather may adversely affect our operations.

Inclement weather may require us to evacuate personnel or curtail operations and may cause damage to our mine site, transportation roads and loading facilities. This could result in the temporary suspension of operations or generally reduce our productivity. Since our commencement of operations at our UHG mine in 2009, we have suspended our mining operations for a total of eight days due to inclement weather. We suffered no material losses due to the inclement weather, but there can be no assurance that inclement weather will not cause significant losses in the future. Any damage to our mine site, transportation roads and loading facilities caused by prolonged periods of inclement weather could materially and adversely affect our business, prospects, financial condition and results of operations.

Destabilizing events in other parts of the world could interrupt our business.

Events related to the terrorist attacks in the United States that took place on September 11, 2001, the war in Afghanistan, developments in the Middle East, Libya and Egypt, natural disasters and the general weakness of the global economy have increased the uncertainty of global economic prospects in general. We cannot assure you that further terrorist acts or other destabilizing events will not occur in the future. In addition, although such acts and events have not been targeted at or directly affected Mongolia, our assets or those of our customers, we cannot assure you that they will not do so in the future. Our current insurance policies do not cover terrorist attacks or other such destabilizing events. Any terrorist attack, natural disaster or other such event including damage to our infrastructure or that of our customers, could cause interruption to our business and materially and adversely affect our business, financial condition, results of operations, cash flows and prospects.

We face risks related to health epidemics and other outbreaks of contagious diseases.

Our business could be adversely affected by the outbreaks of severe acute respiratory syndrome (“SARS”) or other contagious diseases. Mongolia experienced an outbreak of the H1N1 strain of swine influenza in November 2009. The Government imposed a curfew on shops and restaurants, halted long distance transport services and closed schools. Additionally, there have been reports of outbreaks of a highly pathogenic avian flu, caused by the H5N1 virus, in certain regions of Asia and Europe since 2003. In 2010, there were a limited number of reported cases of avian flu in Mongolia although to date there have not been any confirmed cases of human infection. There have been reports on the occurrences of avian flu in various parts of China, including a few confirmed cases of human infection. An outbreak of avian flu in the human population of China could result in a widespread health crisis that has the potential to spread to Mongolia and could adversely affect the economies and financial markets of many countries, particularly in Asia. Additionally, any recurrence of swine influenza or SARS, a highly contagious form of atypical pneumonia, similar to the occurrence in 2003 which affected China, Hong Kong, Taiwan, Singapore, Vietnam and certain other countries, would also have similar adverse effects. As a significant portion of Mongolia’s economy relies on trade with China and as many of our customers have business interests in China, these outbreaks of contagious diseases, or the fear of these outbreaks, and other adverse public health developments in China, could have a material adverse effect on our business, financial condition and results of operations. We have not adopted any written preventive measures or contingency plans to combat any future outbreak any epidemic or outbreak of disease.

Risks Relating to Mongolia

Our ability to conduct our business activity in Mongolia is subject to political risk.

Our ability to efficiently conduct our business activities is subject to changes in government policy or shifts in political attitudes within Mongolia that are beyond our control. Government policy may change to discourage foreign investment, nationalization of mining industries may occur or other government limitations, restrictions or requirements not currently foreseen may be implemented. There can be no assurance that our assets will not be subject to nationalization, 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 our 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 our business, prospects, financial condition and results of operations.

Legislation in Mongolia may be subject to conflicting interpretations.

The Mongolian legal system exhibits 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. The legal framework in Mongolia is, in many instances, based on recent political reforms or newly enacted legislation, which may not be consistent with long-standing local conventions and customs. Local institutions and bureaucracies responsible for administering laws may lack a proper understanding of the laws or the experience necessary to apply them in a modern business context. Many laws have been enacted, but in many instances they are neither understood nor enforced and may be applied in an inconsistent, arbitrary manner, while legal remedies may be uncertain, delayed or unavailable. 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 us, 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 nationalization, 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 nationalization. Expropriation or nationalization of any of our assets, or portions thereof, potentially without adequate compensation, could materially and adversely affect our business, prospects, financial condition and results of operations.

Application of and amendments to legislation could adversely affect our mining rights or make it more difficult or expensive to develop our projects and continue mining.

The Government of Mongolia has, in the past, expressed its strong desire to foster, and has to date protected the development of, an enabling environment for investments in the mining sector. However, there are political constituencies within Mongolia that have espoused ideas that would not be regarded by the mining industry as conducive to investment if they were to become law or official government policy. There can be no assurance that the present government or a future government will refrain from enacting legislation or adopting government policies that are adverse to our interests or that impair our ability to develop and operate our UHG and BN mines.

Mining operations in Mongolia are subject to extensive laws and regulations. These relate to production, development, exploration, exports, imports, taxes and royalties, labor standards, occupational health, waste disposal, protection and remediation of the environment, mine safety, transportation safety and other matters. Compliance with these laws and regulations increases the costs of exploring, drilling, developing, constructing, operating and closing mines and other facilities. It is possible that the costs, delays and other effects associated with these laws and regulations may impact our decision as to whether to continue to proceed with the development of our UHG and BN mines. Since Mongolian legal requirements change frequently, are subject to interpretation and may be enforced to varying degrees in practice, we are unable to predict the ultimate cost of complying with these requirements or their effect on our operations. Although we believe our property ownership interests are valid and in accordance with all applicable rules and regulations, there can be no assurance that the underlying agreements, licenses or legislation upon which our property ownership interests is based will not be interpreted and enforced in a way that materially and adversely affects our rights and obligations. Furthermore, changes in governments, regulations and policies and practices could have an adverse impact on our future cash flows, earnings, results of operations and financial condition.

For example, in 2006, the Government of Mongolia enacted the 2006 Minerals Law. The 2006 Minerals Law preserves to a limited extent some of the substance of the former 1997 minerals legislation, which was drafted with the assistance of legal experts in the area of mining legislation and was widely regarded as progressive, internally consistent and effective. 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 licenses 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. See “– The Government of Mongolia could determine that any one or more of our projects in Mongolia is a Mineral Deposit of Strategic Importance and could take an equity, production, profit sharing or other interest in any of our projects”.

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, the Parliament enacted the Mining Prohibition in Specified Areas Law which 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. New exploration licenses and mining licenses overlapping with the defined prohibited areas will not be granted and previously granted licenses that overlap with the defined prohibited areas will be terminated within five months following the adoption of the Mining Prohibition in Specified Areas 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 according to the Government Resolution No. 299 dated November 17, 2010. 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 MMRE. Subsequent to MMRE's approval of this preliminary list, the Government of Mongolia must still give its final approval before the final list can be published. During MMRE's and the Government of Mongolia's review of the draft list of licenses prepared by MRAM, licenses may be added to or removed from the list at any time prior to approval and publication of the final list. Government Resolution No. 174, dated June 8, 2011, has determined a portion of the boundaries of certain areas containing gold deposits where exploration and mining operations are prohibited according to the Mining Prohibition in Specified Areas Law. On February 9, 2011, the Parliament enacted the Law on Prohibition of Granting New Exploration Licenses which prohibited the granting of new exploration licenses until April 30, 2011. The prohibition was subsequently extended to December 31, 2012. On October 20, 2011, the Supreme Court of Mongolia ruled that the Government must take action to enforce the Mining Prohibition in Specified Areas Law.

As of the date of this offering memorandum, draft laws, which may affect our mining activities including new land and environmental laws and amendments to existing laws are under discussion in the Parliament. A working group is currently drafting amendments to the 2006 Minerals Law. In addition, a new Parliament will be elected in June 2012, adding uncertainty to whether these new laws and amendments will be adopted.

There can be no assurance that future political and economic conditions in Mongolia will not result in the Government of Mongolia 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, labor 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 our ability to undertake exploration and development activities in the manner currently contemplated. Similarly, any restrictions imposed, or Government of Mongolian charges levied or raised (including royalty fees), under Mongolian law on the export of coal could harm our competitiveness.

Uncertainties regarding VAT reimbursement and possible revisions to the Mongolian royalty fee system could adversely affect our financial position.

VAT at a rate of 10% is payable in respect of all goods sold, work performed and services provided within Mongolia. VAT is also payable in respect of goods imported into Mongolia and in respect of certain service fee payments made by Mongolian taxpayers to non-resident service providers. If a legal entity is registered as a value-added taxpayer, it can obtain credits for such tax paid to its suppliers of goods and services and can use such credits to offset value-added, or other, taxes owed in Mongolia. However, the Law on VAT provides certain conditions which can limit the ability of a legal entity to register as a value-added taxpayer. On July 21, 2009, the Parliament passed an amendment to the Law on VAT of Mongolia (the "Amendment") pursuant to which only exported "finished mineral products" are subject to zero-rate VAT. Before the Amendment, there was no distinction between finished and unprocessed mineral products, and all mineral products that were exported were subject to zero-rate VAT regardless of their level of processing. As such, an exporter or producer of mineral products could have the VAT paid on its purchases of services and goods for its operation to produce exported minerals refunded. After the enactment of the Amendment, only finished (processed) mineral products are subject to zero-rate VAT, and sales of other minerals are exempted from the payment of VAT under newly introduced Article 13.1.16 of the Law on VAT. An exporter or producer of mineral products, other than "finished mineral products" for export, is not entitled to have the VAT paid on the purchases of goods and services used for its mining operation refunded. As a result, operating costs of an exporter or producer of non-finished mineral products, which are types of mineral ores or unprocessed minerals will increase. The Amendment does not define what constitutes exported "finished mineral products". Instead, it provides that the Government shall adopt a regulation

on the list and category of the finished mineral products. On November 10, 2010, the Government issued Resolution No. 286 on the List of Final Mining Products, which includes washed and processed coal, briquette and compressed coal generated from the coal and similar solid fuel, coal coke and semi-coke, and lignite coke and semi-coke. However, no assurance can be given that the regulations concerning VAT will not be changed, or interpreted in a way, that could adversely affect us.

As of December 31, 2009, 2010 and 2011, our VAT receivables were US\$5.7 million, US\$23.9 million and US\$43.7 million, respectively.

On November 25, 2010, the Parliament amended the 2006 Minerals Law. Effective from January 1, 2011, we pay a flat 5% royalty on the sale value of all extracted minerals that are sold, shipped for sale or otherwise used, and an additional royalty which is calculated based on the degree to which coal is processed. The additional royalty is based on the monthly comparative price stipulated on the website of the MMRE and is applied at a progressive rate. The level of the progressive royalty rate depends on the level of processing of the minerals. The more processed the minerals are, the lower the progressive royalty rate will be. For example, the progressive royalty rate for raw coal is from 1% to 5% if coal price is above the threshold price of US\$25 per tonne. If coal is processed, the progressive royalty rate will be lower, being 1% to 3%. See “Regulation – Mongolian Laws and Regulations Relating to Exploration for Minerals and Mining – Royalties”. We incurred US\$3.3 million, US\$10.1 million and US\$48.2 million as royalty to the Government of Mongolia for the years ended December 31, 2009, 2010 and 2011, respectively. There can be no assurance that the Government of Mongolia will not further increase royalty rates on the sale value of extracted minerals.

Weaknesses relating to the Mongolian legal system and Mongolian legislation create an uncertain environment for investment and business activity.

The legal system in Mongolia is at an early stage of development and has various uncertainties that could limit the full legal protections that may be available to holders of the Notes in more developed countries. The following risks relating to the Mongolian legal system create uncertainties, many of which rarely exist in countries with more developed market economies:

- inconsistencies among, or uncertainties in the application or official interpretation of, laws, decrees, orders and regulations, and regional and local rules and regulations, as a result of limited judicial guidance, lack of stare decisis or established precedents and other factors;
- limited judicial guidance on interpreting Mongolian legislation;
- gaps in the regulatory structure due to delay in, or absence of, implementing regulations;
- the lack of experience of judges and courts in interpreting new principles of Mongolian legislation, particularly those relating to securities laws;
- a relatively high degree of discretion on the part of governmental authorities; and
- bankruptcy procedures that are not well developed and are subject to abuse.

In general, the Mongolian judicial system is relatively inexperienced in enforcing the laws and regulations that currently exist, leading to a degree of uncertainty as to the outcome of any litigation. The Mongolian judicial system may also favor Mongolian parties over foreign companies and individuals. Further, 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, a number of significant pieces of legislation such as the Company Law, the Minerals Law, the Securities Markets Laws and

the Land Law are under review by the Parliament. The introduction of new Mongolian laws and regulations and the application or interpretation of existing ones may be subject to policy changes reflecting domestic political or social changes. As the Mongolian legal system continues to develop, we cannot assure you that changes in such legislation or application or interpretation thereof will not have a material adverse effect on our business, financial condition, results of operations and future prospects.

In addition, while legislation has been enacted to protect private property against expropriation and nationalization, 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 nationalization. Expropriation or nationalization of any of our businesses, our assets or portions thereof, potentially without adequate compensation, could have a material adverse effect on our business and prospects and on the trading price of the Notes.

Certain facts and statistics contained in this offering memorandum have come from official government sources or other industry publications, the reliability of which cannot be assumed or assured.

Certain facts and statistics in this offering memorandum related to Mongolia, its economy and the industries in which we operate, are derived directly or indirectly from official government sources generally believed to be reliable. While we have taken reasonable care to reproduce such information, we cannot guarantee the quality and reliability of such source material. These facts and statistics have not been independently verified by us, the Initial Purchasers or any of our or their respective affiliates or advisors or any other parties involved in this offering and, therefore, we make no representation as to the accuracy of such facts and statistics, which may not be consistent with other information compiled within or outside Mongolia and may not be complete or up-to-date. Due to possibly flawed or ineffective collection methods or discrepancies between published information and market practice, the facts and statistics in this offering memorandum may be inaccurate and the statistics may not be comparable to statistics produced for other economies. Further, there can be no assurance that they are stated or compiled on the same basis or with the same degree or accuracy as may be the case elsewhere. In all cases, investors should give consideration as to how much weight or importance they should attach to or place on all such facts and statistics.

Mongolia may experience political and social instability.

Since the collapse of communism in 1990, Mongolia has experienced a process of democratic change, resulting in political and social events that have highlighted the unpredictable nature of Mongolia's changing political landscape. Such events have resulted in political instability as well as general social and civil unrest on certain occasions in the past few years. Prior to 1990, Mongolia was a socialist country and the only functioning political party was the Mongolian People's Revolutionary Party (the "MPRP"). In March 1990, due to extended street protests carried out in public and popular demands for faster reform, the political bureau of the MPRP resigned. In May 1990, the constitution was amended, which removed the MPRP's role as the guiding force in the country, legalized opposition parties, created a standing legislative body and established the office of president.

The MPRP and the Democratic Party are two of the main political parties in Mongolia. The MPRP was the ruling party for the first half of the 1990s and was succeeded by the Democratic Party until it regained control of the Parliament in 2000. Following a political realignment in 2006, when a new coalition government was formed, the MPRP won the majority of seats in Parliament again in 2008. However, there were allegations of fraudulent practices in the elections made by the chairman of the Democratic Party. The Mongolian General Committee of Elections dismissed these allegations and confirmed that the MPRP had won the majority of seats in Parliament. The election results also triggered strong protests and riots and the Government declared a state of emergency, which was lifted after four days.

Although Mongolia's transition to democracy has been relatively peaceful and there is representation of various political parties in the Government, tension continues to exist between the governing coalition partners. We cannot assure you that events similar to those described above will not occur in the future and on a wider scale, or that such disturbances will not, directly or indirectly, have a material adverse effect on our business. Elections will be held in June 2012 and May 2013 to elect a new Parliament and president, respectively. Future changes in the Government, the ruling party, major policy shifts or lack of consensus between the various political groups could lead to political instability could also have a material adverse effect on our business. In addition, the possibility of political instability and uncertainty could adversely affect trading in the Notes and have a significant adverse impact on the economy of Mongolia, and investors may adopt a more cautious approach towards Mongolia's securities markets or investments in Mongolia in general, and such factors could adversely affect trading in the Notes.

Risks Relating to the Notes

We are a holding company and payments with respect to the Notes are structurally subordinated to liabilities, contingent liabilities and obligations of our subsidiaries that do not guarantee the Notes.

We are a holding company with no material operations. We conduct our operations through our Mongolian subsidiaries. The Notes will not be guaranteed by certain current or future subsidiaries. Accordingly, our ability to pay principal and interest on the Notes will depend upon our receipt of principal and interest payments on the intercompany loans and distributions of dividends from our subsidiaries.

Creditors, including trade creditors of non-guarantor subsidiaries and any holders of preferred shares in such entities, would have a claim on the assets of the non-guarantor subsidiaries that would be prior to the claims of holders of the Notes. As a result, our payment obligations under the Notes will be effectively subordinated to all existing and future obligations of our subsidiaries that do not guarantee the Notes, including their obligations under guarantees they have issued or will issue in connection with our business operations, and all claims of creditors of our non-guarantor subsidiaries will have priority as to the assets of such entities over our claims and those of our creditors, including holders of the Notes. As of December 31, 2011, our non-guarantor subsidiaries had nil indebtedness, capital commitments of US\$54.2 million and nil contingent liabilities arising from guarantees. The Notes and the indenture permit us, the guarantors and our non-guarantor subsidiaries to incur additional indebtedness and issue additional guarantees, subject to certain limitations.

Our secured creditors or those of any Subsidiary Guarantor would have priority as to our assets or the assets of such Subsidiary Guarantor securing the related obligations over claims of holders of the Notes.

The Notes and the Subsidiary Guarantees will constitute unsubordinated obligations and will rank *pari passu* in right of payment with all other existing and future unsubordinated indebtedness and senior in right of payment to all subordinated indebtedness, if any. The Notes and each Subsidiary Guarantee will be issued as a general obligation of the relevant company. However, the Notes and the Subsidiary Guarantees will be effectively subordinated to any of our or the Subsidiary Guarantors' secured obligations to the extent of the assets serving as security for such secured obligations. In bankruptcy, the holder of a security interest with respect to any assets of us or the Subsidiary Guarantors would be entitled to have the proceeds of such assets applied to the payment of such holder's claim before the remaining proceeds, if any, are applied to the claims of the holders of the Notes. As of the date of this offering memorandum, the Subsidiary Guarantors have pledged certain accounts, our construction agreement with Sedgman for our CHPP, our coal mining agreement with

Leighton, our offtake agreements, our CHPP, our water supply infrastructure assets, our 3x6 MW power plant and certain motor vehicles as collateral in connection with our EBRD, FMO and DEG Loan Agreements, our Existing Standard Bank Facilities Agreement and our Khan Bank Facility Agreement. In addition, ER LLC and we will grant a security interest in favor of Standard Bank over certain accounts, coal collateral and our rights under certain of our coal sales contracts to secure the New Standard Bank Facilities Agreement and, substantially simultaneous with the issuance of the Notes contemplated hereunder, the Collateral will be charged to secure both our obligations under the Notes and the New Standard Bank Facilities Agreement, on a *pari passu basis*. In addition, the Collateral may also be pledged to secure Permitted *Pari Passu* Secured Indebtedness, see “Description of the Notes – Security – Permitted *Pari Passu* Secured Indebtedness.” We or the Subsidiary Guarantors may pledge additional collateral in the future.

We have substantial indebtedness and may incur substantial additional indebtedness in the future, which could adversely affect our financial health and our ability to generate sufficient cash to satisfy our outstanding and future debt obligations.

We now have, and will continue to have after the offering of the Notes, a substantial amount of indebtedness. Our total borrowings, including both current and non-current borrowings, as of December 31, 2011 was US\$561.7 million. See “Description of Other Material Indebtedness”. Our substantial indebtedness could have important consequences to you. For example, it could:

- limit our ability to satisfy our obligations under the Notes and other debt;
- increase our vulnerability to adverse general economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations to servicing and repaying our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and for other general corporate purposes;
- limit our flexibility in planning for or reacting to changes in our businesses and the industry in which we operate;
- limit, along with the financial and other restrictive covenants of our indebtedness, our ability to borrow additional funds; and
- increase the cost of additional financing.

We may from time to time incur substantial additional indebtedness and contingent liabilities. Although the Indenture restricts us and our Restricted Subsidiaries from incurring additional debt and contingent liabilities, these restrictions are subject to important exceptions and qualifications. If we or our subsidiaries incur additional debt, the risks that we face as a result of our existing indebtedness and leverage could intensify.

Our ability to generate sufficient cash to satisfy our outstanding and future debt obligations will depend upon our future operating performance, which will be affected by prevailing economic conditions and financial, business and other factors, many of which are beyond our control. We anticipate that our operating cash flow will be sufficient to meet our anticipated operating expenses and to service our debt obligations as they become due. However, we may not generate sufficient cash flow for these purposes. If we are unable to service our indebtedness, we will be forced to adopt an alternative strategy that may include actions such as reducing or delaying capital expenditures, selling

assets, restructuring or refinancing our indebtedness or seeking equity capital. These strategies may not be instituted on satisfactory terms, if at all.

In addition, the indenture prohibits us from incurring additional indebtedness unless (i) we are able to satisfy a certain financial ratio or (ii) we are able to incur such additional indebtedness pursuant to any of the exceptions to the financial ratio requirement, and meet any other applicable restrictions. Our ability to meet our financial ratio requirement may be affected by events beyond our control. We might not be able to meet this ratio. Such restrictions in the Notes and our other financing arrangements may impair our ability to react to changes in market conditions, take advantage of business opportunities we believe to be desirable, obtain future financing, fund required capital expenditures, or withstand a continuing or future downturn in our business. Any of these factors could materially and adversely affect our ability to satisfy our obligations under the Notes and other debt.

To service our indebtedness, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control.

Our ability to make payments on and to refinance our indebtedness, including these Notes, and to fund planned capital expenditures and project development will depend on our ability to generate cash. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

Our business might not generate cash flow from operations in an amount sufficient to enable us to pay our indebtedness, including the Notes, or to fund our other liquidity needs. We may need to refinance all or a portion of our indebtedness, including the Notes, on or before maturity. We might not be able to refinance any of our indebtedness on commercially reasonable terms or at all.

Our subsidiaries are subject to restrictions on the payment of dividends and the repayment of intercompany loans or advances to us and our subsidiaries.

As a holding company, we depend on the receipt of dividends and the interest and principal payments on intercompany loans or advances from our subsidiaries to satisfy our obligations, including our obligations under the Notes. The ability of our subsidiaries to pay dividends and make payments on intercompany loans or advances to their shareholders is subject to, among other things, distributable earnings, cash flow conditions, restrictions contained in the articles of association of our subsidiaries, applicable laws and restrictions contained in the debt instruments of such subsidiaries. The EBRD, FMO and DEG Loan Agreements prohibit ER LLC from paying dividends if we are in default under any of those loans, including in default of certain financial covenant ratios. In the year ended December 31, 2011, ER LLC was in violation of the debt service coverage ratio, the current ratio and the total liabilities to tangible net worth ratio. While EBRD, FMO and DEG each waived these breaches of the EBRD, FMO and DEG Loan Agreements, there can be no assurance we will be able to obtain waivers for a violation of these financial covenants or other covenants in the future. See “Description of Other Material Indebtedness – EBRD, FMO and DEG Loan Agreements”. In addition, if any of our subsidiaries raises capital by issuing equity securities to third parties, dividends declared and paid with respect to such shares would not be available to us to make payments on the Notes. These restrictions or legal requirements could reduce the amounts that we receive from our subsidiaries, which would restrict our ability to meet our payment obligations under the Notes and the guarantees for the Notes.

Mongolian laws and regulations permit payment of dividends only out of accumulated profits as determined in accordance with Mongolian accounting standards and regulations and such profits differ from profits determined in accordance with IFRS in certain respects, including the use of different bases of recognition of revenue and expenses. Dividends paid by our Mongolian subsidiaries (i) to

their Mongolian parent companies are subject to a 10% withholding tax and (ii) to us and to non-Mongolian parent companies are subject to a 20% withholding tax, unless there is a tax treaty between Mongolia and the jurisdiction in which the non-Mongolian parent company is incorporated which specifically exempts or reduces such withholding tax.

Pursuant to the tax treaty between Mongolia and Luxembourg, any dividend paid by our Mongolian subsidiary to its Luxembourg parent company is not subject to withholding tax in Mongolia, so long as (i) the parent company has directly held, for a consecutive period of at least 12 months (preceding the payment date of the dividend), 25% or more of the share capital of the Mongolian subsidiary, and (ii) the dividend is derived from the income of industrial and commercial activities and investment and investment managing activities (except for banking and insurance activities) in Mongolia. As of the date of this offering memorandum, our Mongolian subsidiaries qualify for the exemptions under the treaty.

As a result of the foregoing, we may not have sufficient cash flow from dividends or payments on intercompany loans or advances from our subsidiaries to satisfy our obligations under the Notes or the obligations of the guarantors under the guarantees.

If we are unable to comply with the terms of the indenture or our existing or future debt agreements, there could be a default under those agreements, which could cause repayment of our debt to be accelerated.

If we are unable to comply with the terms in the indenture or our existing or future debt obligations and other agreements, there could be a default under those agreements. If that occurs, the holders of the debt could terminate their commitments to lend to us, accelerate repayment of the debt and declare all outstanding amounts due and payable or terminate the agreements, as the case may be. Furthermore, the indenture contains, and our future debt agreements are likely to contain, cross-acceleration or cross-default provisions. As a result, our default under one debt agreement may cause the acceleration of repayment of not only such debt but also other debt, including the Notes, or result in a default under our other debt agreements, including the indenture. If any of these events occur, our assets and cash flow might not be sufficient to repay in full all of our indebtedness and we might not be able to find alternative financing. Even if we could obtain alternative financing, it might not be on terms that are favorable or acceptable to us.

Our operations are restricted by the terms of the Notes, which could limit our ability to plan for or to react to market conditions or meet our capital needs, which could increase your credit risk.

The indenture includes a number of significant restrictive covenants. These covenants restrict, among other things, our ability, and the ability of our Restricted Subsidiaries, to:

- incur or guarantee additional indebtedness and issue disqualified or preferred stock, including, with respect to the Subsidiary Guarantors, layering of debt;
- make investments, capital expenditures or other specified restricted payments;
- declare dividends on capital stock or purchase or redeem capital stock;
- issue or sell capital stock of Restricted Subsidiaries;
- guarantee indebtedness of Restricted Subsidiaries;
- prepay or redeem subordinated debt or equity;

- sell, lease or transfer assets;
- create liens;
- enter into sale and leaseback transactions;
- engage in any business other than permitted business;
- enter into agreements that restrict the Restricted Subsidiaries' ability to pay dividends, transfer assets or make intercompany loans;
- enter into transactions with shareholders or affiliates; and
- effect a consolidation or merger.

These covenants could limit our ability to plan for or react to market conditions or to meet our capital needs. Our ability to comply with these covenants may be affected by events beyond our control, and we may have to curtail some of our operations and growth plans to maintain compliance.

ER LLC may be required to list no less than 10% of its shares on the Mongolian Stock Exchange which would result in an event of default.

The 2006 Minerals Law 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 be enforced in practice. If it is enforced, we may be required to reduce our indirect shareholding percentage in ER LLC to 90.0% or less, which would result in an event of default.

We may reallocate the use of proceeds of this offering in response to changing market conditions or circumstances and other factors, including, without limitation, the timing of our UHG-GS railway project.

We intend to use the proceeds of this offering as set forth in "Use of Proceeds". However, we may reallocate the use of proceeds of this offering in response to changing market conditions or circumstances and other factors, including, without limitation, the timing of our UHG-GS railway project. For example, if there is a change in the timing of our UHG-GS railway project, we may decide not to allocate proceeds to our UHG-GS railway project and instead may refinance our existing debt or allocate the proceeds for other purposes.

The insolvency laws of the Cayman Islands and other local insolvency laws may differ from U.S. bankruptcy law or those of another jurisdiction with which holders of the Notes are familiar.

Because we and some of the guarantors are incorporated under the laws of the Cayman Islands, Hong Kong, Mongolia or Luxembourg, an insolvency proceeding relating to us or any such guarantor, even if brought in the United States, would likely involve Cayman Islands, Hong Kong, Mongolian or Luxembourg insolvency laws, the procedural and substantive provisions of which may differ from comparable provisions of United States federal bankruptcy law or other jurisdictions with which the holders of the Notes are familiar. We conduct substantially all of our business operations through Mongolian-incorporated subsidiaries in Mongolia. You should analyze the risks and uncertainties carefully before you invest in our Notes.

We may not be able to repurchase the Notes upon a change of control.

We must offer to purchase the Notes upon the occurrence of a change of control, at a purchase price equal to 101% of the principal amount plus accrued and unpaid interest. See "Description of the

Notes”. The source of funds for any such purchase would be our available cash or third-party financing. However, we may not have enough available funds at the time of the occurrence of any change of control to make purchases of outstanding Notes. Our failure to make the offer to purchase or purchase the outstanding Notes would constitute an event of default under the Notes. The event of default may, in turn, constitute an event of default under other indebtedness, any of which could cause the related debt to be accelerated after any applicable notice or grace periods. If our other debt were to be accelerated, we may not have sufficient funds to purchase the Notes and repay the debt.

In addition, the definition of change of control for purposes of the indenture does not necessarily afford protection for the holders of the Notes in the event of some highly leveraged transactions, including certain acquisitions, mergers, refinancings, restructurings or other recapitalizations, although these types of transactions could increase our indebtedness or otherwise affect our capital structure or credit ratings. The definition of change of control for purposes of the indenture also includes a phrase relating to the direct or indirect sale, lease, transfer, conveyance or other disposition of “all or substantially all” of the properties or our assets taken as a whole. Although there is a limited body of case law interpreting the phrase “substantially all,” there is no precise established definition under applicable law. Accordingly, our obligation to make an offer to purchase the Notes and the ability of a holder of the Notes to require us to purchase its Notes pursuant to the offer as a result of a highly-leveraged transaction or a sale of less than all of our assets may be uncertain.

The liquidity and price of the Notes following the offering may be volatile.

The price and trading volume of the Notes may be highly volatile. Factors such as variations in our revenues, earnings and cash flows and proposals for new investments, strategic alliances and acquisitions, interest rates, the general state of the securities market and fluctuations in price for comparable companies could cause the price of the Notes to change. Any such developments may result in large and sudden changes in the trading volume and price of the Notes. We cannot assure you that these developments will not occur in the future.

A trading market for the Notes may not develop, and there are restrictions on resale of the Notes.

The Notes are a new issue of securities for which there is currently no trading market. Although we have received approval in-principle for listing the Notes on the SGX-ST, we cannot assure you that we will be able to obtain or maintain a listing on the SGX-ST and, even if listed, a liquid trading market might not develop. If no active trading market develops, you may not be able to resell your Notes at their fair market value or at all. Future trading prices of the Notes will depend on many factors, including prevailing interest rates, our operating results and the market for similar securities, which are beyond our control. We have been advised that the initial purchasers intend to make a market in the Notes, but the initial purchasers are not obligated to do so and may discontinue such market making activity at any time without notice. In addition, the Notes are being offered pursuant to exemptions from registration under the Securities Act and, as a result, you will only be able to resell your Notes in transactions that have been registered under the Securities Act or in transactions not subject to or exempt from registration under the Securities Act. See “Transfer Restrictions”. We cannot predict whether an active trading market for the Notes will develop or be sustained. If an active trading market for the Notes does not develop or is not sustained, the market price and liquidity of the Notes may be adversely affected.

The transfer of the Notes and the Subsidiary Guarantees is restricted, which may adversely affect their liquidity and the price at which they may be sold.

The Notes and the Subsidiary Guarantees have not been registered under, and we are not obligated to register the Notes or the Subsidiary Guarantees under, the Securities Act or the securities

laws of any other jurisdiction and, unless so registered, may not be offered or sold except pursuant to an exemption from, or a transaction not subject to, the registration requirements of the Securities Act or the Securities and Futures Act (Chapter 289 of Singapore) (the “SFA”) and any other applicable laws. See “Plan of Distribution” and “Transfer Restrictions”. We have not agreed to or otherwise undertaken to register the Notes and the Subsidiary Guarantees with the SEC or the Monetary Authority of Singapore or the securities regulatory authority of any other jurisdiction, and we have no intention of doing so.

The ratings provisionally assigned to the Notes may be lowered or withdrawn.

The Notes have been provisionally assigned a rating of “B1” by Moody’s and “B+” by Standard and Poor’s. The ratings address our ability to perform our obligations under the terms of the Notes and credit risks in determining the likelihood that payments will be made when due under the Notes. In addition, we have been assigned a rating of “B1” with a stable outlook by Moody’s and “B+” with a stable outlook by Standard and Poor’s. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time. A rating might not remain for any given period of time and could be lowered or withdrawn entirely by the relevant rating agency. We have no obligation to inform holders of the Notes of any such revision, downgrade or withdrawal. A suspension, reduction or withdrawal at any time of the rating assigned to the Notes may adversely affect the market price of the Notes.

The Notes will initially be held in book-entry form, and therefore you must rely on the procedures of the relevant clearing systems to exercise any rights and remedies.

The Notes will initially only be issued in global certificated form and held through DTC and Euroclear and Clearstream as participants in DTC. Interests in the global notes representing the Notes will trade in book-entry form only, and notes in definitive registered form will be issued in exchange for book-entry interests only in very limited circumstances. Owners of book-entry interests will not be considered owners or holders of the Notes for purposes of the indenture. The nominee for DTC will be the sole registered holder of the global notes. Accordingly, you must rely on the procedures of DTC, and if you are not a participant in DTC, on the procedures of the participant through which you own your interest, to exercise any rights and obligations of a holder of the Notes under the indenture. Upon the occurrence of an Event of Default under the Indenture, unless and until definitive registered notes are issued with respect to all book-entry interests, if you own a book-entry interest, you will be restricted to acting through DTC. The procedures to be implemented through DTC may not be adequate to ensure the timely exercise of rights under the Notes. See “Description of the Notes – Book-Entry; Delivery and Form”.

We will follow the applicable corporate disclosure standards for debt securities listed on the SGX-ST, which standards may be different from those applicable to debt securities listed in certain other countries.

We will be subject to reporting obligations in respect of the Notes to be listed on the SGX-ST. The disclosure standards imposed by the SGX-ST may be different from those imposed by securities exchanges in other countries such as the United States or Hong Kong. As a result, the level of information that is available may not correspond to what investors in the Notes are accustomed to.

Certain transactions that constitute “connected transactions” under the Listing Rules will not be subject to the “Limitation on Transactions with Shareholders and Affiliates” covenant in the Description of the Notes.

Our shares are listed on the Hong Kong Stock Exchange and we are required to comply with the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the “Listing

Rules”), which provide, among other things, that a “connected transaction” exceeding the applicable de minimis value thresholds will require certain procedures requirements to be completed or approvals to be obtained. However, the “Limitation on Transactions with Shareholders and Affiliates” covenant set forth in the “Description of the Notes” does not capture transactions between the Company or any Restricted Subsidiary, on the one hand, and an Affiliate of any Restricted Subsidiary, on the other hand. As a result, we are not required by the terms of the Notes to ensure that any such transactions are on terms that are fair and reasonable, and we will not need to deliver officer’s certificates or procure the delivery of fairness opinions of accounting, appraisal or investment banking firms to the trustee of the Notes for any such transactions.

Disclosure standards that apply to us may differ from those in the United States or other jurisdictions.

Our consolidated financial information is prepared in accordance with IFRS, which differs in certain respects from U.S. GAAP. As a result, our consolidated financial information and reported earnings could be significantly different if they were prepared in accordance with U.S. GAAP. We have made no attempt to quantify the impact of those differences. This offering memorandum does not contain reconciliation of our consolidated financial information to U.S. GAAP, and there is no assurance that such reconciliation would not reveal material differences. Potential investors should consult their own professional advisors for an understanding of the differences between IFRS and U.S. GAAP, and how these differences might affect the financial information herein. In addition, our shares are listed on the Hong Kong Stock Exchange. There may be less publicly available information about us than is regularly made available by public companies listed on certain other stock exchanges.

Risks Relating to the Guarantees and the Collateral

We cannot assure you that a guarantee issued by Mongolian company in favor of a parent company will not be challenged or will not have its enforceability impaired.

Few Mongolian-incorporated companies have participated in international financing transactions, especially transactions where a Mongolian company has provided a guarantee with respect to the payment obligations of its offshore parent company. Furthermore, the Mongolian legal system is young and exhibits several of the characteristics typically found in a developing country and its judicial system has relatively little experience in enforcing the laws and regulations that currently exist. See “Risk Factors – Risks Relating to Mongolia – Legislation in Mongolia may be subject to conflicting interpretations” and “Risk Factors – Risks Relating to Mongolia – Weaknesses relating to the Mongolian legal system and Mongolian legislation create an uncertain environment for investment and business activity”. There can be no assurance that a guarantee provided by a Mongolian entity will not be voided or claims in respect of a guarantee provided by a Mongolian entity will not be subordinated to other debt of that entity whether pursuant to law or governmental or judicial mandate. See “ – The guarantees may be challenged under applicable bankruptcy, fraudulent transfer insolvency or similar laws, which could impair the enforceability of the guarantees”.

If a court voids a guarantee, subordinates such guarantee to other indebtedness of the guarantor, or holds the guarantee unenforceable for any other reason, holders of the Notes would cease to have a claim against that guarantor based upon such guarantee, would be subject to the prior payment of all liabilities (including trade payables) of such guarantor, and would solely be creditors of us and any guarantors whose guarantees have not been voided or held unenforceable. In such an event, after providing for all prior claims, there might not be sufficient assets to satisfy the claims of the holders of the Notes.

The guarantees may be challenged under applicable bankruptcy, fraudulent transfer, insolvency or similar laws, which could impair the enforceability of the guarantees.

Under bankruptcy, fraudulent transfer, insolvency or similar laws in Hong Kong, Luxembourg or Mongolia and other jurisdictions where future guarantors may be established, a guarantee could be voided, or claims in respect of a guarantee could be subordinated to all other debts of that guarantor if, among other things, the guarantor, at the time it incurred the indebtedness evidenced by, or when it gives, its guarantee:

for guarantors incorporated in Mongolia:

- was liquidated by a court decision due to bankruptcy based on voluntary or involuntary insolvency;
- was liquidated or reorganized due to intentional arrangement between guarantor and obligor prior to the obligation term, or liquidated on grounds provided by other laws;
- became insolvent even if not liquidated or bankrupt;
- had its license revoked, pledged or suspended, or had guarantor's assets sealed or confiscated due to the guarantor's illegal action or based a government organization decision;
- fraudulently appeared to be financially insolvent;
- was unable to fulfill its obligation due to the occurrence of conditions that makes the issuance of the guarantee impossible (if stated in the guarantee agreement); or
- was unable to fulfill its obligation due to the occurrence of other conditions (such as change of laws and regulations and consequences caused by force majeure events).

for guarantors incorporated in other jurisdictions:

- incurred the debt with the intent to hinder, delay or defraud creditors or was influenced by a desire to put the beneficiary of the guarantee in a position which, in the event of the guarantor's insolvency, would be better than the position the beneficiary would have been in had the guarantee not been given;
- received less than reasonably equivalent value or fair consideration for the incurrence of such guarantee;
- was insolvent or rendered insolvent by reason of the incurrence of such guarantee;
- was engaged in a business or transaction for which the guarantor's remaining assets constituted unreasonably small capital; or
- intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature.

In addition, for guarantors or collateral providers incorporated in Luxembourg:

The insolvency laws of Luxembourg may not be as favorable to holders of the Notes as insolvency laws of jurisdictions with which investors may be familiar. For any Subsidiary Guarantor

incorporated and having its center of main interests in Luxembourg, insolvency proceedings with respect to that Subsidiary Guarantor may proceed under, and be governed by, Luxembourg insolvency laws. The following is a brief description of certain aspects of insolvency laws in Luxembourg.

Under Luxembourg law, the following types of proceedings (altogether referred to as insolvency proceedings) may be opened against a company incorporated in Luxembourg having centre of main interests within the meaning of EU Council Regulation No. 1346/2000 of May 29, 2000 on insolvency proceedings (the “EU Insolvency Regulation”) (respectively its central administration, if different, and if the centre of main interest is located in a jurisdiction where the EU Insolvency Regulation is not applicable) or an establishment in Luxembourg (in latter case assuming that the center of main interests is located in a jurisdiction where the EU Insolvency Regulation is applicable):

- bankruptcy proceedings, the opening of which may be requested by the company, by any of its creditors or by the courts ex officio. Following such a request, the Luxembourg courts having jurisdiction may open bankruptcy proceedings if the company: (i) is in a state of cessation of payments and (ii) has lost its creditworthiness. The main effect of such proceedings is the suspension of all measures of enforcement against the company, except, subject to certain limited exceptions, for enforcement by secured creditors and the payment of the secured creditors in accordance with their rank upon realization of the assets. In addition, the managers or directors of a Luxembourg company that ceases its payments (i.e. is unable to pay its debts as they fall due with normal means of payment) must within a month of them having become aware of the company’s cessation of payments, file a petition for bankruptcy with the court clerk of the district court of the company’s registered office. If the managers or directors fail to comply with such provision they may incur civil and/or criminal liability;
- controlled management proceedings, the opening of which may only be requested by the company and not by its creditors and under which a Luxembourg court may order provisional suspension of payments, including a stay of enforcement of claims by secured creditors; or
- composition proceedings, the opening of which may only be requested by the company (subject to obtaining the consent of the majority of its creditors) and not by its creditors themselves. The Luxembourg court’s decision to admit a company to the composition proceedings triggers a provisional stay on enforcement of claims by creditors.

In addition to these proceedings, the ability of a holder of the Notes to call the guarantee may be affected by a decision of a Luxembourg court to grant a stay on payments or to put a Luxembourg company into judicial liquidation. Judicial liquidation proceedings may be opened at the request of the public prosecutor against companies pursuing an activity violating criminal laws or that are in serious breach or violation of the Luxembourg Commercial Code or of the Luxembourg law dated August 10, 1915 on commercial companies, as amended. The management of such liquidation proceedings will generally follow similar rules as those applicable to Luxembourg insolvency proceedings.

Liability of the Luxembourg companies in respect of the guarantee will, in the event of a liquidation of the company following bankruptcy or judicial liquidation proceedings, only rank after the cost of liquidation (including any debt incurred for the purpose of such liquidation) and any claims that are preferred under Luxembourg law. Preferential claims under Luxembourg law include, among others:

- liquidation or insolvency fees;
- certain amounts owed to the Luxembourg Revenue and value-added tax and other taxes and duties owed to the Luxembourg Customs and Excise;

- social security contributions; or
- remuneration owed to employees.

Assets over which a security interest has been granted will not, in principle, be available for distribution to unsecured creditors (except after enforcement and to the extent a surplus is realized).

Favorable rules apply in relation to security interests of claims or financial instruments securing monetary claims (or claims for the delivery of financial instruments). Article 20 of the Luxembourg law dated August 5, 2005 on financial collateral arrangements as amended (the “Luxembourg Collateral Law”) provides that all Luxembourg law collateral arrangements (pledges, security assignments and repo agreements) over claims and financial instruments, as well as all enforcement measures and valuation and enforcement measures agreed upon by the parties in accordance with this law, are valid and enforceable even if entered into during the hardening period against third parties, commissioners, receivers, liquidators and other similar persons notwithstanding the opening of insolvency or similar proceedings (save in the case of fraud).

Article 21 (2) of the Luxembourg Collateral Law provides that, where a financial collateral arrangement has been entered into after the opening of liquidation proceedings or the coming into force of reorganization measures or the entry into force of such measures, such arrangement is enforceable against third parties, administrators, insolvency receivers, liquidators and other similar organs if the collateral taker proves that it was unaware of the fact that such proceedings had been opened or that such measures had been taken or that it could not reasonably be aware of it.

Article 24 of the Luxembourg Collateral Law provides that foreign law security interests over claims or financial instruments granted by a Luxembourg security provider will be valid and enforceable as a matter of Luxembourg law notwithstanding any Luxembourg insolvency proceedings, if such foreign law security interests are similar in nature to a Luxembourg security interest falling within the scope of the Luxembourg Collateral Act 2005. If Article 24 applies, Luxembourg suspect period rules are disappplied (save the case of fraud).

During insolvency proceedings in Luxembourg, all enforcement measures by unsecured creditors are suspended. Other than as described above, the ability of certain secured creditors to enforce their security interest may also be limited, in particular in the event of controlled management proceedings providing expressly that the rights of secured creditors are frozen until a final decision has been taken by a Luxembourg court as to the petition for controlled management, and may be affected thereafter by a reorganization order given by the court. A reorganization order requires the prior approval by more than 50% of the creditors representing more than 50% of the relevant Luxembourg company’s liabilities in order to take effect. Furthermore, declarations of default and subsequent acceleration (such as acceleration upon the occurrence of an event of default) may not be enforceable during controlled management proceedings.

- Luxembourg insolvency laws may affect transactions entered into, or payments made, by a Luxembourg company during the suspect period which is a maximum of six months preceding the judgment declaring bankruptcy, except that in certain specific situations the court may set the start of the suspect period at the ten days preceding it. In particular:
 - some specific transactions (in particular, the granting of a security interest for antecedent debts, save in respect of financial collateral arrangements within the meaning of the Luxembourg law on financial collateral arrangements of August 5, 2005 (as amended); the payment of debts which have not fallen due, whether payment is made in cash or by way of assignment, sale, set-off or by any other means; the

payment of debts which have fallen due by any means other than in cash or by bill of exchange; the sale of assets without consideration or with substantially inadequate consideration) entered into during the suspect period must be set aside or declared null and void, if so requested by the insolvency receiver;

- payments made for matured debts as well as other transactions concluded for consideration during the suspect period are subject to cancellation by the court upon proceedings instituted by the insolvency receiver if they were concluded with the knowledge of the bankrupt's cessation of payments; and
- the insolvency receiver (acting on behalf of the creditors) has the right to challenge any fraudulent payments and transactions, including the granting of security with an intent to defraud, made prior to the bankruptcy, without any time limit;
- Insolvency proceedings may hence have a material adverse effect on the relevant Luxembourg company's business and assets and the Luxembourg company's respective obligations under the Notes.
- Finally, international aspects of Luxembourg insolvency proceedings may be subject to the EU Insolvency Regulation. In particular, rights in rem over assets located in another jurisdiction where the EU Insolvency Regulation is applicable will not be affected by the opening of insolvency proceedings, without prejudice however to the applicability of rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors (subject to the application of Article 24 of the Luxembourg Collateral Law as described above and Article 13 of the EU Insolvency Regulation).

The measure of insolvency for purposes of the foregoing discussion of the legal regimes of Hong Kong, Luxembourg, Mongolia and other jurisdictions will vary depending on the laws of the applicable jurisdiction. Generally, however, a guarantor would be considered insolvent at a particular time if it were unable to pay its debts as they fell due or if the sum of its debts was then greater than all of its properties at a fair valuation or if the present fair saleable value of its assets was then less than the amount that would be required to pay its probable liabilities in respect of its existing debts as they became absolute and matured.

In addition, a guarantee may be subject to review under applicable bankruptcy, fraudulent transfer, insolvency or similar laws in certain jurisdictions or subject to a lawsuit by or on behalf of creditors of the guarantor. In such case, the analysis set forth above would generally apply, except that the guarantee could also be subject to the claim that, since the guarantee was not incurred for the benefit of the guarantor, the obligations of the guarantor thereunder were incurred for less than reasonably equivalent value or fair consideration.

In an attempt to limit the applicability of bankruptcy, fraudulent transfer, insolvency and other laws in certain jurisdictions, the obligations of the guarantors under the guarantees will be limited to the maximum amount that can be guaranteed by the applicable guarantor without rendering the guarantee, as it relates to such guarantor, voidable under such applicable bankruptcy, fraudulent transfer, insolvency or similar laws.

If a court voids a guarantee, subordinates such guarantee to other indebtedness of the guarantor, or holds the guarantee unenforceable for any other reason, holders of the Notes would cease to have a claim against that guarantor based upon such guarantee, would be subject to the prior payment of all liabilities (including trade payables) of such guarantor, and would solely be creditors of us and any guarantors whose guarantees have not been voided or held unenforceable. In such an event, after providing for all prior claims, there might not be sufficient assets to satisfy the claims of the holders of the Notes.

Corporate benefit, capital maintenance laws and other limitations on the Subsidiary Guarantees and the Collateral may adversely affect the validity and enforceability of the Subsidiary Guarantees and the Collateral.

The laws of certain of the jurisdictions in which the Subsidiary Guarantors are incorporated, including Luxembourg, may limit their ability to guarantee the debt of a parent or sister company or to grant security on account of a related company's debts. These limitations arise from principles of corporate law, which include rules governing capital maintenance, under which, among others, the risks associated with the guaranteeing or granting of security on account of a parent or sister company's debt need to be reasonably, economically and operationally appreciated in the global context of the case and in a perspective of continuity from the Subsidiary Guarantor's perspective, as well as financial assistance, thin capitalization and fraudulent transfer principles. If these limitations were not considered, observed or justified, the guarantees and the grant of security interests by those Subsidiary Guarantors could be subject to legal challenge and be declared invalid. In these jurisdictions, the Subsidiary Guarantees usually contain language limiting the amount of debt that can be guaranteed or secured by the relevant Subsidiary Guarantor to mitigate the risk of legal challenge, which could cause the Guarantee to be voidable or otherwise ineffective under applicable laws. In Luxembourg, the granting of a guarantee or security in absence of sufficient corporate benefit for the guarantor or security provider may constitute a misappropriation of corporate assets and the law makes it a criminal offense. See "Description of the Notes – The Subsidiary Guarantees".

The amount recoverable under the Subsidiary Guarantees and, as the case may be, the Collateral may be limited to a certain maximum amount that can be guaranteed or secured, by a particular Subsidiary Guarantor without rendering such Subsidiary Guarantee or Collateral, as it relates to such Subsidiary Guarantor, voidable or otherwise ineffective under applicable law, or without creating liability risks for its management.

Our Subsidiary Guarantors may not have the funds necessary to satisfy our financial obligations under the Subsidiary Guarantees.

Certain of our current and future subsidiaries will not provide any guarantee for the Notes now or at any time in the future. As a result, the Notes will be effectively subordinated to all the debt and other obligations, including contingent obligations and trade payables, of such non-guarantor subsidiaries.

We cannot assure you that the initial guarantors or any subsidiaries that may become guarantors in the future will have the funds necessary to satisfy our financial obligations under the Notes if we are unable to do so.

The pledge of certain Collateral may in some circumstances be voidable.

The pledge of the Collateral may be voidable as a preference under insolvency or fraudulent transfer or similar laws of Hong Kong at any time within six months of the creation of the pledge or, under some circumstances, within a longer period. Pledges of shares of future Subsidiary Guarantors may also be voidable as a preference under relevant insolvency or fraudulent transfer or similar laws.

If the pledges of the Collateral were to be voided for any reason, holders of the Notes would have only an unsecured claim against us.

The value of the Collateral will likely not be sufficient to satisfy the Company's obligations under the Notes, the New Standard Bank Facilities Agreement and other Permitted Pari Passu Secured Indebtedness.

The Collateral will initially consist only of the capital stock of Mongolian Coal Corporation Limited and Mongolian Coal Corporation S.à.r.l.

Security over the Collateral for our obligations under the Notes and the Indenture will not be granted directly to the holders of the Notes but will be granted only in favor of the Shared Security Agent for the benefit of the Trustee. As a consequence, holders of the Notes will not have direct security and will not be entitled to take enforcement action in respect of the security for the Notes, except through the Shared Security Agent, which has agreed to apply any proceeds of enforcement on such security towards such obligations, subject to equal and ratable sharing with the finance parties under the New Standard Bank Facilities Agreement and the holders of the Permitted *Pari Passu* Secured Indebtedness, if any.

The ability of the Trustee or the Shared Security Agent, as the case may be, on behalf of the holders of the Notes, to foreclose on such Collateral upon the occurrence of an Event of Default or otherwise will be subject in certain instances to perfection and priority issues. Although procedures will be undertaken to support the validity and enforceability of the security interests granted in relation to the Collateral, we cannot assure you that the Shared Security Agent, will be able to enforce such security interests granted in relation to the Collateral. In addition, although the Trustee is entitled under the Intercreditor Agreement to give instructions to the Collateral Agent to enforce the Collateral, such instructions may be overruled by a conflicting instruction given by creditors representing more than 50% of the indebtedness subject to the Intercreditor Agreement, or if the holders of the Notes do not concur with any instructions given to the Collateral Agent from any other creditor subject to the Intercreditor Agreement, the holders of the Notes may not, at such time, represent more than 50% of the indebtedness subject to the Intercreditor Agreement, in order to be able to overrule any such instructions.

The value of the Collateral in the event of a liquidation will depend upon market and economic conditions, the availability of buyers and other factors. No independent appraisals of any of the Collateral have been prepared by or on our behalf in connection with this offering of the Notes. Accordingly, we cannot assure you that the proceeds of any sale of the Collateral following an acceleration of the Notes would be sufficient to satisfy, or would not be substantially less than, amounts due and payable on the Notes, the New Standard Bank Facilities Agreement and other Permitted *Pari Passu* Secured Indebtedness. By their nature, some or all of the Collateral, in particular, the capital stock of the existing or any future Subsidiary Guarantor, may be illiquid and may have no readily ascertainable market value. Likewise, we cannot assure you that the Collateral will be saleable or, if saleable, that there will not be substantial delays in its liquidation.

The Collateral will be shared on a *pari passu* basis by the holders of the Notes and finance parties under the New Standard Bank Facilities Agreement and may be shared on a *pari passu* basis with other Permitted *Pari Passu* Secured Indebtedness. Accordingly, in the event of a default on the Notes, the New Standard Bank Facilities Agreement or the other Permitted *Pari Passu* Secured Indebtedness and an enforcement of the Collateral, any enforcement proceeds would be shared by the holders of secured indebtedness in proportion to the outstanding amounts of each class of such secured indebtedness. The value of the Collateral may not be sufficient to satisfy the full repayment of the indebtedness under the Notes, the indebtedness under the New Standard Bank Facilities Agreement and any other Permitted *Pari Passu* Secured Indebtedness, and the Collateral securing the Notes and the guarantees may be reduced or diluted under certain circumstances, including as a consequence of the issuance of additional Notes or the incurrence of other *pari passu* indebtedness and the disposition of assets comprising the Collateral, subject to the terms of the Indenture. If the proceeds of the sale of the Collateral were insufficient to repay the amounts due under the Notes, the New Standard Bank Facilities Agreement and any additional Permitted *Pari Passu* Secured Indebtedness, holders of the Notes would have only an unsecured claim against the remaining assets of the Company and the remaining assets of the Subsidiary Guarantors.

The guarantees from the Subsidiary Guarantors will be shared on a pari passu basis with the other creditors

The proceeds from the enforcement of the guarantees from the Subsidiary Guarantors will be shared on a *pari passu* basis among the holders of the Notes, the finance parties under the New Standard Bank Facilities Agreement and may be shared on a *pari passu* basis with other indebtedness ranking *pari passu* with the Notes that we may issue or incur in the future. Accordingly, in the event of a default on the Notes, the New Standard Bank Facilities Agreement or such other indebtedness and an enforcement of such guarantees, any proceeds so recovered would be shared by the holders of such indebtedness in proportion to the outstanding amounts of each class of such indebtedness. Since certain of the Subsidiary Guarantors are holding companies with no substantial assets, the proceeds of recovery resulting from such enforcement are likely to be insufficient to discharge the obligations under the Notes, the New Standard Bank Facilities Agreement and other *pari passu* indebtedness.

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

You should read the following discussion and analysis in conjunction with our financial statements prepared in conformity with IFRS, which may differ in certain material aspects from generally accepted accounting principles in other jurisdictions, together with the accompanying notes, set forth in the audited consolidated financial statements included in this offering memorandum. You should read the whole of the audited consolidated financial statements included in this offering memorandum and not rely merely on the information contained in this section.

The following discussion contains certain forward-looking statements that involve risks and uncertainties. Our actual results reported in future periods could differ materially from those discussed below. Factors that could cause or contribute to such differences include those discussed in the sections headed "Risk Factors" and "Business" and elsewhere in this offering memorandum.

For the purpose of this section, unless the context otherwise requires, references to 2009, 2010 and 2011 refer to our financial year ended December 31 of such year. Unless the context otherwise requires, financial information described in this section is described on a consolidated basis.

Overview

We are a leading Asian coking coal mining company. We are engaged in the open-pit mining of coking coal at our UHG deposit which forms the northern branch of the Tavan Tolgoi coal formation and our BN deposit, both located in South Gobi Province, Mongolia. Our UHG mining license permits us to engage in coal mining activities on 2,960 hectares of land at our UHG mine for an initial period of 30 years starting from August 29, 2006. Our UHG mine had 570.8 Mt and 275.0 Mt of JORC-compliant measured, indicated and inferred coal resources and proven and probable coal reserves, respectively, as of December 31, 2011. On June 1, 2011, we completed the acquisition of our BN mine, which is located approximately 30 km southwest of our UHG mine. Our BN mine had 282.2 Mt of JORC-compliant measured, indicated and inferred coal resources as of February 2010 and 185.3 Mt of JORC-compliant proven and probable reserves as of February 2011. We commenced operations at our BN mine in February 2012.

We are the largest producer and exporter of raw and washed coal in Mongolia. We commenced mining at our UHG mine in April 2009 and became profitable in our first year of operations. For the years ended December 31, 2009, 2010 and 2011, we produced 1.8 Mt, 3.9 Mt and 7.1 Mt of ROM coal, respectively. We, together with our contract trucking companies, haul most of our coal by truck to GM, located on the Chinese side of the Sino-Mongolian border crossing, where our customers pick up and further transport the coal to their final destinations in China. In October 2011, we completed the construction of a paved road, with coal transportation capacity of 18.0 Mtpa from our UHG mine to GS. In January 2012, we, together with Erdenes MGL, completed and commissioned an expansion of the GS border crossing, which we expect will increase the border crossing capacity from 10 Mtpa to approximately 20-30 Mtpa.

We sell most of our coking coal into China pursuant to long-term agreements with iron and steel mills and coke and chemical plants. According to Shanxi Fenwei, the selling prices of our coal are the highest among our competitors in Mongolia and are considered the benchmark for the price of Mongolian coking coal. In the years ended December 31, 2009, 2010 and 2011, we sold our coking coal at an average selling price of US\$48.2, US\$70.8 and US\$113.9 per tonne, respectively. In June 2011 and February 2012, we commenced operations of the first and second modules, respectively, of our CHPP with ROM coal nameplate processing capacity of 5.0 Mtpa to produce high-quality washed coal. With the commencement of operations of our CHPP, we have shifted our production from raw

coal to washed coal. Washed coal is sold at a substantial premium to raw coal. In 2011, the average selling price of our raw coal was US\$95.0 per tonne and the average selling price of our washed coal was US\$155.6 per tonne, representing approximately a 63.8% premium to that of raw coal.

Our revenue for the years ended December 31, 2009, 2010 and 2011 was US\$67.0 million, US\$277.5 million and US\$542.6 million, respectively, representing a CAGR of 184.6%. Our net profit for the years ended December 31, 2009, 2010 and 2011 was US\$10.3 million, US\$60.1 million and US\$119.1 million, respectively, representing a CAGR of 240.0%.

Factors Affecting Results of Operations and Financial Condition

Our business and historical financial condition and results of operations have been, and will continue to be, affected by a number of important factors, including the following:

Production and Expansion

Since April 2009, we have been principally engaged in open-pit coking coal mining at our UHG mine, which is located in the Tavan Tolgoi coal formation. We produced 1.8 Mt, 3.9 Mt and 7.1 Mt of ROM coal for the years ended December 31, 2009, 2010 and 2011, respectively, from our UHG mine.

On June 1, 2011, we completed the acquisition of our BN mine, our second mine, through the acquisition of 100% of the equity interests in Baruun Naran Limited (formerly named QGX Coal Limited). and which is located approximately 30 km southwest of our UHG mine. We commenced coking coal production at our BN mine in February 2012.

The following table sets forth our actual and projected ROM coal production volume for the periods indicated:

	Year ended December 31,					
	2009	2010	2011	2012	2013	2014
				(Mt)		
		(Actual)			(Projected)	
UHG mine	1.8	3.9	7.1	10.7	14.7	15.2
BN mine	—	—	—	1.0	1.0 ⁽¹⁾	3.0 ⁽¹⁾
Total.	1.8	3.9	7.1	11.7	15.7	18.2

Note:

(1) ROM coal production figures at our BN mine for 2013 and 2014 are subject to completion of a life-of-mine study which is expected to be completed by the end of 2012.

The projected ROM coal production volumes in the table above are subject to various risks and other factors. See “Risk Factors – Risks Relating to our Business and Industry – The accuracy of our resources and reserves estimates is based on a number of assumptions and we may produce less coal than our current estimates”.

We have completed construction of and commissioned the first and second modules of our CHPP to produce high-quality washed coal. The ramp-up of our CHPP coincides with the ramp-up of our coal mine production. The first and second modules of our CHPP, each with ROM coal nameplate processing capacity of 5.0 Mtpa, have been in operation since June 2011 and February 2012, respectively. The first module processed approximately 2.5 Mt of ROM coal and produced approximately 1.6 Mt of washed coal in 2011. We began constructing the third module with ROM coal nameplate processing capacity of 5.0 Mtpa in August 2011 and expect to complete construction by the end of 2012.

Average Selling Prices

Our contracts have pricing terms that are denominated in RMB and U.S. dollars and are adjustable periodically. Most of our coal is currently sold into the Chinese market. Unlike seaborne coking coal prices, which tend to rigidly follow settlements between Australian producers and Japanese consumers over the fiscal year in Japan, domestic Chinese prices are subject to ongoing negotiation and adjustment according to market dynamics. The far larger size and highly fragmented nature of the Chinese market results in a more fluid pricing system. Our average selling prices are affected by various market factors such as discovery and development of new deposits, expansion of current mine operations, closure of old mines, transportation infrastructure bottlenecks and specific demand of end users. Pursuant to our customer contracts, our selling prices are based on existing market prices and reviewed from time to time. In determining the price of coal sold under our customer agreements, we take into account the delivery point of the coal sold. In 2009, we sold most of our coal at our UHG mine gate, while in 2010, the main delivery point was TKH and, in 2011, it was GM. Our average selling prices have also increased as a result of shifting the delivery point of our coal sold further away from our UHG mine. See “– Transportation Costs”.

Historically, the Chinese coking coal and coal-related product markets have at times experienced alternating periods of increased demand that caused production capacity, volumes, prices and margins to increase, followed by periods of excess supply that caused prices and margins to decline. For example, due to floods in the state of Queensland in Australia in 2008 that negatively impacted the coking coal supply, and the high demand for coking coal products from Chinese state-owned steel manufacturing companies, the selling prices of washed coal and coke reached historically high levels in the first half of 2008. The average selling prices of washed coal and coke dropped significantly by the end of 2008 due to the effects of the global credit crisis and economic slowdown. In an effort to tackle the global financial crisis, China launched a stimulus package aiming at further expanding domestic demand and promoting economic growth which led to heightened domestic structural steel consumption. In 2010, China’s urbanization continued to be one of the key growth drivers for construction steel, and by the end of 2010, washed coal and coke prices rebounded significantly. In 2011, the robust demand and tight supply of coking coal in China offset the effects of a slowdown in world economic growth, which resulted in a stabilized trend in the prices of washed coal and coke. See “Risk Factors – Risks Relating to our Business and Industry – Coking coal prices are cyclical and subject to significant fluctuation”.

In the years ended December 31, 2009, 2010 and 2011, we sold our coking coal at an average selling price of US\$48.2, US\$70.8 and US\$113.9 per tonne, respectively. Sales of washed coal, an increase in market price and a shift in our primary delivery point further away from our UHG mine were the main drivers of the increase in average selling price in 2011. We believe the increase in our average selling prices reflects the proven quality of our coking coal products, and our ability to consistently produce, market, and deliver our coking coal products to our customers.

We began selling washed coal in 2011 after the completion of the first module of our CHPP. Washed coal is sold at a substantial premium to raw coal. In 2011, the average selling price of our washed coal was approximately 63.8% higher than that of raw coal. The following table sets forth the average selling price of our raw and washed coal for the periods indicated:

	Year ended December 31,		
	2009	2010	2011
	(US\$ per tonne)		
Raw coal	48.2	70.8	95.0
Washed coal	—	—	155.6
Blended	48.2	70.8	113.9

Mining Costs

We cooperate with Leighton, our mining contractor, and work closely in all aspects of our coal mining operations at our UHG mine. We entered into a long-term contract with it to undertake overburden removal, coal extraction and mine reclamation activities. We have two components of mining costs: (1) costs directly incurred by us and (2) costs related to our mining contractor. Costs directly incurred by us primarily include fuel costs, power generation costs, labor costs, employee-related expenses (onsite accommodations) and drilling and blasting expenses. Costs related to our mining contractor include capital expenditures, plant rate, wages of our mining contractor's expatriate staff and overhead and a contractor fee. Plant rate primarily includes costs related to the depreciation, repair and maintenance of the mining equipment used at our UHG mine as well as costs associated with major repair provisions, insurance and financing. The contractor fee is proportional to the mining contractor's agreed investment in the mining equipment, supplies and infrastructure used at our UHG mine.

Mining costs represent and will continue to represent a significant portion of our cost of revenue. Our mining costs were US\$24.5 million, US\$78.8 million and US\$120.3 million for the years ended December 31, 2009, 2010 and 2011, respectively. In 2011, approximately 38.4% of our mining costs were primarily fuel, labor and other employee-related costs, as well as drilling and blasting expenses directly incurred by us. The remainder was incurred by Leighton, the majority of which was related to plant rates.

Ownership of Mining Equipment

Pursuant to our agreement with Leighton, we do not own any of the principal mining equipment at our UHG mine. Therefore, we do not directly incur depreciation expenses related to the excavators, loaders, graders, bulldozers, dump trucks and other principal mining equipment. Depreciation expenses associated with the Leighton-sourced equipment are covered by the plant rate under mining costs.

Transportation Costs

Transportation costs are costs associated with the transportation of our coal from UHG to TKH and GM by our own fleet as well as contractors' trucks. In October 2011, we completed the construction of a paved road parallel to the existing gravel road from our UHG mine to GS and by the end of 2011, we transported all of the coal produced at our UHG mine to the Sino-Mongolian border on this road. In 2011, we also expanded our truck fleet by acquiring 300 heavy haul double-trailer trucks, each capable of carrying up to 140 metric tonnes of coal using a double trailer road train configuration. Costs associated with the operation, repair, maintenance and depreciation of our paved and gravel roads and our coal hauling trucks are also included in the transportation costs. Transportation costs associated with coal sold were approximately \$5.8, \$15.5 and \$22.7 per tonne, respectively, for the years ended December 31, 2009, 2010 and 2011. In 2009, we sold most of our coal at our UHG mine gate, while in 2010, the main delivery point was TKH. In 2011, the main delivery point was GM. Our transportation costs have increased in each of the last three years as the primary delivery point of our coal sold has moved further away from our UHG mine.

Fuel Costs

We directly bear the costs related to the use of fuel in our mining operations and for the coal hauling trucks owned by us for coal transport from our UHG mine to TKH and GM. Fuel costs are included in both mining costs and transportation costs. For the years ended December 31, 2009, 2010 and 2011, fuel costs relating to our mining operations represented approximately 20.5%, 19.1% and 20.2% of mining costs, respectively. During the same period, fuel costs associated with the transportation of our coal were approximately 36.5%, 27.8% and 31.2% of transportation costs, respectively. Our fuel costs for the years ended December 31, 2009, 2010 and 2011 was US\$7.9 million, US\$17.7 million and US\$31.9 million. The average price for fuel in the years ended December 31, 2009, 2010 and 2011 was US\$1.06, US\$1.06 and US\$1.25 per liter, respectively. We signed a fuel supply contract with NIC in July 2011. Under this contract, NIC has agreed to supply, store and distribute fuel to our UHG mine. We expect NIC to complete a 6 million liter fuel storage facility at UHG by September 2012, which will provide backup fuel for approximately one month of operations at our UHG mine. NIC also stores 20 million liters of fuel at its own storage facility to provide two to three months of backup fuel in the event of a fuel shortage or significant price increase. The fuel price is adjusted monthly in accordance with the change in the monthly fuel import price on a DAP basis. All other costs, such as taxes, transportation and service fees, are fixed under the contract.

Increased Headcount

Our headcount has increased over the last three years as our mine production and infrastructure has expanded. As of December 31, 2009, 2010 and 2011, we had 704, 1,161 and 2,177 employees, respectively. Total staff costs for the years ended December 31, 2009, 2010 and 2011 were US\$3.0 million, US\$10.7 million and US\$21.4 million, respectively.

Critical Accounting Policies

Critical accounting policies are those that require our management to exercise judgment and to make estimates that would yield materially different results if our management applied different assumptions or made different estimates. These accounting policies are set forth in note 2 to our financial statements included elsewhere in this offering memorandum. The preparation of our financial information pursuant to IFRS requires our management to adopt accounting policies and make estimates and assumptions that affect the amount reported in our financial information. These estimates and assumptions are continually evaluated by management and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from those estimates and assumptions. We have identified the following accounting policies as critical to an understanding of our financial condition and results of operations.

In determining the carrying amounts of certain assets and liabilities, we make assumptions of the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimates involve assumptions about such items as risk adjustment to cash flows or discount rates used, future changes in salaries and future changes in prices affecting other costs. Our estimates and assumptions are based on the expectations of future events and are reviewed periodically. In addition to assumptions and estimations of future events, judgements are also made during the process of applying our accounting policies.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Provided it is probable that the economic benefits will flow to us and the revenue and costs, if applicable, can be

measured reliably. Revenue associated with the sale of coal is recognized when the risks and rewards of ownership of the goods have been passed to the customer. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts and volume rebates.

Reserves

Engineering estimates of our coal reserves are inherently imprecise and represent only approximate amounts because of the subjective judgements involved in developing such information. Reserve estimates are updated at regular basis and have taken into account recent production and technical information about the relevant coal deposit. In addition, as prices and cost levels change from year to year, the estimate of coal reserves also changes. This change is considered a change in estimate for accounting purposes and is reflected on a prospective basis in related depreciation and amortization rates.

Despite the inherent imprecision in these engineering estimates, these estimates are used in determining depreciation and amortization expenses. Depreciation and amortization rates are determined based on estimated coal reserve quantity (the denominator) and capitalized costs of mining structures and mining rights (the numerator). The capitalized cost of mining structures and mining rights are depreciated and amortized based on the units produced.

Useful Lives of Property, Plant and Equipment

We determine the estimated useful lives of and related depreciation charges for our property, plant and equipment. This estimate is based on the actual useful lives of assets of similar nature and functions. It could change significantly as a result of significant technical innovations and competitor actions in response to industry cycles. We will increase the depreciation charges where useful lives are less than previously estimated lives, and will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

Impairment of Assets

We review the carrying amounts of the assets at each balance sheet date to determine whether there is objective evidence of impairment. When indication of impairment is identified, we prepare discounted future cash flow to assess the differences between the carrying amount and value in use and provide for impairment loss. Any change in the assumptions adopted in the cash flow forecasts would increase or decrease the provision of the impairment loss and affect our net asset value.

In relation to trade and other receivables (including VAT 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 we will not be able to collect all of the amounts due under the original terms of the invoice. We use judgment in determining the probability of insolvency or significant financial difficulties of the debtor.

An increase or decrease in the above impairment loss would affect the net profit in future years.

Obligation for Reclamation

The estimation of the liabilities for final reclamation and mine closure involves the estimates of the amount and timing for the future cash spending as well as the discount rate used for reflecting current market assessments of the time value of money and the risks specific to the liabilities. We consider the factors including future production volume and development plan, the geological structure of the mining regions and reserve volume to determine the scope, amount and timing of reclamation

and mine closure activities to be performed. Determination of the effect of these factors involves judgements by us and the estimated liabilities may turn out to be different from the actual expenditure to be incurred. The discount rate used by us may also be altered to reflect the changes in the market assessments of the time value of money and the risks specific to the liability, such as change of the borrowing rate and inflation rate in the market. As changes in estimates occur (such as mine plan revisions, changes in estimated costs, or changes in timing of the performance of reclamation activities), the revisions to the obligation will be recognized at the appropriate discount rate.

Recognition of Deferred Tax Assets

Deferred tax assets in respect of unused tax losses and tax credit carried forward and deductible temporary differences are recognized and measured based on the expected manner of realization or settlement of the carrying amount of the assets, using tax rates enacted or substantively enacted at the balance sheet date. In determining the carrying amounts of deferred assets, expected taxable profits are estimated which involves a number of assumptions relating to our operating environment and requires a significant level of judgement exercised by the directors. Any change in such assumptions and judgement would affect the carrying amounts of deferred tax assets to be recognized and hence the net profit in the future years.

Derivative Financial Instruments

In determining the fair value of the derivative financial instruments, considerable judgment is required to interpret market data used in the valuation techniques. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Exploration and Evaluation Expenditure

The application of our accounting policy for exploration and evaluation expenditure requires judgement in determining whether it is likely that future economic benefits will flow to us. It requires us to make certain estimates and assumptions about future events or circumstances, in particular, whether an economically viable extraction operation can be established. Estimates and assumptions made may change if new information becomes available. If, after expenditure is capitalized, information becomes available suggesting that the recovery of expenditure is unlikely, the amount capitalized is written off in profit or loss in the period when the new information becomes available.

Capitalized Stripping Costs

We capitalize stripping (waste removal) costs incurred during the production phase to the extent that the actual waste to ore ratio is higher than the estimated ratio. This calculation requires the use of judgements and estimates relating to the expected tonnes of waste to be removed over the life of the mining area and the expected economically recoverable reserves to be extracted as a result. Changes in a mine's life and design will usually result in changes to the average life of mine strip ratio. These changes are accounted for prospectively.

Translation of Foreign Currencies

Our reporting currency is U.S. dollars. The functional currency of our offshore holding companies is U.S. dollars and the functional currency of other group entities located in Mongolia is the Togrog. Foreign currency transactions during the year are translated at the foreign exchange rates as at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates as at the balance sheet date. Exchange gains and losses are recognized in profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates.

The results of operations in Mongolia are translated into U.S. dollars at the exchange rates approximating the foreign exchange rates as at the dates of the transactions. Balance sheet items are translated into U.S. dollars at the foreign exchange rates as at the balance sheet date. The resulting exchange difference is recognized directly in a separate component of equity.

Description of Selected Statement of Comprehensive Income Line Items

Revenue

We are principally engaged in the mining, processing, transportation and sale of coking coal. Revenue represents the sales value of goods sold to customers, exclusive of value added or sales taxes and after deduction of any trade discounts and volume rebate. In 2011, we derived more than 10% of our revenue from three customers, who were invoiced US\$185.0 million, US\$148.6 million and US\$73.6 million, respectively. In 2010, we derived more than 10% of our revenue from four customers, who were invoiced US\$105.2 million, US\$92.7 million, US\$33.5 million and US\$27.3 million, respectively. In 2009, we derived more than 10% of our revenue from four customers, who were invoiced US\$26.1 million, US\$15.4 million, US\$15.2 million and US\$10.2 million, respectively.

The table below sets forth the volume and average selling prices of our coking coal sold for the periods indicated:

	Year ended December 31,		
	2009	2010	2011
ROM coal production (Mt)	1.8	3.9	7.1
Average stripping ratio (actual) (BCM/t)	3.4	5.1	5.2
Total Coal sales (Mt)			
Raw coal	1.4	3.9	3.3
Washed coal	—	—	1.5
Average selling price (US\$/Mt)			
Raw coal	48.2	70.8	95.0
Washed coal	—	—	155.6
Blended	48.2	70.8	113.9

Cost of Revenue

Our cost of revenue consists primarily of mining costs, transportation costs, processing costs and others. See “– Factors Affecting Results of Operation and Financial Condition – Mining costs” and “– Factors Affecting Results of Operation and Financial Condition – Transportation costs”. Processing costs primarily include the costs associated with the operations of our CHPP, which commenced operations in June 2011.

The following table presents, for the periods indicated, individual costs of revenue in terms of amount and percentages of our total cost of revenue:

	Year ended December 31,								
	2009			2010			2011		
	US\$'000	%	US\$ per tonne	US\$'000	%	US\$ per tonne	US\$'000	%	US\$ per tonne
Mining costs . . .	24,500	63.3	17.6	78,759	47.9	20.1	120,326	35.8	25.3
Transportation costs	8,000	20.7	5.8	60,626	36.9	15.5	107,928	32.1	22.7
Processing costs ⁽ⁱ⁾	—	—	—	—	—	—	21,738	6.4	4.5
Others ⁽ⁱⁱ⁾	6,182	16.0	4.5	24,983	15.2	6.3	86,376	25.7	18.1
Total ⁽ⁱⁱⁱ⁾	<u>38,682</u>	<u>100.0</u>	<u>27.9</u>	<u>164,368</u>	<u>100.0</u>	<u>41.9</u>	<u>336,368</u>	<u>100.0</u>	<u>70.6</u>
Sales volume (Mt)			<u>1.4</u>			<u>3.9</u>			<u>4.8^(iv)</u>

Notes:

- (i) Processing costs included handling costs of US\$12.4 million incurred by our CHPP, power generation and distribution costs of US\$7.4 million incurred by our power plant and water extraction and distribution costs of US\$1.9 million incurred by our water supply facility in 2011. The unit handling cost, unit power generation and distribution cost and unit water extraction and distribution cost associated with washed coal sold during 2011 was approximately US\$8.3, US\$4.8 and US\$1.3 per tonne, respectively.
- (ii) Others included royalties, customs fees, road maintenance expenses and others.
- (iii) In addition to mining cost which is reflected in the income statement, the balance sheet contains capitalized cost of pre-stripped overburden. Pre-stripped overburden is coal to be mined, processed, transported and sold in the future.
- (iv) Sales volume includes 1.5 Mt of washed coking coal sold in 2011.

On November 25, 2010, the Parliament amended the 2006 Minerals Law. Effective from January 1, 2011, we pay a flat 5% royalty on the sale value of all extracted minerals that are sold, shipped for sale or otherwise used, and an additional royalty which is calculated based on the degree to which coal is processed. The additional royalty is based on the monthly comparative price stipulated on the website of the MMRE and is applied at a progressive rate. The level of the progressive royalty rate depends on the level of processing of the minerals. The more processed the minerals are, the lower the progressive royalty rate will be. For example, the progressive royalty rate for raw coal is from 1% to 5% if coal price is above the threshold price of US\$25 per tonne. If coal is processed, the progressive royalty rate will be lower, being 1% to 3%. See “Regulation – Mongolian Laws and Regulations Relating to Exploration for Minerals and Mining – Royalties”. We incurred US\$3.3 million, US\$10.1 million and US\$48.2 million as royalty to the Government of Mongolia for the years ended December 31, 2009, 2010 and 2011, respectively.

Gross Profit

Gross profit is equal to revenue less cost of revenue.

Other Revenue

Other revenue mainly includes transportation income related to transportation services provided to third parties and our Tavan Tolgoi airport fee income.

Administrative Expenses

Our administrative expenses relate primarily to a management fee, staff costs, consultancy and professional fees, depreciation and amortization of office equipment and other expenses. The following table presents, for the periods indicated, individual administrative expenses in terms of amount and as a percentage of our total administrative expenses:

	Year ended December 31,					
	2009		2010		2011	
	US\$'000	%	US\$'000	%	US\$'000	%
Management fee ⁽¹⁾	2,357	22.6	6,262	16.2	10,406	17.2
Staff costs	1,423	13.6	6,593	17.0	8,980	14.9
Consultancy and professional fees . .	2,520	24.0	9,110	23.5	17,413	28.9
Depreciation and amortization	506	4.8	1,375	3.6	3,427	5.7
Allowance for doubtful debts	—	—	—	—	4,145	6.9
Others ⁽²⁾	3,621	35.0	15,345	39.7	15,932	26.4
Total	<u>10,427</u>	<u>100.0</u>	<u>38,685</u>	<u>100.0</u>	<u>60,303</u>	<u>100.0</u>

Notes:

- (1) The management agreement with MCS Holding expired on December 31, 2011. We therefore will not be obligated to pay a management fee under this agreement in 2012.
- (2) Others included meal allowances, travelling expenses, rental fees, community support expenses and other expenses.

Other Net (Expenses)/income

Other net (expenses)/income included write-off of construction in progress and the net (loss)/gain on disposal of property, plant and equipment.

Net Finance (Costs)/Income

Net finance (costs)/income are the sum of finance income primarily derived from interest paid on bank deposits and net foreign exchange gains minus finance costs primarily consisting of interest paid on borrowings less capitalized interest and net foreign exchange losses. Interest expenses were capitalized at a rate of approximately 4%, 8% and 5% per annum for the years ended December 31, 2009, 2010 and 2011, respectively. Interest expenses related primarily to our loans from domestic Mongolian banks, international banks and shareholders. Foreign exchange gains and losses are related to the fluctuations in exchange rates between MNT, RMB and U.S. dollar denominated payables, receivables and cash at bank and in hand.

Income Tax

We are subject to income tax on an entity basis on profit arising in or derived from the tax jurisdictions in which we or our subsidiaries operate. The general income tax rate applicable to business entities with Mongolian source income is 10% on the first MNT3 billion of taxable income and 25% on amounts in excess thereof.

Results of Operations and Financial Condition

2011 Compared to 2010

Revenue. Our revenue increased 95.5% from US\$277.5 million in 2010 to US\$542.6 million in 2011. The increase in revenue was primarily attributable to increases in our sales volume from 3.9 Mt in 2010 to 4.8 Mt in 2011 and our average selling price from US\$70.8 per tonne in 2010 to US\$113.9 per tonne in 2011. The increase in our average selling price was due to (i) our commencing sales of washed coal in 2011, in which year we sold 1.5 Mt of washed coal, while the sales volume of our raw coal decreased from 3.9 Mt in 2010 to 3.3 Mt in 2011, (ii) an increase in the market price for coal and (iii) the shifting of our primary delivery point from TKH to GM in 2011.

Cost of Revenue. Our cost of revenue increased by 104.6% from US\$164.4 million in 2010 to US\$336.4 million in 2011. The increase in cost of revenue was mainly due to an increase in mining and transportation volume, an increase in transportation costs as a result of the shifting of our primary delivery point further away from UHG and the commencement of coal processing at our CHPP.

In 2011, our mining costs increased by 52.8% from US\$78.8 million to US\$120.3 million. This was primarily due to increased production volume, VAT expenses on cost of sales associated with raw coal exports and progressive royalty fees.

In 2011, we produced 7.1 Mt of ROM coal with a strip ratio of approximately 5.2 BCM/tonne and per BCM total movement cost of US\$4.52 compared to 3.9 Mt produced in 2010 with a strip ratio of approximately 5.1 BCM/tonne and per BCM total movement cost of US\$4.00.

In 2011, we sold 4.8 Mt of raw and washed coal primarily at GM compared to approximately 3.9 Mt of raw coal primarily at TKH in 2010. Due to increased sales volume at the Sino-Mongolian border as a result of the change in our primary delivery point from TKH to GM, our transportation costs increased 78.1% from US\$60.6 million in 2010 to US\$107.9 million in 2011.

Gross Profit and Gross Profit Margin. As a result of the foregoing, our gross profit increased 82.3% from US\$113.1 million in 2010 to US\$206.2 million in 2011. Our gross profit margin was 38.0% in 2011 compared to 40.8% in 2010.

Administrative Expenses. Our administrative expenses increased 55.8% from US\$38.7 million in 2010 to US\$60.3 million in 2011. The increase in our administrative expenses were mainly due to (i) expenses related to geology exploration activities at our UHG mine, (ii) costs directly attributable to the acquisition of our BN mine, which was one-off, (iii) allowance for the doubtful debts, being provision for past-due trade receivables, (iv) an increase in the amount of the management fees and (v) an increase in headcount.

Net Finance (Costs)/Income. Our net finance income increased 4.9% from US\$8.1 million in 2010 to US\$8.5 million in 2011. The increase in net finance income was primarily due to increased interest income on time deposits partially offset by increased interest expenses arising from borrowings and foreign exchange loss arising from the depreciation of the Togrog against the U.S. dollar.

Income Tax Expenses. Our income tax expenses increased 56.6% from US\$22.8 million in 2010 to US\$35.7 million in 2011. The increase in our income tax expenses was due to an increase in taxable income.

Profit for the Year. As a result of the foregoing, our profit attributable to our equity shareholders increased 98.2% from US\$60.1 million in 2010 to US\$119.1 million in 2011. Our net profit margin was 21.9% in 2011, compared to 21.7% in 2010.

2010 Compared to 2009

Revenue. Our revenue increased 314.2% from US\$67.0 million in 2009 to US\$277.5 million in 2010. The increase was primarily attributable to increases in sales volume and average selling price. Our sales volume increased 178.6% from 1.4 Mt of raw coal in 2009 to 3.9 Mt of raw coal in 2010. Our average selling price also rose significantly from US\$48.2 per tonne in 2009 to US\$70.8 per tonne in 2010, a 46.9% year-on-year increase.

Cost of Revenue. Our cost of revenue increased by 324.8% from US\$38.7 million in 2009 to US\$164.4 million in 2010. The increase in cost of revenue was mainly due to increases in mining and transportation volume. In 2010, we produced 3.9 Mt of ROM coal with a strip ratio of approximately 5.1 BCM/tonne and per BCM total movement cost of US\$4.00 compared to 1.8 Mt produced in 2009 with a strip ratio of approximately 3.4 BCM/tonne and per BCM total movement cost of US\$4.01.

In 2010, we sold 3.9 Mt of raw coal primarily at TKH compared to approximately 1.4 Mt coal in 2009 primarily at our UHG mine gate and TKH. Due to the increase of sales volume and the change in our primary delivery point to TKH from our UHG mine gate, transportation cost increased 657.8% from US\$8.0 million in 2009 to US\$60.6 million in 2010.

Gross Profit and Gross Profit Margin. As a result of the foregoing, our gross profit increased 299.6% from US\$28.3 million in 2009 to US\$113.1 million in 2010. Our gross profit margin was 40.8% in 2010 compared to 42.3% in 2009.

Administrative Expenses. Our administrative expenses increased 272.1% from US\$10.4 million in 2009 to US\$38.7 million in 2010. Our higher administrative expenses were mainly due to the following factors: (i) the extensive expansion of our operations, (ii) our hiring of additional staff, (iii) costs related to the initial public offering of the Company's shares on the main board of the SEHK in October 2010, (iv) social and environmental expenses, and (v) domestic inflation.

Net Finance (Costs)/Income. We had a net finance cost of US\$3.5 million in 2009 as compared to net finance income of US\$8.1 million in 2010. The change was primarily due to foreign exchange gains caused by the appreciation of the Togrog against the U.S. dollar.

Income Tax Expenses. Our income tax expenses increased 456.1% from US\$4.1 million in 2009 to US\$22.8 million in 2010. The substantial increase in our income tax expenses was due to the increase of taxable income.

Profit for the Year. As a result of the foregoing, our profit attributable to equity shareholders of the Company increased 483.5% from US\$10.3 million in 2009 to US\$60.1 million in 2010. Our net profit margin was 21.7% in 2010 compared to 15.3% in 2009.

Liquidity and Capital Resources

Historically, our cash needs have been related primarily to costs associated with mining and infrastructure development which included, construction of our CHPP, our coal fired 3x6 MW power plant, our water supply facility, our 245 km paved road from our UHG mine and supporting infrastructure, as well as expert studies conducted in connection with the development of our mines and related infrastructure. We also acquired our BN mine in the first half of 2011. Our cash resources have come from shareholder financings, proceeds of our initial public offering and bank loans and operating activities. We regularly monitor current and expected liquidity requirements and compliance with loan covenants to ensure that we maintain sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet our liquidity requirements in the short and

long term. For more details related to risks associated with our liquidity and capital resources, see “Risk Factors – Risks Relating to our Business and Industry – We are dependent on future cash flows generated from our business and obtaining additional financing to support our business operations, capital expenditure and to continue as a going concern”. Taking into consideration the financial resources available to us, including cash generated from our operating activities and the proceeds of this offering, we believe that we will have sufficient liquidity to meet our working capital and operating requirements for at least the next 12 months.

The following table sets forth certain information regarding our consolidated cash flows for the periods indicated:

	Year ended December 31,		
	2009	2010	2011
	(US\$'000)		
Net cash (used in)/from operating activities.	(4,024)	69,641	20,985
Net cash used in investing activities	(62,061)	(564,380)	(215,417)
Net cash generated from/(used in) financing activities	62,683	823,495	(79,871)
Net (decrease)/increase in cash and cash equivalents	(3,402)	328,756	(274,303)
Cash and cash equivalents at beginning of the year	3,791	371	328,262
Effect of foreign exchange rate changes	(18)	(865)	(12,953)
Cash and cash equivalents at end of the year	371	328,262	41,006

Cash Flows from Operating Activities

Net cash (used in)/from operating activities was US\$(4.0) million, US\$69.6 million and US\$21.0 million in the years ended December 31, 2009, 2010 and 2011, respectively.

In 2011, we generated net cash from operating activities of US\$21.0 million, primarily due to profit before taxation of US\$154.7 million, mainly adjusted by depreciation and amortization of US\$19.4 million, net finance income of US\$8.5 million, transaction costs of US\$4.3 million in relation to the acquisition of BN, allowance for doubtful debts of US\$4.1 million and equity-settled share-based payment expenses of US\$1.6 million, and the effects of changes in working capital and income taxes paid of US\$26.0 million. Changes in working capital mainly included (i) an increase in trade receivables of US\$41.4 million and other receivables of US\$47.0 million, primarily due to an increase in coal sales receivables of US\$41.4 million and VAT receivables of US\$29.2 million, (ii) an increase in trade and other payables of US\$15.0 million due to our expansion and our scaled-up operations and (iii) an increase in inventories of US\$55.9 million mainly relating to the production of washed coal in 2012.

In 2010, we generated net cash from operating activities of US\$69.6 million, primarily due to profit before taxation of US\$82.9 million, mainly adjusted by depreciation and amortization of US\$3.2 million and net finance income of US\$8.3 million, and the effects of changes in working capital, and income tax paid of US\$15.1 million. Changes in working capital mainly included (i) an increase in trade and other receivables of US\$8.1 million, primarily due to higher production and sales volume in 2010 compared to 2009 and (ii) an increase in trade and other payables of US\$15.1 million mainly due to increased prepayment for coal sales by customers by US\$10.3 million. In ordinary course of business, we receive advance payments from customers with balance of receipt in advance amounting to US\$18.8 million as at December 31, 2010.

In 2009, we used net cash in operating activities of US\$4.0 million, primarily due to the effects of changes in working capital, and income tax paid of US\$1.3 million, which was partially offset by a profit before taxation of US\$14.4 million representing approximately nine months of the production

and sale of coking coal from our UHG mine mainly adjusted for depreciation and amortization of US\$1.9 million. Changes in working capital mainly included (i) an increase in trade and other receivables of US\$7.0 million, primarily due to increased trade receivables, (ii) an increase inventories of US\$6.9 million and (iii) a decrease in trade and other payables of US\$4.6 million, primarily due to the decrease in prepayments by customers. Normally, according to the respective sales contracts, we demand prepayment in advance from our customers. During the year ended December 31, 2009, we received prepayments of US\$31.6 million in aggregate from Qinghua, Winsway, Puxing and Huazhen and utilized US\$37.7 million.

Cash Flows from Investing Activities

Net cash used in investing activities was US\$62.1 million, US\$564.4 million and US\$215.4 million for the years ended December 31, 2009, 2010 and 2011, respectively.

In 2011, net cash used in investing activities was US\$215.4 million primarily as a result of payments for the acquisition of our BN mine of US\$103.5 million, payments for construction in progress and purchases of property and plant and equipment of US\$292.2 million, which was partially offset by net time deposits withdrawn of US\$160.0 million. The total consideration for the acquisition of our BN mine was US\$464.5 million, including the cash of US\$100.0 million immediately paid by the Group to Kerry Mining (Mongolia) Limited on June 1, 2011, the promissory note of US\$279.5 million which was paid by Standard Bank directly to Kerry Mining (Mongolia) Limited under the Existing Standard Bank Loan Agreement and the convertible bond of US\$85.0 million. Therefore, the net payments for the acquisition of our BN mine of US\$103.5 million represented the cash of US\$100.0 million and the transaction costs of US\$ 4.3 million, netting off the cash acquired of US\$0.8 million from our BN mine. The major expenditures for construction in progress and property, plant and equipment were our CHPP, our coal fired 3x6 MW power plant, 4x2 MW generators, our water supply facility, our paved road, our purchase of 300 double trailer coal hauling trucks, our mining main office building and township housing apartment for employees.

In 2010, net cash used in investing activities was US\$564.4 million primarily as a result of payments for construction in progress and purchases of property, plant and equipment of US\$220.2 million and time deposits of US\$344.6 million. The major expenditures and construction in progress were our CHPP, our coal fired 3x6 MW power plant, our water supply facility, our paved road, our mine camp and our mining workshop.

In 2009, net cash used in investing activities was US\$62.1 million primarily as a result of payments for construction in progress and purchases of property, plant and equipment of US\$58.6 million, time deposits of US\$2.0 million and loan to a shareholder of US\$2.3 million. The major expenditures for property, plant and equipment were temporary offices/housing at our mine site, loaders used in our coal stockpile, small and light transport vehicles, diesel generators, weighing station equipment and mining structures.

Cash Flows from Financing Activities

Net cash generated from/(used in) financing activities was US\$62.7 million, US\$823.5 million and US\$(79.9) million for the years ended December 31, 2009, 2010 and 2011, respectively.

In 2011, net cash used in financing activities was US\$79.9 million primarily as a result of repayments of bank borrowings of US\$201.7 million, interest paid of US\$19.6 million and other borrowings costs paid of US\$2.4 million, which was partially offset by proceeds from bank borrowings of US\$143.9 million. The net proceeds from bank borrowings during 2011 were mainly from the proceeds from Standard Bank of US\$115.4 million in relation to US\$400 million Existing

Standard Bank Loan Agreement among which US\$279.5 million was paid to Kerry Mining (Mongolia) Limited directly to settle the promissory note, netting off the transaction costs by US\$5.1 million for under Existing Standard Bank Loan Agreement.

In 2010, net cash generated from financing activities was US\$823.5 million primarily as a result of our initial public offering which generated net proceeds of US\$617.7 million (partially offset by transaction costs of US\$2 million) and proceeds from bank borrowings of US\$232.3 million, which was partially offset by repayments of bank borrowings of US\$11.5 million, interest paid of US\$6.8 million and other borrowing costs paid of US\$6.2 million.

In 2009, net cash generated from financing activities was US\$62.7 million primarily as a result of proceeds from new borrowings of US\$53.3 million and proceeds from share issuances of US\$18.8 million and advanced payments from customers of US\$14.7 million, which was partially offset by the repayment of borrowings of US\$22.1 million and interest paid of US\$1.9 million. In 2009, we entered into an agreement with one of our customers and received the advances of US\$14.7 million as funding of mine project development.

Taxation

Income tax expenses for the years ended December 31, 2009, 2010 and 2011 can be reconciled to profit before income tax as follows:

	2009	2010	2011
	US\$'000	US\$'000	US\$'000
Profit before income tax	14,381	82,896	154,740
Notional tax on profit before taxation	2,990	19,642	35,725
Tax effect of non-deductible items (<i>Note (iii)</i>)	1,135	1,258	1,508
Tax effect of non-taxable items (<i>Note (iv)</i>)	(83)	(242)	(2,588)
Tax loss not recognised	69	2,099	1,005
Actual tax expenses	4,111	22,757	35,650
Effective tax rate	28.6%	27.5%	23.0%

- (i) Pursuant to the Mongolian Enterprise Income Tax, we paid tax at a rate of 10% for the first MNT3 billion taxable income and 25% of the remaining taxable income for the years ended December 31, 2009, 2010 and 2011.
- (ii) We are not subject to any income tax in the Cayman Islands. We are not subject to Hong Kong and Luxembourg profits tax as we had no assessable income arising in or derived from Hong Kong and Luxembourg during the years ended December 31, 2009, 2010 and 2011.
- (iii) Non-deductible items mainly represent the non-deductible expenses and the unrealized exchange losses which is non-deductible pursuant to the Mongolian Enterprise Income Tax.
- (iv) Non-taxable items mainly represent the unrealized exchange gains which is non-taxable pursuant to the Mongolian Enterprise Income Tax.

The effective tax rate of 28.6% for the year ended December 31, 2009 was higher than the statutory rate of 25%, which was mainly due to the impact of unrealized exchange losses which was a non-deductible expense.

The effective tax rate of 27.5% for the year ended December 31, 2010 was higher than the statutory rate of 25%, which was mainly due to the impact of tax losses not recognized from some of our subsidiaries and unrealized exchange losses.

The effective tax rate of 23.0% for the year ended December 31, 2011 was mainly because we earned interest income of US\$22.2 million which was subject to income tax at the rate of 10% pursuant to the income tax rules and regulations of Mongolia.

Indebtedness

The following table sets forth our borrowings as of the dates indicated and the maturity profile of such borrowings:

	2009	2010	2011
		(US\$'000)	
Indebtedness			
Bank loans (Secured)	31,200	255,000	482,091 ⁽¹⁾
Bank loans (Unsecured)	3,000	—	—
Sub-total	34,200	255,000	482,091
Less: unamortized transaction cost	—	(3,877)	(3,862)
Sub-total	34,200	251,123	478,229
Convertible bond (Unsecured)	—	—	83,508
Total	34,200	251,123	561,737
Maturity Profile of Bank loans:			
Due within one year	24,200	85,909	334,818
Due after one year, but within two years	10,000	21,818	21,818
Due after two years	—	147,273	125,455
Total	34,200	255,000	482,091

Note:

(1) As of December 31, 2011, the outstanding principal amount of the Existing Standard Bank Facilities Agreement was US\$298.8 million. We plan to repay the outstanding principal amount on March 23, 2012.

As of December 31, 2011, we had US\$561.7 million in outstanding short-term and long-term borrowings, including indebtedness incurred under (i) our EBRD, FMO and DEG Loan Agreements, (ii) our Existing Standard Bank Facilities Agreement, (iii) our US\$85 million 2.0% QGX Convertible Bonds and (iv) our Khan Bank Loan Agreement. See “Description of Other Material Indebtedness”.

The EBRD, FMO and DEG Loan Agreements bear interest semi-annually at the rate of six-month LIBOR plus a margin of 4.75%-6.85% per annum as of December 31, 2011. Interest is now payable semi-annually at the rate of six-month LIBOR plus a margin of 3.25% to 3.75% per annum. US\$120 million principal amount of the loans are repayable in 11 semi-annual installments ending on May 15, 2016 and US\$60 million principal amount of the loans are repayable in two equal installments on May 15, 2015 and May 15, 2016. As of December 31, 2011, the outstanding principal amount was US\$169.1 million.

The Existing Standard Bank Facilities Agreement bears interest at the rate of six-month LIBOR plus a margin of 3.25% per annum. The loan matures on March 23, 2012. As of December 31, 2011, the outstanding principal amount was US\$298.8 million. We plan to repay the outstanding principal amount on March 23, 2012. On March 8, 2012, we entered into the New Standard Bank Facilities Agreement with Standard Bank, pursuant to which Standard Bank and potentially a syndicate of

lenders have agreed to make available to us term loan facilities of up to US\$300 million. We plan to draw down US\$50 million under the New Standard Bank Facilities Agreement on March 14, 2012 for our working capital requirements and US\$150 million on March 23, 2012 to repay a portion of the outstanding amount under the Existing Standard Bank Facilities Agreement.

The US\$85 million 2.0% QGX Convertible Bonds will mature on December 1, 2012. The maturity date is extendable to March 1, 2013 subject to a reserve adjustment. The QGX Convertible Bonds are convertible into our shares at the bondholder's option in the four days prior to the maturity date at a conversion rate of HK\$10.92 per share.

The US\$13.0 million Khan Bank Loan Agreement bears interest at the rate of 11% per annum. As of December 31, 2011, the outstanding principal amount was US\$13.0 million.

Capital Commitments and Capital Expenditures

Capital commitments outstanding at respective balance sheet dates not provided for in the financial statements were as follows:

	2009	2010	2011
	US\$'000	US\$'000	US\$'000
Contracted for	81,097	80,079	14,827
Authorized but not contracted for	—	102,592	80,075
	<u>81,097</u>	<u>182,671</u>	<u>94,902</u>

The following table sets forth our historical and forecast capital expenditures for the periods indicated:

	Year ended December 31,					
	2009	2010	2011	2012	2013	2014
	(Forecast)					
	(US\$'000)					
Capital Expenditures:						
BN coal mine	—	—	11,740	11,795	9,521	61,663
CHPP	13,573	80,218	142,252	95,210	38,675	53,669
Road.	—	47,929	49,470	35,688	8,279	13,693
Railway.	5,543	2,135	7,256	249,505	374,454	20,108
Water supply facility	8,024	20,658	7,718	51,500	—	—
Power plant	8,137	34,190	15,501	5,175	—	—
Property (camp, airport and workshop)	12,607	8,118	11,850	40,673	19,828	498
Trucks and equipment	7,893	4,957	44,081	—	—	—
Others ⁽¹⁾	7,181	6,836	6,266	—	—	—
Total.	62,959	205,041	296,134	489,546	450,757	149,631

Note:

(1) Others include capital expenditures for exploration and expert studies.

Our forecast capital expenditures set forth in the table above represent our current estimates. We will reassess our capital expenditures from time to time in light of the then current circumstances, including without limitation our operational requirements and our financial capacity, and there can be no assurance that our actual capital expenditure will correspond to our current forecast set forth in the table above.

Contingent Liabilities

The total consideration was US\$464.5 million for the acquisition of our BN mine, consisting of US\$100.0 million in cash, the promissory note of US\$279.5 million and the issuance of the QGX Convertible Bonds in the aggregate principal amount of US\$85.0 million. This consideration is subject to adjustments as a result of the total reserves of such mine exceeding 150 Mt or the production exceeding certain amounts as described in more detail in “Business – BN Mine – Consideration”. The maximum amount of additional consideration payable by us pursuant to such adjustments is US\$485.5 million, including up to US\$105.0 million for the reserve adjustment which will be determined by the results of a new reserve report that is expected to be completed by the end of 2012. See “Risk Factors – Risks Relating to our Business and Industry – We may have to make additional payments under the acquisition agreement for our BN mine” and “Business – BN Mine”.

Quantitative and Qualitative Disclosures About Market Risk

We are, in the normal course of business, exposed to market risks relating primarily to credit risk, foreign currency exchange risk, interest rate risk, liquidity risk and commodity price risk.

Credit Risk

Our credit risk is primarily attributable to our cash at bank and trade and other receivables. Our management monitors the exposures to these credit risks on an ongoing basis. See “Risk Factors – Our dependence on our major customers may cause significant fluctuations or declines in our revenues”.

With regard to trade receivables, we have established a credit management committee which is comprised of members of our senior management. The committee has established a policy for determining credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the committee evaluates and reviews the credit quality and the recoverable amount of each individual trade debt on an ongoing basis. At the end of the reporting period, we believe that adequate allowance for doubtful debts has been made in the consolidated financial statements and we consider that our credit risk is significantly reduced. Nevertheless, management continues to monitor the exposures, including but not limited to the current ability to pay, and take into account information specific to the customer as well as pertaining to the economic environment in which the customer operates, on an ongoing basis. In 2012, we began extending credit generally not exceeding a period of 90 days to certain of our customers with whom we have long-term supply agreements and expect to extend credit to more customers as we develop long-term relationships.

Our other receivables are primarily VAT receivables, deposits and prepayments. We believe that no impairment allowance is necessary for our other receivables based on past experiences.

Foreign Currency Exchange Risk

During the years ended December 31, 2009, 2010 and 2011, 100% of our revenue and approximately 50%, 36%, 27% of our purchases, respectively, were denominated in currencies other than Togrogs, the functional currency of our Mongolian entities. Cash and cash equivalents denominated in the currency other than the functional currency of the entity to which they are related as of December 31, 2009, 2010 and 2011 amounted to US\$2.2 million, US\$273.6 million and US\$119.9 million, respectively. Total borrowings denominated in the currency other than the functional currency of the entity to which they related as of December 31 2009, 2010 and 2011 amounted to US\$34.2 million, US\$251.1 million and US\$179.5 million, respectively.

For the years ended December 31, 2009, 2010 and 2011, approximately 77.0%, 62.1% and 66.6% of our revenues, respectively, were denominated in U.S. dollars with the remaining denominated in

RMB. For the year ended December 31, 2009, approximately 79%, 13% and 88% of our cost of revenue, operating expenditures and capital expenditures were denominated in U.S. dollars, respectively, with the remaining denominated in Togrogs. For the year ended December 31, 2010, approximately 34%, 28% and 26% of our cost of revenue, operating expenditures and capital expenditures were denominated in U.S. dollars, respectively, 5% and 1% of operating expenditures and capital expenditures were denominated in RMB, respectively, with the remaining denominated in Togrogs. For the year ended December 31, 2011, approximately 28%, 27% and 23% of our cost of revenue, operating expenditures and capital expenditures were denominated in U.S. dollars, with the remaining denominated in Togrogs.

Although the majority of our assets and operational expenses are denominated in Togrogs, a large portion of those, including fuel and capital expenditures were denominated in U.S. dollar and RMB prices. Therefore, we believe that there exists a natural hedge that partially offsets foreign exchange risk.

We have not entered into any derivative instruments to manage foreign currency exchange fluctuations. However, our management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arise.

Our presentation currency is U.S. dollars. The functional currency of our Mongolian entities is Togrogs and of our overseas entities is U.S. dollars. Due to the depreciation of Togrogs against U.S. dollars by approximately 11% in 2011, the significant negative exchange reserve arose during 2011 when translating the financial statements of other group entities with Togrogs as their functional currency to our presentation currency.

To the extent that we decide to do so in the future, we cannot assure you that any such hedging activities will protect us from fluctuations in exchange rates. See “Risk Factors – Risks Relating to our Business and Industry – Foreign currency exchange fluctuations could affect expenses and any future earnings”.

Interest Rate Risk

Our exposure to interest rate risk relates primarily to our floating rate bank borrowings, which totaled US\$465.2 million as of December 31, 2011. In addition, an increase in prevailing interest rates would lead to an increase in interest cost on our short-term borrowings when such debt is rolled over. To date, we have not entered into any type of interest rate agreements or derivatives to hedge against interest rate fluctuations. To the extent that we decide to do so in the future, we cannot assure you that any such hedging activities will protect us from fluctuations in interest rates.

Liquidity Risk

Liquidity risk is the risk that we will not be able to meet our financial obligations as they fall due. To manage our liquidity risk, we maintain a balance between continuity of funding and the flexibility through the use of borrowings. Our management closely monitors our liquidity position and expects to have adequate sources of funding to finance our projects and operations. We maintain a suitable level of liquidity to finance daily operations, capital expenditures and repayments of borrowings. We regularly monitor current and expected liquidity requirements to ensure that we maintain sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet our liquidity requirements in the short and longer terms.

Commodity Price Risk

Our profitability depends on coal prices. Prices of bulk commodities such as coal are affected by numerous factors such as interest rates, exchange rates, inflation or deflation and global and regional

supply and demand. We have not entered into any commodity derivative instruments or futures to hedge against fluctuations of coal prices. Therefore, fluctuations in the prices of coal will have a direct effect on our results of operations.

Effects of Inflation

According to the Bank of Mongolia, Mongolia's annual inflation, as measured by the consumer price index, was 4.0% in 2009, 13.0% in 2010 and 10.2% in 2011. We do not consider inflation in Mongolia, where all of our operations are located, to have had a material impact on our results of operations.

Seasonality

Our site is fully operational throughout the year. The infrastructure and equipment used in our operations are designed to work during most weather conditions. Occasional inclement weather conditions, such as dust storms, have had no significant effect on our operations. However, our transportation and sales volume slow down during the winter period due to scheduled maintenance and the holiday seasons, such as the Chinese New Year.

New Accounting Pronouncements

The International Accounting Standards Board has released revisions to existing and new accounting standards that may have a material impact on our future financial statements. We are currently evaluating the potential impact that the adoption of such accounting standards may have on our financial statements. See note 35 to our financial statements included elsewhere in this offering memorandum.

INDUSTRY OVERVIEW

We commissioned Shanxi Fenwei, a leading Chinese consultancy and service provider in coal and coke industry, to prepare an independent report for use, in whole or in part, in this section. Shanxi Fenwei prepared its report based on its industry knowledge, in-house database, independent third-party reports and publicly available data from reputable industry organizations. Where necessary, Shanxi Fenwei visits companies operating in the industry to gather and synthesize information about the market, prices and other relevant information. Shanxi Fenwei has assumed that the information and data on which it relied are complete and accurate.

Forecasts and assumptions included in the Shanxi Fenwei Report are inherently uncertain because of events or combinations of events that cannot reasonably be foreseen, including, without limitation, the actions of governments, individuals, third parties and competitors. Specific factors that could cause actual results to differ materially include, among others, fluctuations in coal prices, risks inherent in the mining industry, financing risks, labor risks, uncertainty of mineral reserve and resource estimates, equipment and supply risks, regulatory risks and environmental concerns.

Shanxi Fenwei has provided part of the statistical and graphical information contained in this section, including tables of historical data and estimated future supply, demand and market trends created by compiling, interpreting and analyzing engineering, production, economic, statistical and technical information from many third-party sources. The information contained herein has been obtained from sources believed by Shanxi Fenwei to be reliable, but there can be no assurance as to the accuracy or completeness of included information. Most of the data presented in this section with respect to the Chinese coal industries has been extracted from the Shanxi Fenwei Report.

Unless otherwise specified, all of the data presented in this section with respect to Chinese coal reserves and resources refer to the Chinese national standard for the Classification of Resources/Reserves for Solid Fuels and Mineral Commodities (GB/T 17766-1999).

While we, the Initial Purchasers and the other parties involved in the offering have taken reasonable care in the extraction, compilation and reproduction of the information and statistics from the Shanxi Fenwei Report, none of us, the Initial Purchasers and the other parties involved in the offering has independently verified the information and statistics derived directly or indirectly from official government sources or made any representation as to their accuracy. Such information and statistics may be out of date and may not be consistent with other information and statistics compiled within or outside Mongolia. You should not place undue reliance on such information and statistics contained in this section.

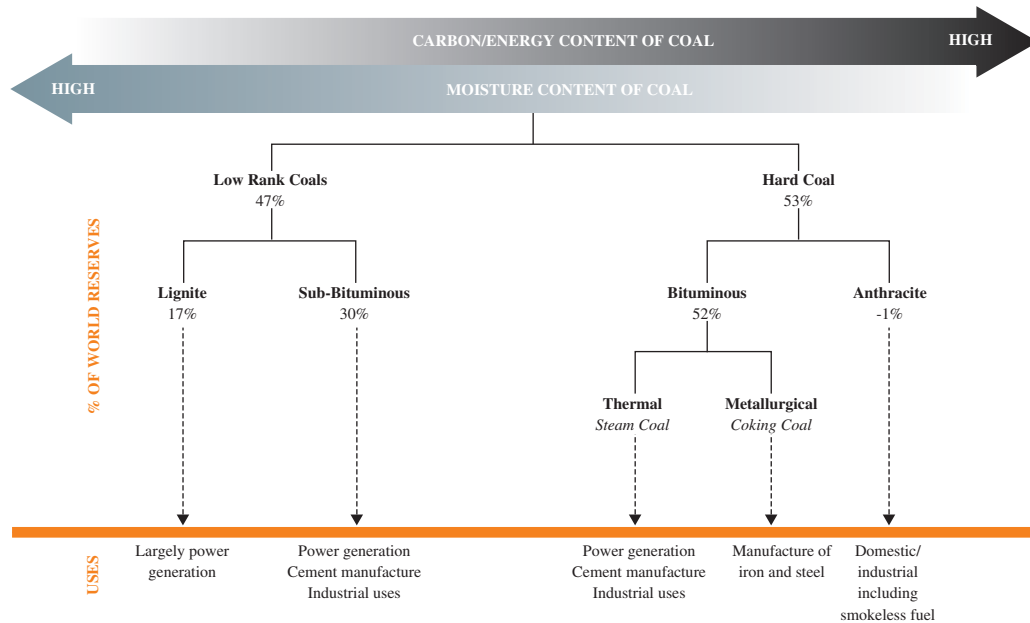
An Introduction to Coking Coal

Coal is one of the most abundant fossil fuels worldwide. Various types of coal exist and it depends on the degree of change undergone by the coal as it matures in terms of carbon content from its lowest form, peat, to its highest form, anthracite. This process is known as coalification and effectively “ranks” the coal in terms of its physical and chemical properties. The diagram on the next page summarizes the different types of coal and the associated end-uses, which includes electricity generation, coke production for steel making, and industrial uses such as cement manufacturing.

Low rank coal (e.g. lignite and subbituminous coal) or “brown” coal are typically softer, friable materials and are dull and earthy in appearance. Typically, these types of coal are characterised by high moisture levels and low carbon content and hence have lower energy content.

Higher rank coal or “hard” coal is generally harder and stronger with a black, vitreous lustre (e.g. bituminous coal such as coking coal and anthracite). These types of coal contain more carbon, have lower moisture content, and generate more energy than low rank coal. While anthracite has the highest carbon content and contains the fewest impurities of all types of coal, it has a lower energy content than many types of coking coal.

Figure 1. Types of Coal



Source: World Coal Association

While there are several systems of coal classification used in different countries of the world, coking coal can be broadly categorized into four distinct grades, namely hard coking coal, semi-hard coking coal, semi-soft coking coal and soft coking coal. Hard/semi-hard coking coal is essential for the production of coke, which is used as a reductant in the manufacturing of iron and steel. Semi-soft/soft coking coal is typically used for blending purposes to enhance certain physical and chemical parameters of the coke, but in a way that reduces costs by maximizing the proportion of less expensive hard coking coal.

China Coal Classification

According to the national standard of Chinese Coal Classification, coal is classified into three categories: lignite, bituminous and anthracite based on the metaphoric rank. Bituminous is further classified into several types based on volatile matter and caking index (G). Coking coal is composed of meager lean coal (“PS”), lean coal (“SM”), primary coking coal (“JM”), fat coal (“FM”), 1/3 coking coal (“1/3 JM”), gas fat coal (“QF”), and gas coal (“QM”). There is no direct correlation between the Chinese and other international classifications but generally, hard coking coal under typical international standards is equivalent to JM and FM in China, while semi-soft coking coal is similar to 1/3 JM and SM in China.

Table 1. Chinese Terminology for Coking Coal

Type	Similar Chinese type	Ash (ad, %)	Volatile matter (ad, %)	CSN	CSR (%)
Premium hard coking coal .	JM, FM	<8.5	19-38	8-9	55-74
Standard hard coking coal .		<9.7	19-38	6-9	>55
Semi-hard coking coal	1/3JM, SM	8.0-10.5	17-26	4-6	50-60
Semi-soft coking coal		8.0-11.0	25-41	3-8	45-55
Low volatility PCI.	QM, PM, SM, RN	6.0-10.5	10-19	1-2	—
High volatility PCI		4.0-10.0	26-42	1-5	—

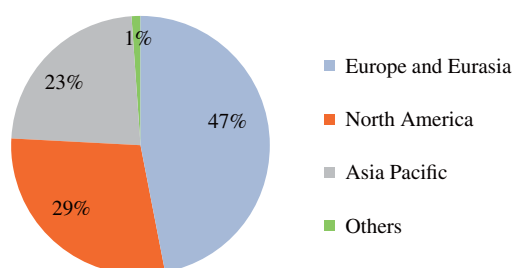
Source: Fenwei Energy

Note: RN is weakly sticky coal in the Chinese classification of coal. RN is used as thermal coal for power generation mostly, but it can also be used as PCI for making pig iron.

Global Coking Coal Industry Overview

Global Coal Resources and Reserves

The proven coal reserves globally is estimated to be over 860 billion tonnes as of the end of 2010, according to 2011 British Petroleum Statistical Review of World Energy report. Low rank coal accounts for approximately 47% and hard coal accounts for the remaining 53%. High quality coking coal is a scarce resource which constitutes less than 25% of total coal reserves. Currently, over 6,185 million tonnes of hard coal and 1,042 million tonnes of low rank coal are produced globally. Most of the coal production is consumed domestically and mere 15% of hard coal is available for international coal trade. The top five hard coal producers are China, U.S., India, Australia and South Africa. The chart below shows the distribution of global hard coal proven reserves by region in 2010.

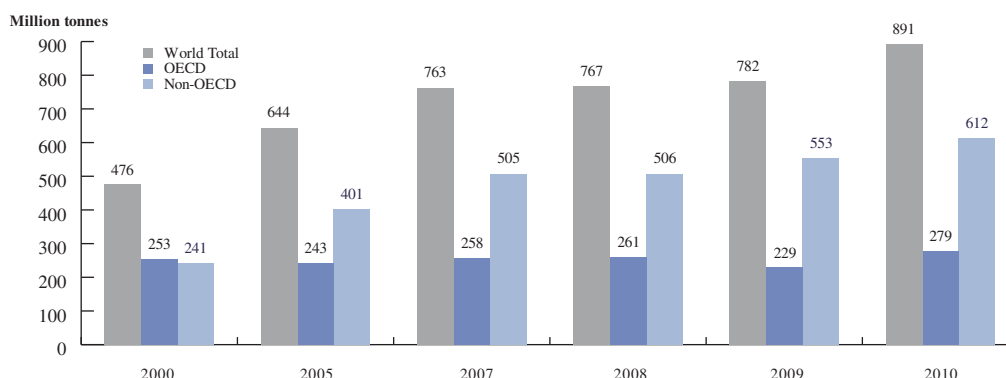
Figure 2. Global Hard Coal Proven Reserves by Region in 2010

Source: 2011 British Petroleum Statistical Review of World Energy

Global Coking Coal Supply

In 2010, world coking coal production reached a record level 891 million tonnes, an increase of 13.9% from 2009. OECD countries, coking coal production increased significantly by 21.8% in 2010 to 279 million tonnes, after a decline of 12.3% in 2009 due to the financial crisis. Non-OECD countries did not suffer a decline in coking coal production and posted an increase of 10.7% instead to 553 million tonnes in 2009. As a result, world total coking coal production posted a slight increase of 2.0% to 782 million tonnes in 2009 despite the tough economic environment.

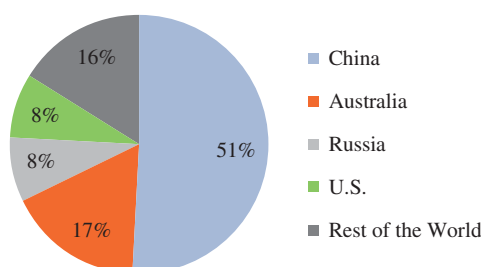
Figure 3. Historical World Coking Coal Production, 2000-2010



Source: International Energy Agency, 2011

Coking coal is a scarce resource and its production is highly concentrated geographically. China and Australia are world's two major coking coal producers, contributing 51.0% and 17.1% respectively to 2010 global coking coal production. In 2010, China's and Australia's coking coal production increased by 9.2% and 16.9% respectively, reaching 454.8 million tonnes and 152.1 million tonnes.

Figure 4. Global Coking Coal Production by Country in 2010

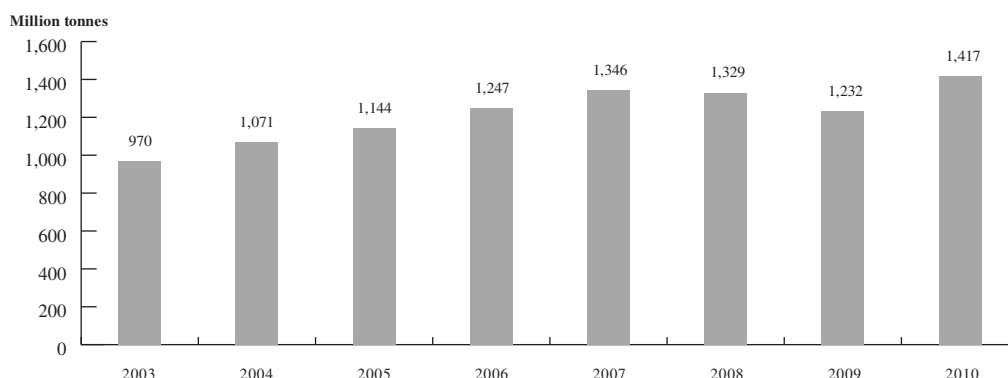


Source: International Energy Agency, 2011

Global Coking Coal Demand

World wide steel production declined by 7.7% to 1,227 million tonnes in 2009 due to the economic slow down as a result of the 2008 financial crisis. In 2010, driven by world wide economy recovery, crude steel production reached a new record of 1,414 million tonnes, an increase of 15% compared to 2009. It is expected that to the extent the world economy maintains its growth, demand for steel and iron will also increase steadily, which bodes well for demand for coking coal. In 2010, non-OECD countries coking coal production increased by 10.7% to 612 million tonnes, whereas coking coal consumption increased by 15.8% to 696 million tonnes, which is driving the growth for future coking coal imports.

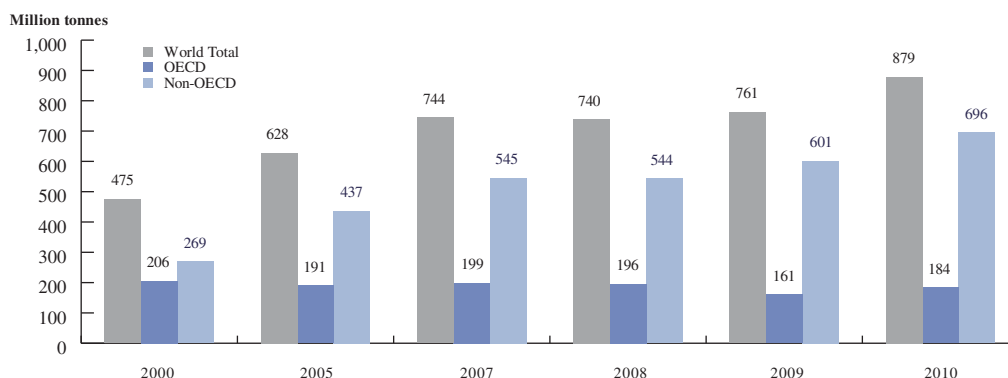
Figure 5. Historical Global Crude Steel Production, 2003-2010



Source: World Steel Association

In 2010, global coking coal consumption increased by 15.5% to 879 million tonnes. OECD countries coking coal consumption increased significantly by 14.5% to 184 million tonnes, after a sharp decline of 17.8% in 2009 due to declining steel production. On the contrary, non-OECD countries posted an increase of 10.5% in coking coal consumption. As a result, world total coking coal consumption increased by 2.8% to reach 761 million tonnes. In 2010, non-OECD countries consumption increased by 15.8% to 696 million tonnes, of which China represents 72.3% of non-OECD countries coking coal consumption and 57.2% of world coking coal consumption.

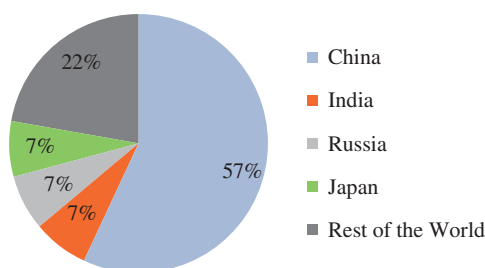
Figure 6. Historical Global Coking Coal Consumption, 2000-2010



Source: International Energy Agency 2011

China is the single largest consumer of coking coal in the world, representing 57.2% of world coking coal consumption as of 2010. China's coking coal consumption reached 502.7 million tonnes in 2010, an increase of 14.6% from 2009. In comparison, China's coking coal production increased only by 9.2%, which is much slower than its coking coal consumption. China's coking coal consumption is expected to continue increasing faster than its domestic supply as its economy continues to grow rapidly, which drives its growing demand for imported coking coal.

Figure 7. Global Coking Coal Consumption by Country in 2010



Source: International Energy Agency 2011

Global Coking Coal Trade

In 2010, global coking coal exports increased by 28.1% to 270.9 million tonnes. Australia remains the largest coking exporter at 154.6 million tonnes, representing 57.1% of total coking coal export. The U.S. is the second largest coking coal exporter at 50.9 million tonnes, an increase of 50.6%. Mongolia currently ranks as fifth largest coking coal exporter at 10.9 million tonnes, an increase of 137.0%.

Table 2. Global Major Coking Coal Exporters in 2009 and 2010

Million Tonnes	2009	2010
Australia	125.2	154.6
U.S.	33.8	50.9
Canada.	21.5	27.5
Russia	13.3	13.7
Mongolia	4.6	10.9
Czech Republic	4.0	3.8
New Zealand	2.0	2.3
Indonesia	2.0	2.2
Poland	1.7	1.8
South Africa.	1.4	1.4
Total	<u>211.5</u>	<u>270.9</u>

Source: World Coal Association, International Energy Agency 2011

In 2010, global coking coal imports increased by 26.3% to 256.2 million tonnes. Japan remains the largest coking importer at 57.7 million tonnes, representing 22.5% of total coking coal imports. China is the second largest coking coal importer at 48.4 million tonnes, representing 18.9% of total coking coal imports. China's coking coal imports increased by 40.7% in 2010, whereas Japan's coking coal imports increased by 9.9%. It is expected that China will continue the trend of fast growing coking coal imports due to favourable import policy and strong demand.

Table 3. Global Major Coking Coal Importers in 2009 and 2010

Million Tonnes	2009	2010
Japan	52.5	57.7
China	34.4	48.4
India	24.7	30.4
Korea	20.7	27.7
Brazil	9.1	12.5
Ukraine	5.3	10.5
Germany	6.4	7.8
Turkey	5.2	6.8
UK	5.2	6.2
Italy	3.2	5.1
Total	<u>202.9</u>	<u>256.2</u>

Source: World Coal Association, International Energy Agency 2011

Chinese Coking Coal Industry Overview

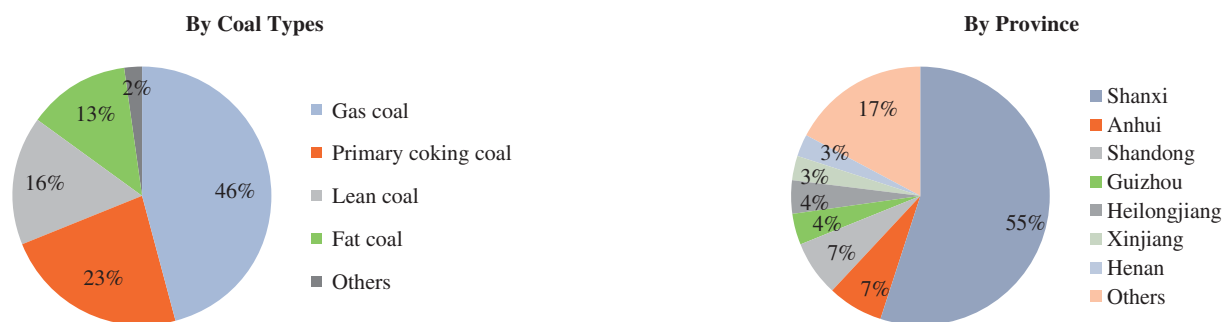
China Coking Coal Reserves

According to Shanxi Fenwei, China has abundant coal reserves, but coking coal accounts for a distinct minority of total coal reserves, and with greater geographic concentration. According to State Administration of Coal Mine Safety (“SACMS”), the proven coking coal reserves in China stood at 280.4 billion tonnes as of the end of 2009, which represents approximately 24.2% of the national proven coal reserves.

Figure 8 shows the Chinese coking coal reserves split by coal type and by province in 2009 respectively. Although China boasts rich coking coal reserves, hard coking coal reserves, as represented by JM and FM type coal comprise only 23.6% and 12.8% respectively of this reserve base.

Shanxi alone contains the bulk of Chinese proven coking coal reserves with about 155.2 billion tonnes, or 55.3% of the total. Anhui, Shandong, Guizhou and Heilongjiang also contain a substantial portion of China’s current coking coal reserves, accounting for 20.8% of the total.

Figure 8. Chinese Coking Coal Reserves by Coal Type and by Province in 2009



Source: State Administration of Coal Mine Safety, Shanxi Fenwei

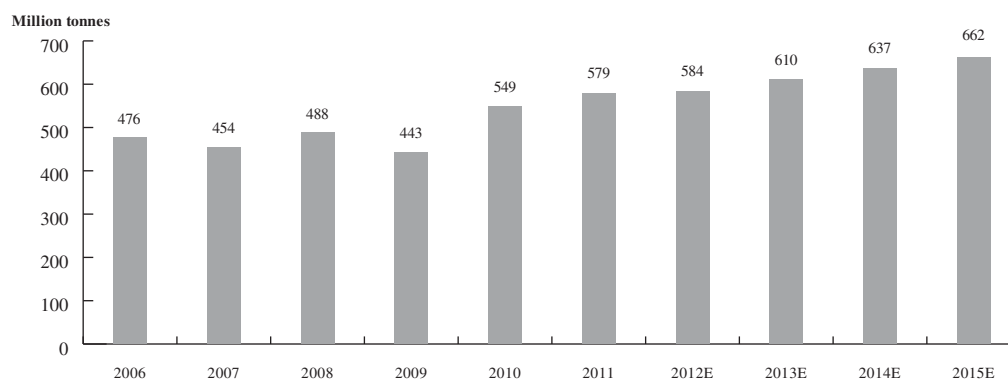
China Coking Coal Supply

Coking coal in China is mainly produced in Northern China and Eastern China, following by Southwestern and Northwestern China. According to SACMS, Shanxi is by far the largest coking coal producing province, followed by Shandong. By contrast, some of China's traditional coal mining regions, such as Jilin, Hebei and Liaoning are facing resource depletion and their output of coking coal is expected to decline.

Despite the dominance of a few large coal producers, there are thousands of small coal mines providing marginal supply to the market. This fragmentation creates a slew of problems, including safety and environmental issues, increased costs, poor mining conditions, and inefficient resource usage (small mines typically have much lower resource recovery rates). Ongoing coal mine safety campaigns and growing government pressure to close smaller, inefficient and unsafe coal mines are expected to reduce the supply of high-rank, high-quality coking coal. In the longer term, the continued depletion of Chinese hard coking coal reserves could add to China's dependence on coking coal imports. This is particularly the case for premium hard coking coal, as it accounts for around 55% to 65% of the coke blend for steel mills, according to Shanxi Fenwei.

According to the State Administration of Work Safety, the production of Chinese coking coal increased from 475.9 million tonnes in 2006 to 579.1 million tonnes in 2011, representing a CAGR of 4.0%. Shanxi Fenwei projected that China's production of coking coal will reach 661.7 million tonnes by 2015. Figure 9 provides historical and forecast on China's coking coal production for 2006 to 2015.

Figure 9. Historical and Forecast Chinese Coking Coal Production, 2006-2015



Source: State Administration of Coal Mine Safety, Shanxi Fenwei

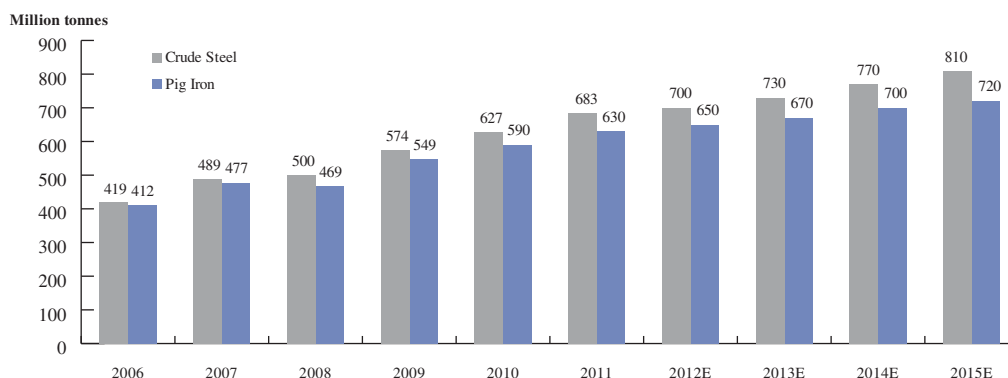
China Coking Coal Demand

According to the World Steel Association, China produced 683.3 million tonnes of steel in 2011, more than North America, Europe, and the rest of Asia combined, representing 45.9% of global crude steel production. This represents a sharp increase from 2008, when China produced 37.6% of global crude steel.

China is expected to remain the key driver of global steel industry growth in 2012 with the continued rapid development of its economy. The global financial crisis of the past two years has precipitated a structural change in the global steel industry. Steel producers used the slowdown in steel production as an opportunity to reorganize their operations, closing sub-economic blast furnace operations or moving production to lower cost regions. Closure of steel mills in Europe and the U.S. will be countered by new blast furnaces built in South-East Asia, India, China, Eastern Europe and Brazil.

According to China's 12th Five-Year Plan for the iron and steel industry, the crude steel production is set to grow from 2011 to 2015, albeit at a slower pace, with forecasts ranging from 3% to 4%. Steel demand in China will be supported by housing construction and specialty steel manufacturing as the Chinese Government intends to construct 36 million units of affordable housing and develop key infrastructure such as high-speed railways, nuclear power plants and hydropower facilities. Figure 10 shows China's historical and projected crude steel production levels from 2006 to 2015.

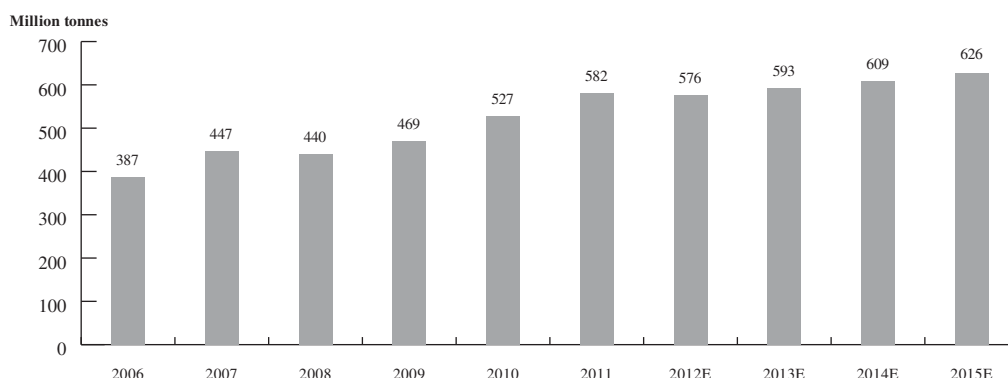
Figure 10. Historical and Forecast Chinese Crude Steel and Pig Iron Production, 2006-2015



Source: World Steel Association, Shanxi Fenwei

The coking coal produced in China is mainly used for the manufacturing of coke, which is used as a key input for steelmaking. Consequently, coking coal consumption in China has grown significantly since 2003, due to a significant expansion in steel production. The growth in heavy industry and steel demand is expected to continue driving coking coal consumption in China. Figure 11 following chart shows China's historical and projected washed coal consumption from 2006 to 2015.

Figure 11. Historical and Forecast Chinese Washed coal Consumption, 2006-2015



Source: Shanxi Fenwei

China Coking Coal Trade

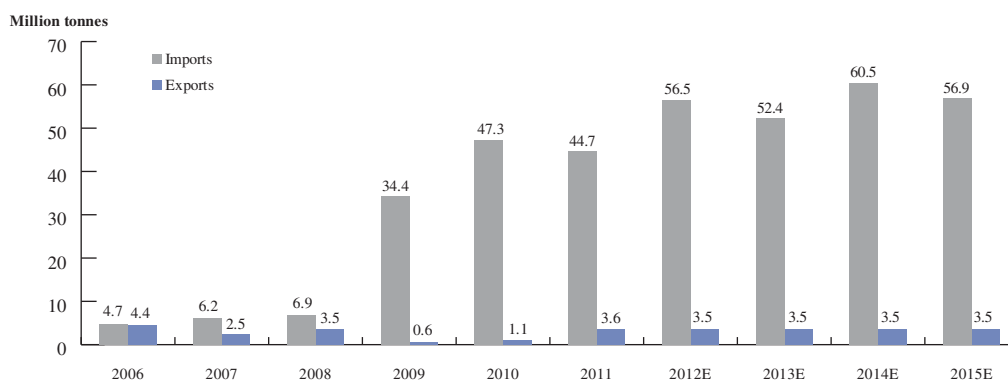
In recent years, the increase in demand for coking coal in China has substantially outpaced domestic supply, leading to a shortage. This increased the amount of coking coal imports into China and resulted in China becoming a net importer of coking coal. Also as part of its long-term strategy to preserve its natural resources base, the Chinese Government has encouraged imports of coal, while at the same time limiting exports.

Due to a zero tariff on coal imports, the implementation of the 5% provisional export tariff on coking coal from November 1, 2006 onwards and the high increase of domestic coke production in China, the demand for imported coking coal in China increased in 2007. In 2007, China's coking coal imports were 6.2 million tonnes, an increase of 33.5% from the year before. In 2009, due to the reduction in production by the major coking coal producers in Shanxi, China's coking coal production decreased, and the price of international coking coal also fell, leading to a significant increase in Chinese coking coal imports. In 2009, China imported 34.4 million tonnes coking coal, an increase of 401.8% year on year and the increasing trend continued in 2010 as the steel industry continued to grow rapidly. However, a slight decline in imports was observed in 2011 due to a dramatic rebound in domestic coking coal supply post-consolidation of the coal mining industry and high international coking coal prices.

China's coking coal exports have significantly decreased in recent years. As China levied a 5% provisional export tariff on coking coal in 2006, the coking coal exports dropped dramatically to 2.5 million tonnes in 2007. In 2008, China's exports grew to 3.5 million tonnes of coking coal due to the high price of international coking coal. In 2011, the recovery of the global economy and the related increase in international coking coal prices fueled the growth in China's coking coal exports.

According to Shanxi Fenwei, Chinese coking coal imports are projected to continue to rise, increasing to 56.9 million by 2015, while coking coal exports are expected to remain flat at 3.5 million tonnes. Figure 12 shows the historical and projected Chinese coking coal imports and exports from 2006 to 2015.

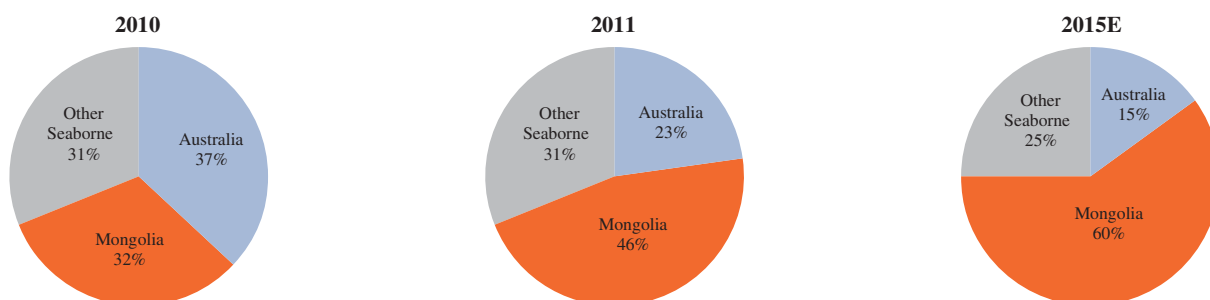
Figure 12. Historical and Forecast Chinese Coking Coal Trade, 2006-2015



Source: General Administration of Customs, Shanxi Fenwei

The emergence of Mongolia as a significant landborne supplier of coking coal to China is expected to displace established suppliers such as Canada and the United States and will augment seaborne supply from Australia. Shanxi Fenwei estimated that 60% of China's coal imports will come from Mongolia by 2015. Figure 13 shows the increasing trend in Mongolian exports of coking coal into China.

Figure 13. Trend in Australian and Mongolian Exports of Coking Coal into China



Source: General Administration of Customs, Shanxi Fenwei

China Coal Transportation Infrastructure

Rail is the main method for long distance coal transportation within China. Chinese coal production is mainly concentrated in Shanxi, Shaanxi and Inner Mongolia provinces in the northern part of China, while consumption has been relatively concentrated in the industrialized eastern and southern provinces. This defines the general movement of coal in China, which follows the west to east coal distribution routes. China's coal-dedicated rail system is shown in Figure 14, which contains the names of all the main coal carrying rail lines, as well as the main coal loading and unloading ports.

Figure 14. China's Major Coal-dedicated Railways



Source: Shanxi Fenwei

The 653 km Datong-Qinhuangdao railway in northern China is one of the main coal railways in the country. The railway links coal production regions in Datong and Shanxi to the Qinhuangdao port in Hebei and plays a pivotal role in meeting the coal demand of power generators in China's eastern and southern provinces. Qinhuangdao is one of the main ports for international and domestic coal imports and exports in China.

The 802 km Shenmu-Huanghua railway is another major coal railway in northern China. This railway links coal mines in Erdos and Shenmu in Inner Mongolia with Huanghua port in the coast of Hebei province. It connects with the Baotou-Shenmu railway at the north, meets with Shenmu-Yanan railway at the south, reaches Huanghua port at the east and passes through seven counties of Shanxi and Shaanxi.

The 1,000 km Jicao line extends from Jining in Inner Mongolia to Caofeidian in Hebei with near term capacity of 120 million tonnes and long term capacity of 200 million tonnes. It is expected to be the third major west to east line for coal transportation in addition to Daqin line and Shenmu-Huanghua line. It provides important access to coal resources in west Inner Mongolia linking Jining-Baotou line and related lines.

Numerous new rail lines and expansions of existing lines are under development that will impact our TMR. The Chinese government has significantly increased spending on railway development projects and has undertaken to develop the construction of special coal transportation railways in the future to increase coal transportation capacity.

Railway transportation costs vary depending on insurance fees and construction fees, and whether it is a coal dedicated and electrified railway. For example, the Datong-Qinhuangdao railway, which is a coal dedicated and fully electrified railway, currently charges an all inclusive rate of approximately RMB0.11-0.12 per km for every tonne of coal transported, while the charges for other coal-dedicated railways are approximately RMB0.18-0.25 per km for every tonne of coal transported.

Trucking is also widely used to transport coal and is considered economic for distances shorter than 300 km for thermal coal, and up to 850 km for higher value coking coal. Trucking fees vary, mainly in relation to distance as well as road conditions.

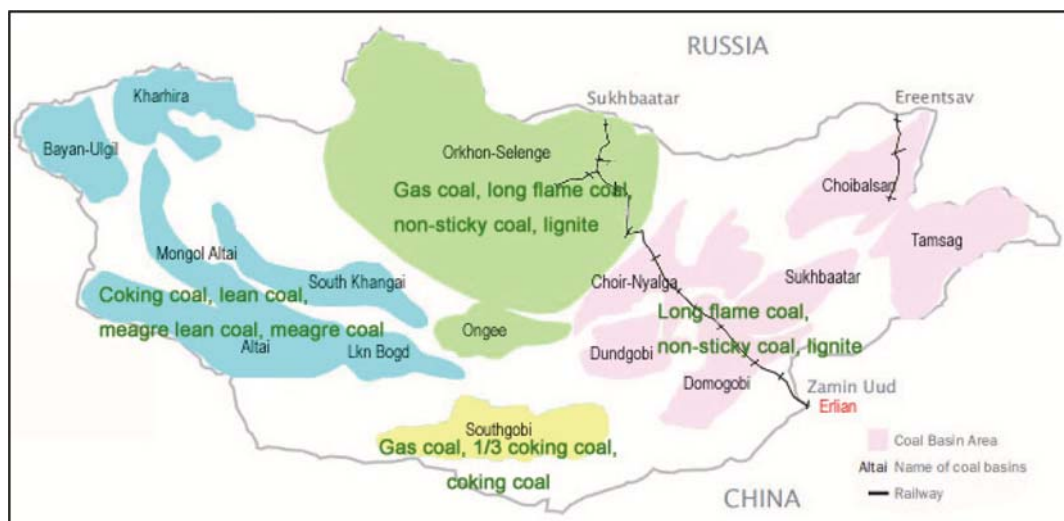
The nearest coal loading ports to our UHG mine are in the Bohai Sea region at Qinhuangdao, Tianjin and Huanghua.

Mongolian Coking Coal Industry Overview

Mongolian Coking Coal Resources

Mongolia has vast coal resources with significant potential, but most of it remains untapped. According to MMRE, Mongolia has an estimated 162.4 billion tonnes of total coal reserves, of which 17.6 billion tonnes are proven reserves as of end 2011.

Figure 15. Distribution of Different Types of Coal Resources in Mongolia



Source: Shanxi Fenwei

25% of Mongolian coal resources are lignite concentrated in the central and eastern parts, 40% are thermal coal distributed in the western and northern parts, 35% are coking coal in the central and Southern Gobi areas as shown in the figure above. From eastern to western areas of Mongolia, the metallurgical grade of coal takes on a rising trend, in other words, the central and southern Mongolia produce higher quality JM, 1/3 JM and FM type coal, whereas the western part produces lower quality JM, SM and PS type coal.

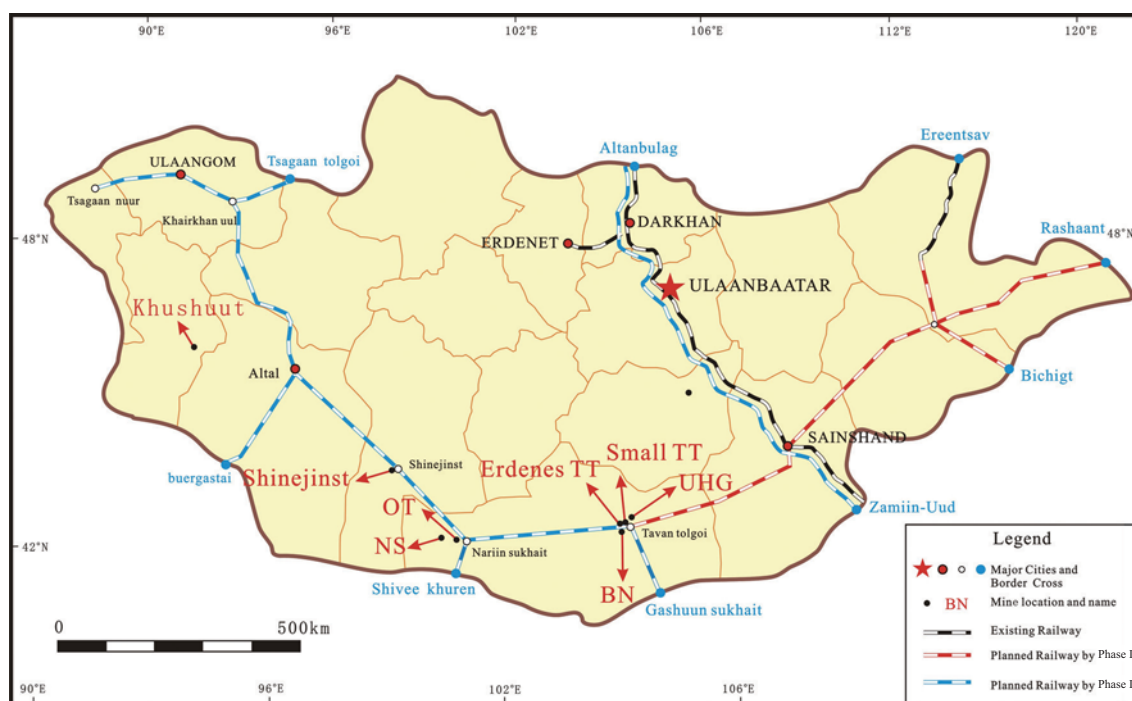
Given the insufficient supply of oil and natural gas, coal is considered to be Mongolia's main energy source. As a country of an estimated 2.8 million people with relatively little industrial activity outside of agriculture and mining, growth in domestic consumption of coal, especially coking coal, is likely to be limited. Much of the locally-consumed coal is low quality lignite used in thermal power plants near the capital, Ulaanbaatar. By comparison, most of the growing Mongolian coal exports to China consist of coking coal.

Mongolian Coking Coal Production and Exports

Prior to 2006, Mongolian coal was mainly consumed by the domestic market and nearly all of its coal production was thermal coal. In 2006, stimulated by increasing coal demand from China, the production of Mongolian coal, and coking coal in particular, began to grow rapidly. Mongolia's coal output reached 30.4 million tonnes in 2011 with a year-on-year increase of 30.4% according to Shanxi Fenwei, of which 22.4 million tonnes of coking coal was produced.

The key driver behind Mongolia's future production expansion will be demand from China and, to a lesser extent, demand from Russia, South Korea and Japan. China is currently and will likely continue to be, the main destination for Mongolian coal exports, due to Mongolia's proximity to China. As a landlocked country, the cost advantage of transportation and the relatively high demand for premium coking coal from China has driven a robust growth in exports of coking coal from Mongolia.

Figure 16. Locations of Major Coal Mines in Mongolia



Source: Shanxi Fenwei

Currently, there are four major Mongolian mines exporting significant amounts of coal to China – our UHG mine; the Nariin Sukhait (“NS”) coal mine, which is a joint venture between Mongolyn Alt Corporation (“MAK”) in Mongolia and the Qinhua in China; the existing Tavan Tolgoi JSC (“Small TT”), owned by Tavan Tolgoi Joint Stock Company (listed on the Mongolian Stock Exchange and 51% owned by South Gobi Province and 49% owned by private investors) and the Ovoot Tolgoi (“OT”) mine owned by SouthGobi Resources Ltd. They are all located in South Gobi Province, as shown in the map above. Table 4 summarizes the major coal mines in Mongolia in 2011, listed in descending order of total coal output in 2011.

Table 4. Major Coal Mines in Mongolia and Output Levels in 2011

Coal Mine Name	Company Name	Coal Type	2011 ¹⁶ Output (Mt)
UHG.....	MMC	JM	7.1
NS	Qinhua-MAK Joint Venture	1/3 JM	7.0
Small TT	Tavantolgoi JSC	JM	4.6
OT	SouthGobi Resources Ltd.	1/3 JM	3.0
		1/2 ZN	
Erdenes TT	Erdenes MGL	JM, 1/2 ZN	0.8

Source: Shanxi Fenwei

¹⁶ Note: Shanxi Fenwei to confirm accuracy of data in the table.

In addition to the coal mines listed in the above table, the Baganuur coal mine and the Shivee-Ovoocoal mine have relatively large coal output, but they only produce lignite and locate far from the Chinese border. Their coal products are supplied to the power plants in Mongolia. The other coal mines are smaller in size and produce lignite, long-flame coal and 1/2 sticky coal (“1/2 ZN”) which are sold to the local power plants.

By 2015, Shanxi Fenwei expects a number of other new major projects to come online, as listed in Table 5.

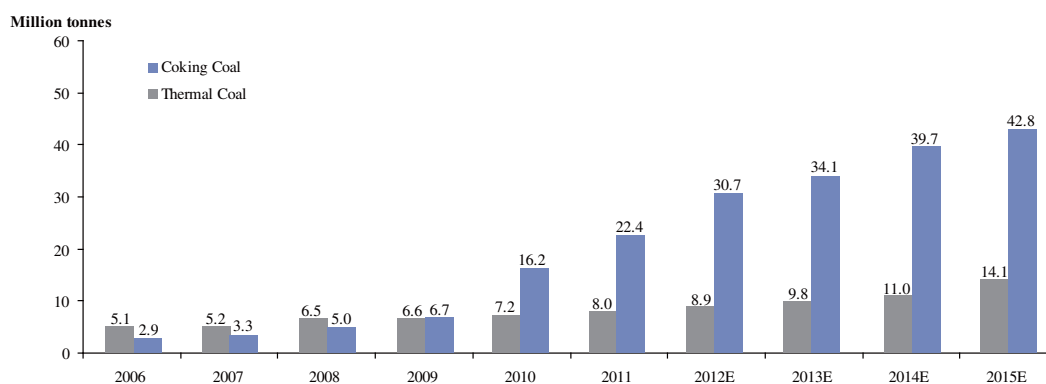
Table 5. Major Coal Mines in Mongolia Being Constructed and Planned

Coal Mine Name	Company Name	Coal Type	Scheduled Start of Operations	Designed Capacity (Mt)
Soumber	South Gobi Resources Ltd.	SM	2013	4.0
Zeegt	Gobi Coal and Energy Ltd.	SM, RN	2015	3.0
OT Underground. . .	South Gobi Resources Ltd.	1/3 JM, 1/2 ZN	2015	2.0
BN	MMC	1/3 JM	2012	3.0

Source: Shanxi Fenwei

Based on the above analysis of coal quality and target production at each mine, Shanxi Fenwei estimated the raw coal output in Mongolia to reach 56.9 million tonnes by 2015. Figure 17 shows the historical and projected Mongolian coal output from 2006 to 2015.

Figure 17. Historical and Forecast Mongolian Coal Output, 2006-2015



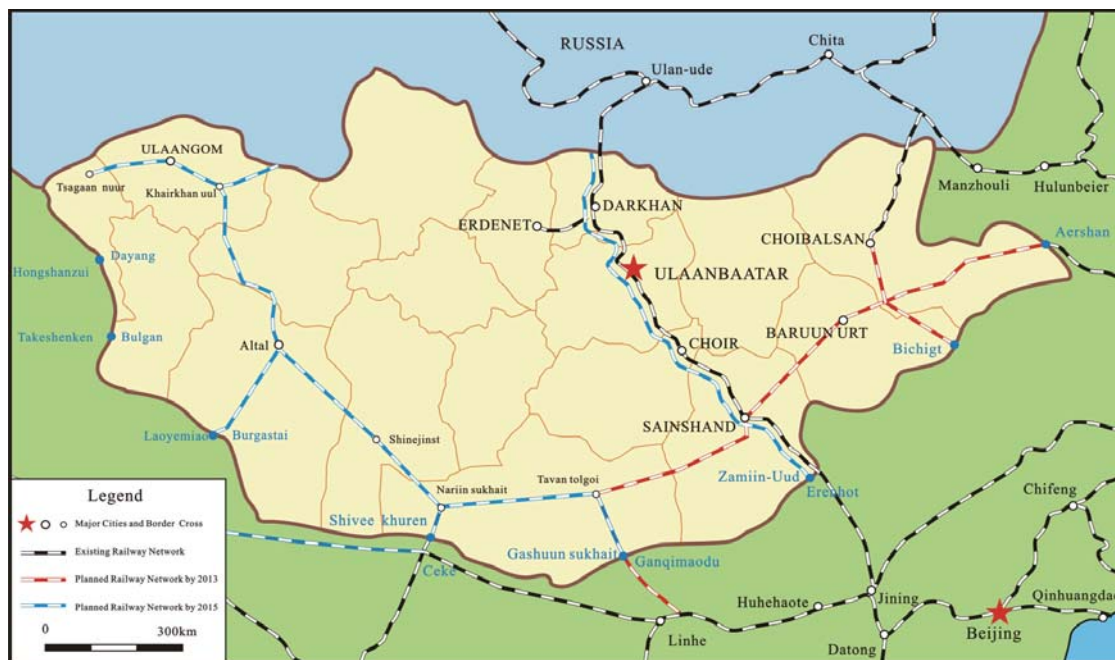
Source: Shanxi Fenwei

Mongolia Coal Transportation Infrastructure

Mongolia is landlocked by Russian to the north and China to the south. Neither rail system in the neighbouring countries has sufficient additional capacity to cope with a large-scale expansion of Mongolian coal exports. A high proportion of Mongolia’s reserves have not been developed due to the lack of infrastructure. In recent years, there have been several proposed plans for new rail line

developments pertaining to coal mining projects inside Mongolia, including our proposed 240 km rail line from UHG to GS. From GS, there are two main proposals/alignments for connecting to the existing Chinese rail system. See “Business – Logistics and Transport – Railway”. Figure 18 shows the existing and planned railways in Mongolia.

Figure 18. Existing and Planned Railways in Mongolia



Source: Shanxi Fenwei

Mongolian coal enters China through three main border crossings in China: the GM, Ceke and Mandula border points as shown in the map on the next page. Most coal exports from Mongolia are currently trucked into China, from the coal mines to the Mongolian side of the border, where it is unloaded at a stockpile facility. Border fees are paid in Mongolia and China, and the coal is then trucked over to stockpile facilities on the Chinese side of the border. From the stockpiles, some buyers truck the raw coal directly to end users. Most stockpile coal except ours, however, is trucked south to coal handling and preparation plants in China where it is processed into higher value product – that is, crushed and sized, and in some cases, washed. Transportation costs are a key issue that will determine a Mongolian coal mining project’s competitiveness in the Chinese and international seaborne markets.

Figure 19. Locations of Sino-Mongolia Border Crossings



Source: Shanxi Fenwei

In Mongolia, GS is the largest border crossing that exports Mongolian coal products to China, and its coal export volume has been rapidly increasing since 2006. The Mongolian GS border crossing is 26 km from the Chinese GM border crossing. Apart from our UHG and BN mines, Small TT and other mines in the defined region will be exporting coal to China via the GS border crossing.

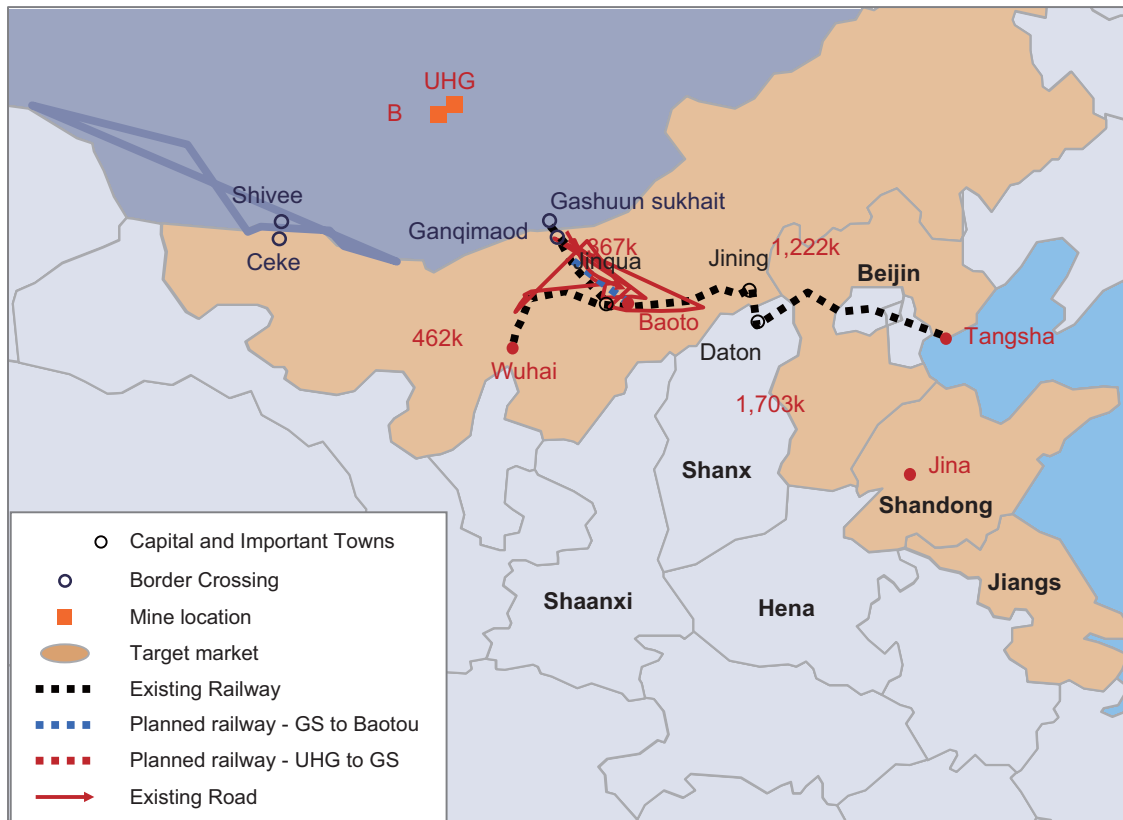
In Mongolia, Shivee Khuren is the second largest border crossing for raw coal exports to China. The Shivee Khuren border crossing is only 1 km from China's Ceke border crossing. OT, NS and Soumber coal mines are located in an area only 40-70 km to the north of Shivee Khuren, so these coal mines will transport their coal products to China via the Shivee Khuren border crossing.

The Khuchit border crossing in Mongolia is 25 km from China's Mandula border crossing. Currently, iron ore exports take up over 80% of the cargo volume passing through Khuchit; raw coal exports come next to iron ore.

Target Market Region for Our Coal

By analyzing transport logistics, supply costs, demand and price levels comprehensively, the TMR for our coal products has been determined by Shanxi Fenwei. It is shaded in beige color in Figure 20 and is considered the most likely area that our coal products could be competitively sold into.

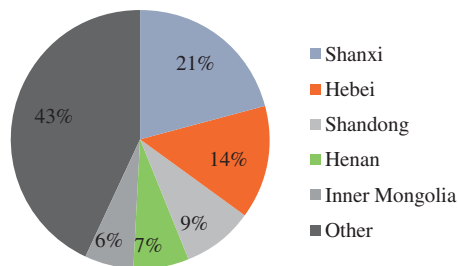
Figure 20. Our Target Market Region in China



Source: Shanxi Fenwei

Shanxi, Hebei, Shandong, Henan and Inner Mongolia are China's top five coke producing provinces, with a total production of 244.0 million tonnes in 2011, accounting for 57.0% of the national total.

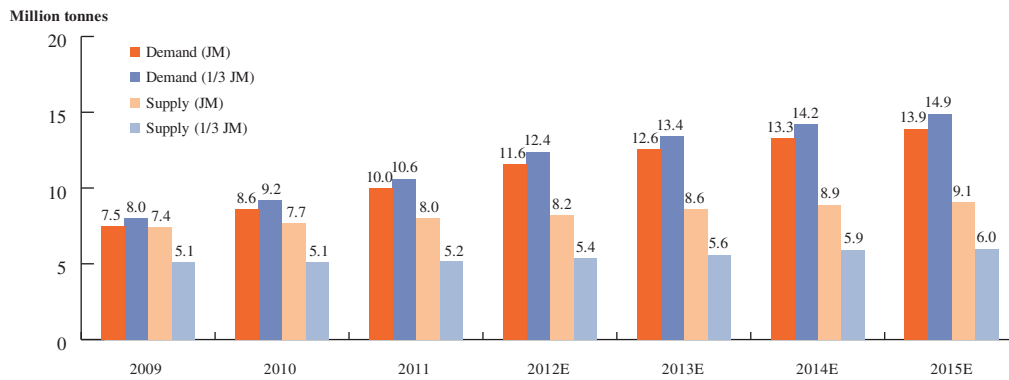
Figure 21. Coke Production by Province in 2011



Source: National Statistics of Bureau of China, Shanxi Fenwei

The central and western regions of Inner Mongolia are the nearest areas from the GM border crossing, with a number of new coking production facility projects under construction. The rapid growth of the coking industry in Wuhai and Baotou cities and their periphery areas in Inner Mongolia will pave the way for the expansion of the coking coal market. A coking coal supply shortage is expected to continue to increase in these areas. Figure 22 shows the historical and projected washed coal demand and supply dynamics in Inner Mongolia from 2009 to 2015.

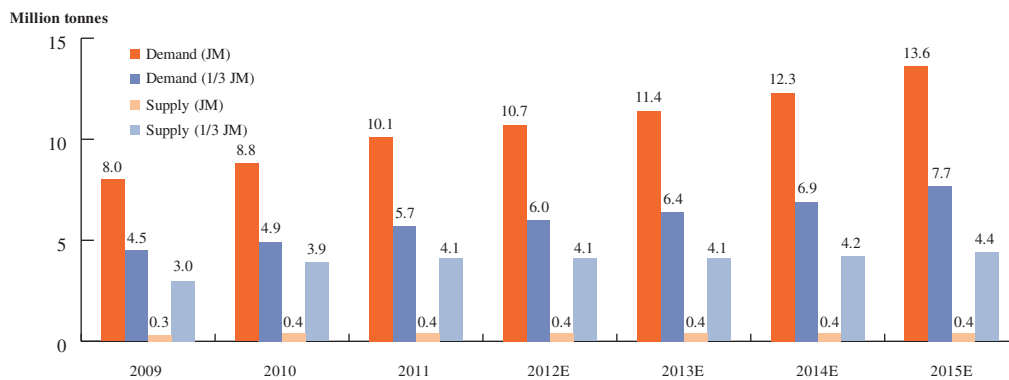
Figure 22. Historical and Forecast Washed coal Demand and Supply in Inner Mongolia, 2009-2015



Source: Shanxi Fenwei

Hebei is China's second largest coke producing province and Tangshan city is the largest iron and steel producing base in China. Currently its coking coal products are mostly lower quality FM type coal, hence it has strong demand for JM and 1/3 JM type coal, which are the main products at our UHG mine. Figure 23 shows the historical and projected washed coal demand and supply dynamics in Tangshan from 2009 to 2015.

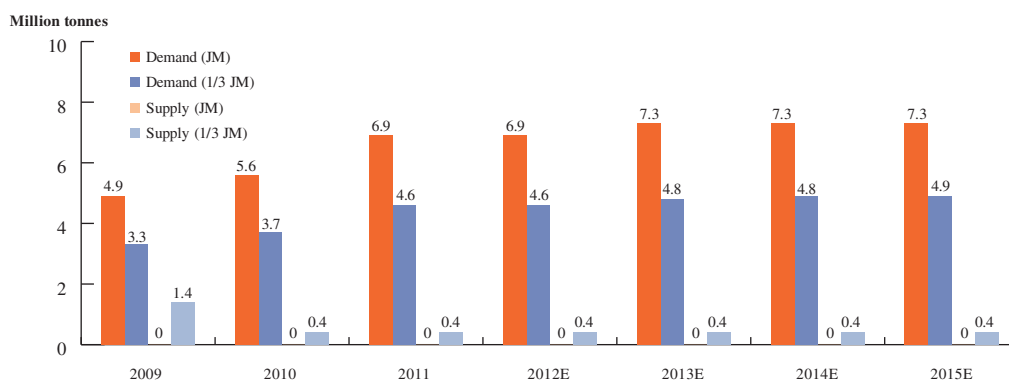
Figure 23. Historical and Forecast Washed coal Demand and Supply in Tangshan, 2009-2015



Source: Shanxi Fenwei

In addition, Inner Mongolia railway transportation capacity will gradually improve and the Mongolian coal imports can also be transported to Jiangsu by sea via Jingtang Port. According to Shanxi Fenwei, there is no coking coal mined in Jiangsu and the production of washed 1/3 JM will also decrease in the next few years. Figure 24 shows the historical and projected washed coal demand and supply dynamics in Jiangsu from 2009 to 2015.

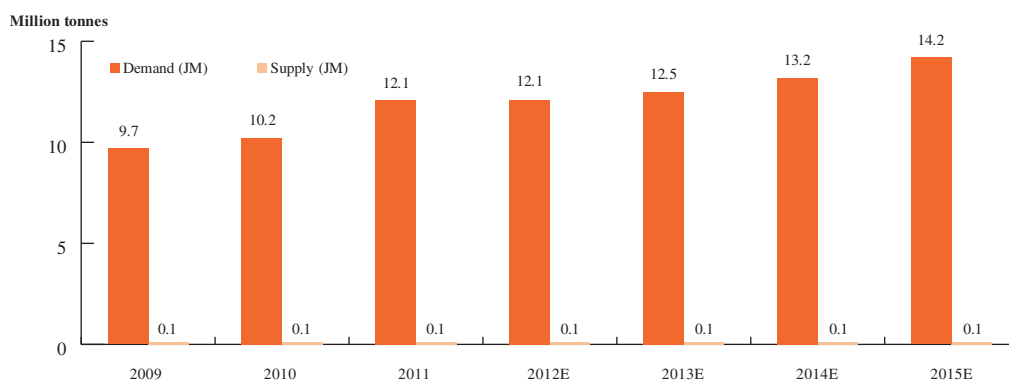
Figure 24. Historical and Forecast Washed coal Demand and Supply in Jiangsu, 2009-2015



Source: Shanxi Fenwei

Shandong is China's third largest coke producing province, and its coking coal products are mainly 1/3JM and QF type coal, lacking in JM type coal. Currently JM type coal is primarily imported from Shanxi, Hebei, Qinghai and these could potentially be a key target market for our coal products going forward. Figure 25 shows the historical and projected washed coal demand and supply dynamics in Inner Mongolia from 2009 to 2015.

Figure 25. Historical and Forecast Washed coal Demand and Supply in Shandong, 2009-2015



Source: Shanxi Fenwei

Rail and road transport distances from GM to each of the potential target markets are shown in Table 6.

Table 6. Transport Distance from GM to TMR

Origin	End-Destination	Rail Transport Distance	Road Transport Distance
		(km)	(km)
GM border crossing	Wuhai, Inner Mongolia	462	427
	Baotou, Inner Mongolia	367	355
	Tangshan, Hebei	1,222	1,150
	Jinan, Shandong	1,703	1,435

Source: National Statistics of Bureau of China, Shanxi Fenwei

Coal Pricing

The information below relates to the prices of washed coal only. Raw coal is generally sold at a significant discount to washed coal.

Global Coking Coal Pricing

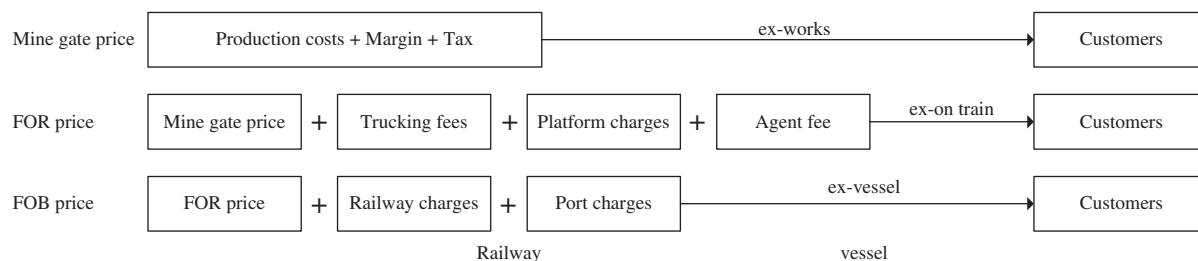
Coal is a bulk commodity commonly traded by contract. Coking coal prices are principally dependent on the coking characteristics of the coal, as compared to thermal coal prices which are dependent on the energy level of the coal. Coking coal is typically priced at a significant premium to thermal coal, with pricing differences between the different coking coal types. Hard coking coal ranks highest due to its high value in use (it is essential to make strong coke) and relatively limited sources of supply, semi-hard coking coal ranks lower due to higher ash content, soft coking coal is typically high fluidity coal and generally achieve a premium over semi-soft coking coal, and semi-soft coking coal is higher in volatility (+30%), low to medium ash (8%-10%) and with modest coking properties.

A number of factors also influence the direction and magnitude of benchmark coal prices, in particular, structural supply side changes, productivity improvements, cash cost levels, foreign exchange rates, demand and supply balances, profitability of steel companies and suppliers and consolidation within the sector. Historically, global coal export contract negotiations were held annually to establish the benchmark prices for the respective coal types. Commencing from the second quarter of 2010, the price setting mechanism is now done on a quarterly basis, helping to set the benchmark prices closer to spot prices.

China Coking Coal Pricing

There are three common coal pricing mechanisms in China: mine gate (also called mine mouth), free on rail (“FOR”) and free on board (“FOB”). Mine gate price refers to the sales price of coal sold at the producing mines. The FOR price refers to sales where coal is loaded onto trains which is mainly impacted by the mine gate price, freight charges (usually short-distance trucking), platform fee and agent fee. The FOB price refers to the price of coal loaded onto ships for export markets. These pricing mechanisms are summarized in Figure 26:

Figure 26. China Coal Pricing Flow



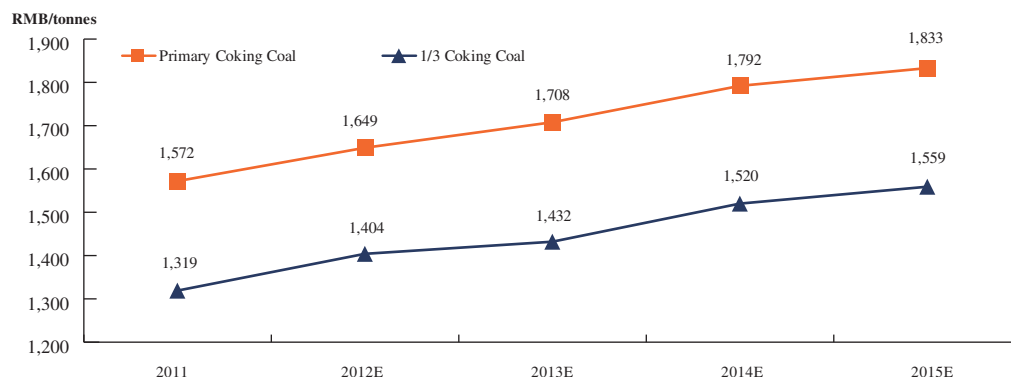
Tangshan, Hebei is China’s largest iron and steel producing base as well as China’s largest coking coal consumer and for this reason, its coking coal price is often used as a reference for the national price.

The coking coal price in China has generally been on an upward trend since 2005. Coking coal prices soared in 2007 with the increased demand for coking coal and prices in China reached a record level in the first half of August 2008, with the Tangshan coking coal prices reaching RMB2,100 per tonne. By the end of 2008, as a result of the global economic downturn, the coking coal price declined and the coking coal price in Tangshan dropped to RMB1,200 per tonne. In 2009/10, the Chinese Government implemented a stimulus package, which boosted the demand for coking coal. As a result, the coking coal price in Tangshan reached RMB1,500 per tonne in 2010.

The Chinese economy is expected to maintain robust growth from 2011 to 2015, and the demand for coking coal is expected to continue growing during this time. The primary coking coal FOR price in Tangshan is expected to reach RMB1,833 per tonne by 2015, representing an increase of 16.7% compared to 2011.

Shanxi Fenwei forecasts coking coal prices in Tangshan, China as shown in Figure 27.

Figure 27. Forecast Coking Coal Prices in Tangshan, 2011-2015



Source: Shanxi Fenwei

Note: Prices are inclusive of VAT

Based on the projections of coal prices in our TMR and taking into consideration the logistics costs from GM to the TMR, Shanxi Fenwei forecasts the prices of our coal products at GM as shown in Table 7.

Table 7. Forecast MMC Coking Coal Prices at GM Border Crossing, 2011-2015

Coal Product	End-Destination	2011	2012E	2013E	2014E	2015E
(in RMB)						
UHG washed coal	Wuhai, Inner Mongolia	1,232	1,297	1,432	1,463	1,545
	Tangshan, Hebei	1,200	1,275	1,413	1,494	1,534
	Jinan, Shandong	—	—	1,443	1,529	1,571
	Suzhou, Jiangsu	—	—	1,495	1,583	1,627
BN washed SSCC	Wuhai, Inner Mongolia	892	931	1,055	1,089	1,158
	Tangshan, Hebei	885	963	1,070	1,150	1,186
	Suzhou, Jiangsu	—	—	1,059	1,143	1,180

Source: Shanxi Fenwei

Note: Prices are inclusive of VAT

BUSINESS

Overview

We are a leading Asian coking coal mining company. We are engaged in the open-pit mining of coking coal at our UHG deposit which forms the northern branch of the Tavan Tolgoi coal formation and our BN deposit, both located in South Gobi Province, Mongolia. Our UHG mining license permits us to engage in coal mining activities on 2,960 hectares of land at our UHG mine for an initial period of 30 years starting from August 29, 2006. Our UHG mine had 570.8 Mt and 275.0 Mt of JORC-compliant measured, indicated and inferred coal resources and proven and probable coal reserves, respectively, as of December 31, 2011. On June 1, 2011, we completed the acquisition of our BN mine, which is located approximately 30 km southwest of our UHG mine. Our BN mine had 282.2 Mt of JORC-compliant measured, indicated and inferred coal resources as of February 2010 and 185.3 Mt of JORC-compliant proven and probable reserves as of February 2011.

We are the largest producer and exporter of raw and washed coal in Mongolia. Most of our coal is transported by trucks to our customers in China, while a small portion is shipped on the Trans-Siberian railway to explore alternative markets, such as European and other Asian markets. According to Shanxi Fenwei, our coking coal is of high quality that is comparable to the quality of hard coking coal produced in Shanxi, China and the Bowen Basin, Australia.

We commenced mining at our UHG mine in April 2009 and became profitable in our first year of operations. For the years ended December 31, 2009, 2010 and 2011, we produced 1.8 Mt, 3.9 Mt and 7.1 Mt of ROM coal, respectively. We plan to produce approximately 10.7 Mt, 14.7 Mt and 15.2 Mt of ROM coal at our UHG mine in the three years ending December 31, 2014, respectively.

Our UHG mine is strategically located approximately 240 km from the Sino-Mongolian border and approximately 600 km from Baotou, China. Baotou is an important railway transportation hub providing access from Mongolia to the largest steel producing provinces in China, including Inner Mongolia, Hebei, Shandong and Jiangsu provinces. We, together with our contract trucking companies, haul most of our coal by truck to GM, located on the Chinese side of the Sino-Mongolian border crossing, where our customers pick up and further transport the coal to their final destinations in China. The total length of transportation is approximately 250 km between our UHG mine and GM, including a transshipment and handling stopover at TKH, which is located approximately 21 km from GM.

In October 2011, we completed the construction of a paved road, with coal transportation capacity of 18.0 Mtpa from our UHG mine to GS, parallel to the existing coal transport gravel road from our UHG mine to GS. In January 2012, we, together with Erdenes MGL, completed and commissioned an expansion of the GS border crossing, which we expect will increase the border crossing capacity at GS from 10 Mtpa to approximately 20-30 Mtpa. We maintain our own fleet of trucks, which is supplemented by contract trucking companies, to ship our coal from UHG to GM. In 2011, we increased the size of our own fleet from 100 to 400 trucks. In order to further lower transportation costs and increase reliability and operational efficiency, we plan to commence construction of a railway directly from our UHG mine to GS in 2012. See “Risk Factors – Risks Relating to our Business and Industry – Our UHG-GS railway is subject to various risks and uncertainties; we are not sure when we can commence and complete construction of the railway, what the actual cost of the project will be, or whether the project will be successful”.

As part of our strategy to improve our margins, we have completed construction of and commissioned the first and second modules of our CHPP to produce high-quality washed coal. The first and second modules of our CHPP, each with ROM coal nameplate processing capacity of 5.0 Mtpa, have been in operation since June 2011 and February 2012, respectively. We began constructing the third module with ROM coal nameplate processing capacity of 5.0 Mtpa in August 2011 and expect to complete construction by the end of 2012, which will increase the capacity of our CHPP from 10.0 Mtpa to 15.0 Mtpa. The ramp-up of our CHPP capacity coincides with the ramp-up of our coal production. With the commencement of operations of our CHPP, we have shifted our production from raw coal to washed coal, and we plan to sell only washed coal and middlings beginning in the second quarter of 2012. In 2011, the yield of washed coal from raw coal processed at our CHPP was approximately 63.3%.

We sell most of our coking coal into China pursuant to long-term agreements with iron and steel mills and coke and chemical plants. We have already contracted to sell all of our scheduled production of coal for the year ending December 31, 2012 pursuant to the terms of our long-term agreements. However, our customers are allowed to adjust the amount of coal they will purchase, subject to mutual agreement. According to Shanxi Fenwei, the selling prices of our coal are the highest among our competitors in Mongolia and are considered the benchmark for the price of Mongolian coking coal. In the years ended December 31, 2009, 2010 and 2011, we sold our coking coal at an average selling price of US\$48.2, US\$70.8 and US\$113.9 per tonne, respectively. Washed coal is sold at a substantial premium to raw coal. In 2011, the average selling price of our raw coal was US\$95.0 per tonne and the average selling price of our washed coal was US\$155.6 per tonne, representing approximately a 63.8% premium to that of raw coal.

We work with a number of industry-leading experts throughout the planning, development and operations of our business. We work closely with our mining contractor, Leighton, a world-class mining operator with over 30 years of experience in Asia, in all aspects of our coal mining operations. We have entered into a long-term contract with them to train and supervise our employees to conduct mining operations at our UHG mine and, in addition, Leighton has agreed to work with us to build out our coal production capacity to 15.0 Mtpa. We have communicated our expansion plans to our other major contractors and suppliers and are working with them to ensure they have sufficient resources to support our expansion.

On June 1, 2011, we completed the acquisition of our second mine, BN, through the acquisition of 100% of the equity interests in Baruun Naran Limited (formerly named QGX Coal Limited). The acquisition provided us with a unique opportunity to purchase a coking coal asset strategically located in close proximity to our UHG mine and which is in an advanced development stage, and allowed us to expand our existing footprint in Mongolia. We expect the sizable coking coal resources and reserves at our BN mine will allow us to target a larger customer base and to expand our product offerings to include semi-soft coking coal and high calorific value thermal coal. In addition, we believe the proximity between our BN mine and our UHG mine will enable us to benefit from synergies such as sharing of mining, processing and transportation infrastructure and marketing resources. We commenced operations at our BN mine in February 2012.

Our revenue for the years ended December 31, 2009, 2010 and 2011 was US\$67.0 million, US\$277.5 million and US\$542.6 million, respectively, representing a CAGR of 184.6%. Our net profit for the years ended December 31, 2009, 2010 and 2011 was US\$10.3 million, US\$60.1 million and US\$119.1 million, respectively, representing a CAGR of 240.0%.

Our Competitive Strengths

World-class coking coal assets with abundant resources

We own and operate two high quality coking coal mines in South Gobi Province, Mongolia, namely our UHG and BN mines. According to Shanxi Fenwei, we have one of the largest coking coal resource bases in Asia, the quality parameters of our washed coal are comparable to those of Shanxi, China and the Bowen Basin, Australia, and our washed coal is highly marketable in the Chinese and other international markets. Our UHG mine had 570.8 Mt of JORC-compliant measured, indicated and inferred coal resources and 275.0 Mt of JORC-compliant proven and probable reserves as of December 31, 2011.

Our BN mine is located approximately 30 km southwest of our UHG mine. It is mainly comprised of sizeable semi-soft coking coal and high calorific value thermal coal resources and reserves, which we believe will create the potential to diversify our coking coal product offerings and to enhance revenue streams. We believe the proximity between our UHG and BN mines will enable us to benefit from synergies such as the sharing of mining, processing and transportation infrastructure and of marketing. Our BN mine had 282.2 Mt of JORC-compliant measured, indicated and inferred coal resources as of February 2010 and 185.3 Mt of JORC-compliant proven and probable reserves as of February 2011.

The table below shows the quality comparison between our coal and comparables from Shanxi, China and the Bowen Basin, Australia.

Quality Attribute	HCC			SSCC		
	UHG	Liulin, Shanxi	Australia	BN	Linfen, Shanxi	Australia
Ash %	9.4%	10.3%	8%	10%	8%	10.5%
Volatile Matter % (ad)	25%	21.6%	24%	30-32%	32-36%	32%
Total Sulfur % (ad).	0.6%	0.36%	0.55%	0.5-0.6%	0.6%	0.8%
G Index	85	86	85	70-90	75-85	82
Y Index	14	16	15	11-14	11-12	12
CSR.	64.8	70	65	30	35	36

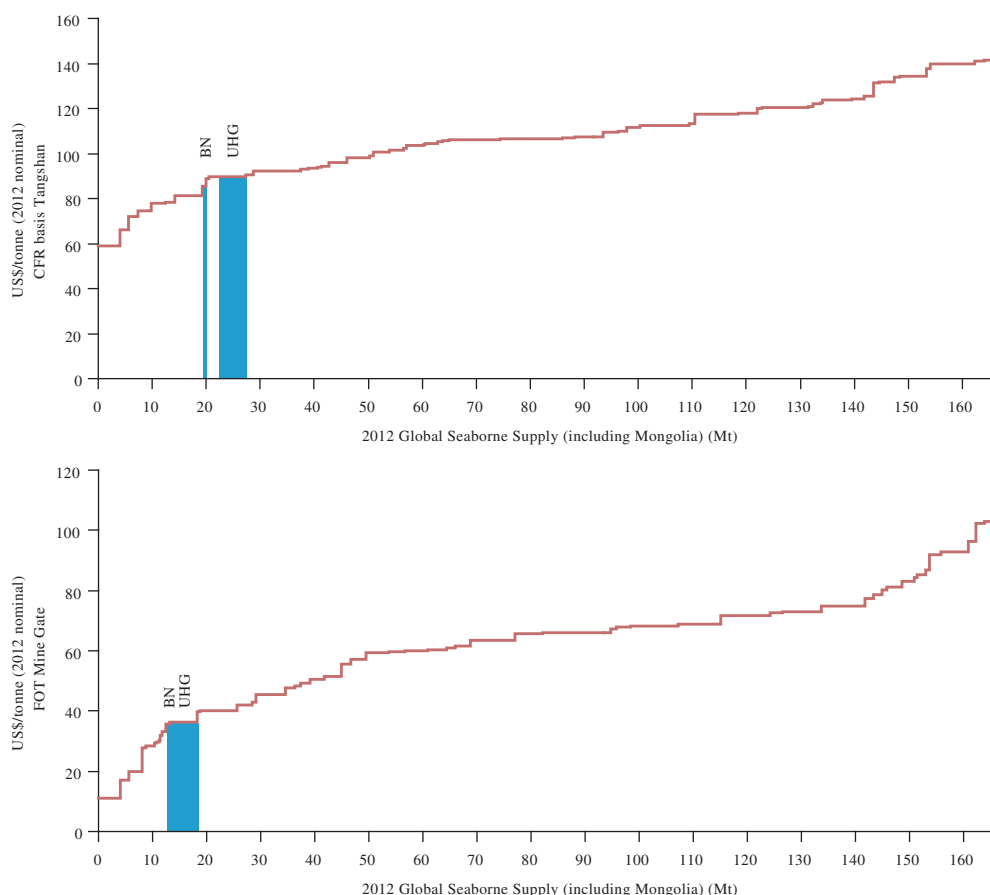
Source: Shanxi Fenwei

One of the lowest cost coking coal producers in the world

We believe that we have one of the lowest mining and processing cash operating costs of production among coking coal producers. For the year ended December 31, 2011, our total cash operating costs of washed coal on a FOT basis were US\$37.1 per tonne comprising US\$30.5 per tonne of mining costs and US\$6.6 per tonne of coal processing costs. The cash costs of our UHG and BN mines on FOT at mine gate and CFR at Tangshan bases are ranked in the first quarter of global hard coking coal cash cost curve according to Wood Mackenzie.

Our low cost structure is partly attributable to the favorable geological conditions of the coal seams at our UHG mine, according to Norwest. The majority of our coal deposits are close to the surface, which enables the development of lower cost open pit mines. In terms of deposit structure, our coal seams are thick, relatively uniform and only slope slightly, which provide for low stripping ratios. The stripping ratio of our UHG mine in 2011 was 5.2. Our coal also has a high degree of friability, which means it can be easily broken into smaller pieces without drilling or blasting. This makes it easier for us to both mine and transport our coal. The yield of our washed coal from raw coal was approximately 63.3% in 2011, which compares favorably to the 55% yield that most Chinese producers are able to achieve. These characteristics increase the efficiency of our mining operations and the productivity of mining equipment, thereby enabling us to produce high quality washed coal at a low cost.

Our cost of production is lower than our principal competitors serving China, namely coking coal producers from China and Australia. Coking coal from China is predominantly produced from underground mines. In general, underground mining is significantly more capital intensive, costly and operationally challenging than open-pit mining. In the last several years, mine production costs have significantly increased in Australia due to high levels of taxation, increased labor, operational and infrastructure costs, transportation capacity bottlenecks, inflation and currency appreciation. Furthermore, mining operations in Australia normally have higher stripping ratios, and consequently higher costs per tonne of coal produced. The figures below show the forecast cash cost curves, on FOT basis at mine gate and on CFR basis at Tangshan, of washed coking coal sold at Tangshan for 2012, which illustrates our cost advantage compared to other major coking coal producers.



Source: Wood Mackenzie

Closest coking coal exporter to major Chinese steel mills

China is the world's largest steel producer. According to the World Steel Association, China produced 683.3 Mt of crude steel in 2011, representing 45.9% of the world's total steel production. Based on the 12th Five-Year plan (2011 to 2015) for China's iron and steel industry, the steel industry in China is expected to grow at a rate of 5-6% per annum from 2011 to 2015. As a result, China is and is expected to remain the world's largest coking coal consumer, and one of the fastest growing importers of coking coal. In 2011, China imported 44.7 Mt of coking coal, of which 44.7% was sourced from Mongolia, which surpassed Australia in 2011 to become the largest coking coal exporting country to China according to Shanxi Fenwei.

We believe that we are strategically positioned to benefit from the Chinese steel industry's strong demand for coking coal. We are the closest coking coal exporter to the largest steel producing provinces in China, including Inner Mongolia, Hebei, Shandong and Jiangsu. Our UHG and BN mines are located approximately 240 km and 230 km from the GS border crossing, respectively. We are also only approximately 600 km from Baotou, China and 1600 kilometers to Hebei, China. Proximity to Baotou is of strategic importance to Mongolian coking coal producers for its railway network, which provides access to China's large steel producing provinces. Through Baotou, our coking coal can be transported by rail to the ports of Jingtang, Caofeidian and Tianjin, which, we believe, will allow our coal to be sold in the international seaborne market subject to obtaining requisite approvals and licenses to export coal from China.

Most advanced coking coal operations in Mongolia supported by internationally recognized experts

As of December 31, 2011, we believe we had the most advanced coking coal operations in Mongolia. We commenced mining operations in April 2009 and produced 7.1 Mt of ROM coal in 2011. We plan to produce approximately 15.2 Mt of ROM coal in 2014. See "Risk Factors – Risks Relating to our Business and Industry – We face risks under our expansion program". We have chosen to work with internationally recognized experts, such as Leighton and Sedgman, to develop and operate our mining and processing infrastructure. We have entered into contractual arrangements with Leighton as our mining contractor, who has agreed to procure and commit upfront capital expenditures for the necessary mining equipment as well as provide mine management and on-the-ground staff training for our employees to support our planned production ramp-up to approximately 15.0 Mtpa. Leighton sources a large proportion of the mining equipment from internationally recognized equipment manufacturers such as Liebherr and Caterpillar.

We have contracted with Sedgman to construct and operate our CHPP. The first and second modules of our CHPP, each with ROM coal nameplate processing capacity of 5.0 Mtpa, have been in operation since June 2011 and February 2012, respectively, and we continue to work with Sedgman to complete construction of the third module of our CHPP by the end of 2012, which will increase its current capacity from 10.0 Mtpa to 15.0 Mtpa to match our target long-term production levels. Our CHPP is designed to operate year round in Mongolia's weather conditions. According to Shanxi Fenwei, our CHPP is expected to be one of the largest coking coal processing plants in the world, the most advanced in Asia and will have one of the highest process recovery efficiencies in the industry. Based on publicly available information available at the time of this offering memorandum, we believe no other coking coal producer in Mongolia has commenced construction of a similar facility and that we are the only producer of washed coal in Mongolia. In addition, our CHPP currently uses water supplied from an aquifer located in Naimant Depression and we plan to use water from another reservoir located in Naimdain Khundii which we expect will begin supplying water by the end of 2012.

We have constructed a paved road with coal transportation capacity of 18.0 Mtpa from our UHG mine to GS to transport our coal and are permitted to charge tolls to third parties using its excess capacity under the terms of our BOT contract with the Government of Mongolia. We believe that most Mongolian coal producers still use unpaved gravel roads, which generally have smaller transportation capacities and require higher maintenance costs and result in significantly higher transportation costs. In addition, we, together with Erdenes MGL, completed an expansion of the GS border crossing, which we expect to increase the border crossing capacity from 10 Mtpa to approximately 20-30 Mtpa.

We believe working alongside international experts gives us a strategic advantage over many of our competitors as our personnel are able to acquire and apply the knowledge necessary to operate a world-class coking coal mine. We are also working with other leading contractors in their respective areas of expertise including Parsons Brinckerhoff (power plant feasibility study and design review), Deutsche Bahn and its sub-contractor Wilbur Smith Associates (railway feasibility studies), and Aquaterra (underground water exploration, water supply facility design and construction supervision).

Higher profitability driven by washed coal sales and integrated infrastructure

We began operation of the first and second modules of our CHPP in June 2011 and February 2012, respectively, and expect a positive contribution to our margins from the sale of washed coal and from the shift of our trucking operations to the paved road from the gravel road. Previously, we were only able to sell raw coal and had to rely on coal traders and customers to wash our coal. With the commencement of our CHPP operations, we have been able to produce washed coal at consistent quality levels. As a result, we are able to sell high-quality washed coal directly to end-use customers under our own brand, which we believe will significantly increase our market recognition, competitiveness and bargaining power. The sale of washed coal not only allows us to command a substantially higher price than raw coal, but also allows us to enjoy lower royalty tax rates and qualify for VAT refunds on our washed coal sales. In 2011, the average selling price of our raw coal was US\$95.0 per tonne and the average selling price of our washed coal was US\$155.6 per tonne, representing a 63.8% premium to that of raw coal. According to Shanxi Fenwei, the selling prices of our coal are the highest among our competitors in Mongolia and are considered the benchmark for the price of Mongolian coking coal.

In October 2011, we completed, within 10 months, the construction of a paved road parallel to the existing coal transport gravel road from our UHG mine to GS, which was a significant improvement in the transportation infrastructure necessary to support our production growth. Our paved road is sufficient to support our current expansion plans, and its excess capacity may be used by third parties for a toll fee. We believe that the paved road has indirectly improved our margins by (i) allowing us to use double-trailer trucks capable of hauling 140 tonnes each, thereby substantially increasing the amount of coal that may be transported by each truck, (ii) reducing repair and maintenance costs of our coal hauling trucks and (iii) decreasing the amount of fuel used by each coal hauling truck. Smooth operations at GS are also critical to our operational performance, and in January 2012, we, together with Erdenes MGL, completed and commissioned an expansion of the GS border crossing, which we expect will increase the border crossing capacity from 10 Mtpa to approximately 20-30 Mtpa. In addition, our 3x6 MW power plant has been fully operational since October 2011 and supplies substantially all of the power required at our UHG mine. We also operate 4x2 MW diesel power generators to provide additional power during peak use periods and as a backup source of power. Furthermore, the initial stage of the water supply facility was completed and became operational in the second quarter of 2011. It has capacity of 117 liters per second and is supplied from a reservoir located in Naimant Depression, approximately 20 km from our UHG mine.

Stable revenue streams underpinned by off-take agreements with diversified customer base

We have already contracted to sell all of our scheduled production of coal for the year ending December 31, 2012, under long-term agreements which allow our customers to adjust the amount of their purchases, primarily to iron and steel mills, as well as coke and chemical plants, located in China. As of December 31, 2011, we have entered into off-take agreements with Chinese end-use customers, such as Baotou Steel, Shagang, Risun, Tangshan Jiahua Coke and Chemical, Qinghua, and Shenhua Bayannaoer Energy and coal traders, such as Hua Zheng and Winsway. The long-term off-take agreements have terms of one to ten years, allowing us to secure relatively stable long-term demand, and relatively predictable revenue streams and cash flows. As the only mining operator in Mongolia with a coal processing facility, we are the first exporter that is able to sell washed coal products directly to end-use customers, thereby diversifying our customer base beyond principally relying on coal traders. In the years ended December 31, 2009, 2010 and 2011, the amount of our sales of coal to iron and steel mills and coke and chemical plants was 45.8%, 61.3% and 91.0%, respectively.

Strong management team with proven execution track record

Our directors and senior management include representatives of our shareholders and professionals who have extensive industry knowledge and experience in their respective industries, which include mining operations, exploration, development, finance and marketing resources. Mr. Odjargal Jambaljamts, our executive Director, chairman of the Board and executive chairman, has overseen the development of our business from the time of our establishment. Dr. Battengel Gotov, our chief executive officer, has been instrumental in transforming our UHG mine from a greenfield project to a full-fledged mining operation. Building on extensive industry experience, our management team has demonstrated strong execution abilities to expand mine operations and infrastructure. We turned profitable in the first year of commercial operations in 2009 and listed on the Hong Kong Stock Exchange in the following year. Our management team has proven capable of effectively managing our operations while employing international mining practices and corporate governance standards.

Our Strategy

We intend to pursue the following key strategies to maintain and enhance our position as a leading Asian coking coal mining company.

Expand coal mine production

For the year ended December 31, 2011, we produced 7.1 Mt of ROM coal. We plan to produce 10.7 Mt, 14.7 Mt, and 15.2 Mt of ROM coal at our UHG mine in the three years ending December 31, 2014, respectively. As of December 31, 2011, we had equipment sufficient to support production of 10.0 Mtpa. We have been working with Leighton to implement an equipment procurement and use schedule to maximize the use of their existing equipment given our mine production ramp-up plans. Leighton has agreed to work with us to provide the necessary capital and equipment to build out our coal production capacity at our UHG mine to 15.0 Mtpa. We also intend to continue to conduct exploration activities in our current mining license area in order to increase and optimize our coal resources and reserves base. We commenced operations at our BN mine in February 2012. We plan to produce approximately 1.0 Mt, 1.0 Mt and 3.0 Mt of ROM coal at our BN mine in the three years ending December 31, 2014, respectively. ROM coal production figures at our BN mine for 2013 and 2014 are subject to completion of a life-of-mine study which is expected to be completed by the end of 2012. See “Risk Factors – Risks Relating to our Business and Industry – We face risks under our expansion program”.

Expand our coal handling and processing capacity

As part of our strategy to improve our profitability, we have completed construction of and commissioned the first and second modules of our CHPP which produces high-quality washed coal. The first and second modules of our CHPP, each with ROM coal nameplate processing capacity of 5.0 Mtpa, have been in operation since June 2011 and February 2012, respectively. Our CHPP enables us to produce and sell washed coal products directly to end-use customers under our own brand and not have to rely on coal traders, who previously washed and then sold our coal to end-use customers. We began constructing the third module of our CHPP with ROM coal nameplate processing capacity of 5.0 Mtpa in August 2011 and expect to complete construction by the end of 2012. The ramp-up of our CHPP capacity coincides with the ramp-up of our coal production at our UHG and BN mines and is planned to support our operations at maximum capacity.

Our 3x6 MW power plant has been fully operational since October 2011 and supplies substantially all of the power supply at our UHG mine. In addition, we operate 4x2 MW diesel power generators to provide additional power during peak use periods and as a backup source of power. We expect the Tavan Tolgoi area to be connected to the central power grid via transmission lines by the end of 2012, thus expanding our power source options.

The initial stage of the water supply facility was completed and became operational in the second quarter of 2011. It has capacity of 117 liters per second and is supplied from a reservoir located in Naimant Depression, approximately 20 km from our UHG mine. We have planned to use the water from a reservoir located in Naimdain Khundii, approximately 50 km from our UHG mine, as a second source of water. We plan to expand the existing capacity of our water supply facility by approximately 100 liters per second in 2012 with water from our second water supply source. A hydrogeological study of the Naimdain Khundii area indicates sufficient water resources to accommodate this additional requirement.

Improve our transportation infrastructure

Since commencing operations in 2009, we have taken significant steps to improve our transportation infrastructure. We maintain our own fleet of trucks which is supplemented by contract trucking companies and trucks provided by our customers. In 2011, we increased the size of our own fleet from 100 to 400 trucks and may consider acquiring an additional 100 trucks in 2012 to improve the reliability and capacity of our coal transport and to reduce our dependency on contract trucking companies. See “– Logistics and Transport”. In October 2011, we completed, within 10 months, the construction of a paved road between UHG and GS with coal transportation capacity of 18.0 Mtpa. In January 2012, we, together with Erdenes MGL, completed and commissioned an expansion of the GS border crossing, which we expect to increase the border crossing capacity from 10 Mtpa to approximately 20-30 Mtpa. We have commenced construction of a paved road connecting our UHG and BN mines, which we expect to complete in the fourth quarter of 2012, and will enable us to benefit from synergies such as sharing of mining, processing and transportation infrastructure and marketing resources. In order to further lower transportation costs and increase reliability and operational efficiency, we plan to commence construction of a railway directly from our UHG mine to GS in 2012. See “Risk Factors – Risks Relating to our Business and Industry – Our UHG-GS railway is subject to various risks and uncertainties; we are not sure when we can commence and complete construction of the railway, what the actual cost will be, or whether the project will be successful”.

Continue to develop and diversify our long-term customer base and promote our own brand

In line with our production expansion initiatives, we intend to continue to expand and diversify our customer base, and have identified, and will continue to identify, new customers for our incremental coal volumes. We seek to sell high-quality washed coal under our own brand directly to end-use customers, which we believe will significantly increase our market recognition, competitiveness and bargaining power. We sell most of our washed coal into China pursuant to long-term agreements with iron and steel mills and coke and chemical plants under our own brand. Even in connection with our sales to coal traders, we have made the identification of our actual end-use customers a priority. Although we believe there is sufficient demand for our coking coal in China, we have shipped a small portion on the Trans-Siberian railway to explore alternative markets, such as European and other Asian markets.

Expand and diversify our business operations through acquisitions, investments and joint ventures

Where suitable opportunities arise, we may acquire or invest in companies or assets in the steel industry supply chain. We may selectively pursue natural resources used in the steelmaking industry, (in particular, coking coal and iron ore), especially those that we believe will enhance our revenue growth, operational efficiency and profitability. In addition, given the importance of transportation infrastructure and a sales network as an integral part of our mining business, we may consider strategic investments and joint ventures that will enhance our existing logistics capabilities and product penetration in the TMR and new markets, thereby strengthening our leading position as Mongolia's largest producer and exporter of coal.

Continued strong commitment to safety, the environment and social responsibility

We attach great importance to maintaining safe operations. We apply and will continue to apply international standards of industrial health and safety and work with Leighton to ensure that our mining activities are conducted in such a way as to provide a safe and healthy working environment while satisfying Mongolian legal requirements, industry best practices and clients' expectations. We have not experienced any fatalities at our UHG and BN mines since their respective commencement of operations in 2009 and 2012.

We strive to be an environmentally and socially responsible company and attach great importance to creating sustainable economic and social opportunities for the communities in which we operate. We seek to minimize the impact of our activities on the environment through carefully designing mining plans, in particular land rehabilitation and mining closure plans, and closely monitor the effects of mining. We plan to introduce an ISO 14001 environmental management system which will provide better guidance on our environmental protection activities. We have invested in various community development programs that support local community and preserve the tangible and intangible cultural heritage. We have received numerous awards and recognitions as a result of our efforts. See "– Community Development".

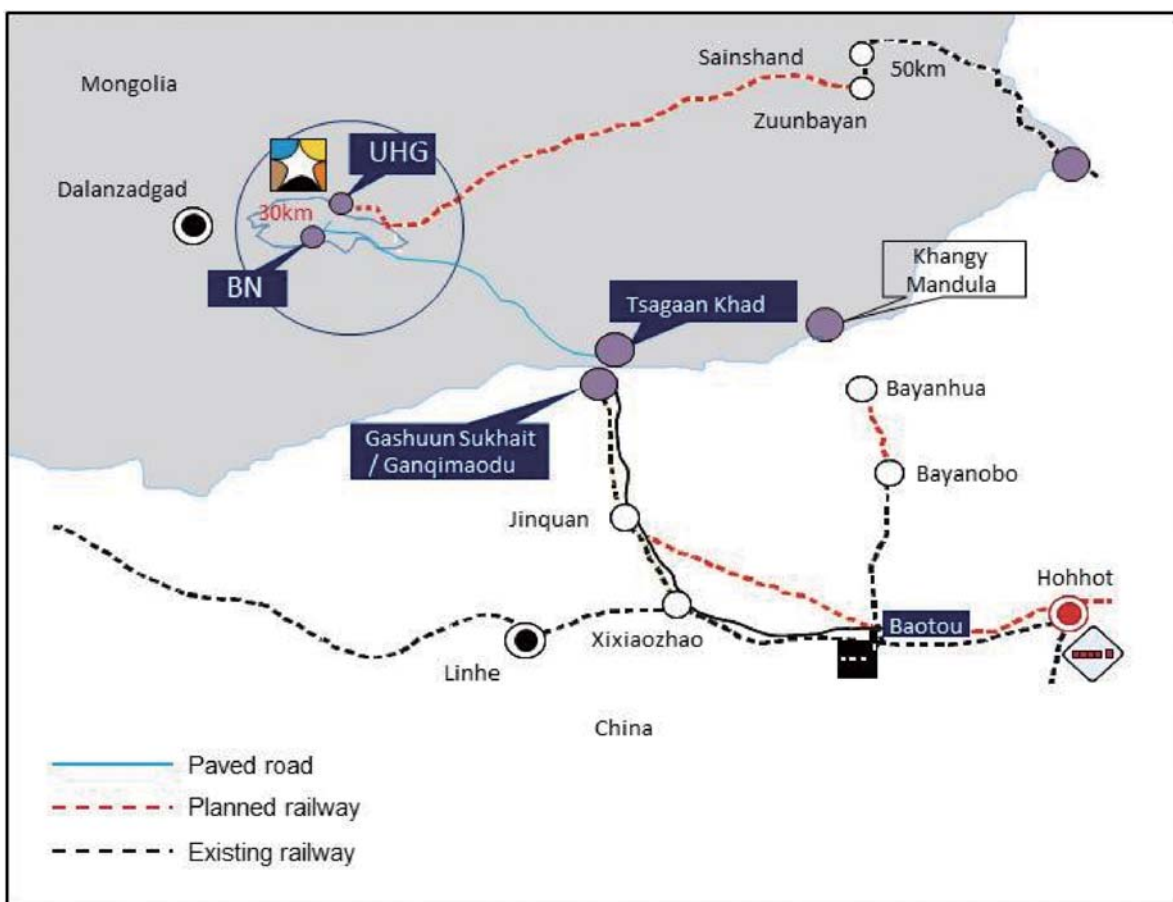
Recent Developments

New Standard Bank Facilities Agreement

On March 8 2012, we entered into the New Standard Bank Facilities Agreement, pursuant to which Standard Bank and potentially a syndicate of lenders have agreed to make available to us term loan facilities of up to US\$300 million. We plan to draw down US\$50 million under the facilities on March 14, 2012 for our cash needs and US\$150 million on March 23, 2012 to repay a portion of the outstanding amount under the Existing Standard Bank Facilities Agreement.

Our Location and Licenses

The following map shows the location of our UHG and BN deposits and our existing and proposed transportation infrastructure. See “– BN Mine” for further information on our BN mine.



South Gobi Province, Mongolia's largest aimag by territory, has a population of approximately 60,855 and is divided into 15 soums. Our UHG deposit is located in the Tsogttsetsii soum of South Gobi Province. A small town site located approximately 7 km from our mine serves as an administrative and logistical center for our UHG mine. The mine itself is located approximately 540 km south of Ulaanbaatar and approximately 240 km from the Sino-Mongolian border.

We have constructed and operate an airstrip just north of Tsogttsetsii soum. We use this airstrip principally for staff rotations. In addition to flights operated by us, commercial airlines currently operate six scheduled flights per week from this airstrip.

We hold Mining License MV-11952 covering our UHG deposit located in the Tavan Tolgoi coal formation located in South Gobi Province, Mongolia. Our license area covers 2,960 hectares and was initially issued on August 29, 2006 by the former Mineral Resources and Petroleum Authority for a period of 30 years, extendable twice, each for an additional 20 years, subject to certain conditions. Our license does not specify what kind of mining method we are permitted to use. We pay US\$5 per hectare annually as a license fee. Our UHG deposit is one of six separate deposits of the greater Tavan Tolgoi coal formation, which consist of the Borteeg, Bortolgoi, Eastern, Southwest, Tsankhi and UHG deposits.

In July 2006, the 2006 Minerals Law was adopted, which introduced the concept of a Mineral Deposit of Strategic Importance. See “Risk Factors – Risks Relating to our Business and Industry – The Government of Mongolia could determine that any one or more of our projects in Mongolia is a Mineral Deposit of Strategic Importance and could take an equity, production, profit sharing or other interest in any of our projects”. The 2006 Minerals Law stated that the Government of Mongolia had the right to participate up to 50% jointly with private entities in the exploitation of a Minerals Deposit of Strategic Importance in situations where exploration funded by the Government of Mongolia was used to determine the proven reserves of the deposit.

When we were granted our mining licenses on August 29, 2006, we paid US\$1,000 as a service fee for the conversion of each of these licenses into mining licenses. We did not pay any consideration for the acquisition of any underlying “original materials and reports on prospecting and exploration work” in relation to the six exploration licenses. In February 2007, the Parliament declared that the six mining licenses originally held by us to be Mineral Deposits of Strategic Importance under the 2006 Minerals Law. After taking into consideration the economic development policies of Mongolia, we decided to sign the Minerals License Transfer Agreement, pursuant to which we agreed to transfer five of our six mining licenses to the Government of Mongolia. We assumed no liability after these five mining licenses were transferred to the Government of Mongolia. We received no cash consideration for the transfer of five of the six mining licenses to the Government of Mongolia. In the year ended December 31, 2007, we wrote off US\$3.5 million, almost all of which relates to the write-off of the carrying amount of the relevant capitalized drilling and exploration expenditures to profit and loss. Our UHG deposit was on the list of Mineral Deposit of Strategic Importance, but having entered into the Minerals License Transfer Agreement with the Government of Mongolia, the Government of Mongolia guaranteed that our mining license would not be terminated or amended by requiring state equity participation on the development.

Our Mongolian counsel, Economic & Legal Consultancy LLC, has confirmed that the Minerals License Transfer Agreement is valid, binding and enforceable in accordance with its terms and is binding on the Government of Mongolia. Economic & Legal Consultancy LLC has also confirmed that the Government of Mongolia has under the Minerals License Transfer Agreement waived its right under the 2006 Minerals Law to participate jointly with us (by compulsorily taking a 50% or other ownership interest in ER LLC or the relevant minerals) in the exploitation of the minerals deposit covered by Mining License MV-11952, or withhold any further permits or licenses or access to infrastructure necessary for such exploitation provided that we apply for the same in accordance with relevant rules. See “Risk Factors – Risks Relating to our Business and Industry – The Government of Mongolia could determine that any one or more of our projects in Mongolia is a Mineral Deposit of Strategic Importance and could take an equity, production profit sharing or other interest in any of our projects”.

Coal Resources and Reserves

Our coal resources and reserves are contained in our UHG deposit located within the Tavan Tolgoi coal formation and our BN deposit located in South Gobi Province. See “– BN Mine – Reserves” for a summary of our BN deposit coal resources and reserves. As of December 31, 2011, our UHG mine had 570.8 Mt and 275.0 Mt of JORC-compliant measured, indicated and inferred coal resources and proved and probable reserves, respectively. Since the commencement of mining operations, all of our coal production has been from our UHG deposit, although we expect to commence production of limited volumes of coal at our BN deposit in 2012. According to Shanxi Fenwei, we have one of the largest coking coal resource bases in Asia.

The following table sets out our estimated resources and reserves at our UHG deposit as of December 31, 2011:

Summary of Our Coal Reserves⁽¹⁾⁽²⁾

	<u>Proved</u>	<u>Probable</u>	<u>Total</u>
		(Mt)	
UHG deposit	180.0	95.0	275.0

Summary of Our Coal Resources⁽¹⁾⁽²⁾⁽³⁾

	<u>Measured</u>	<u>Indicated</u>	<u>Inferred</u>	<u>Total</u>
			(Mt)	
UHG deposit (open-pit)	195.9	205.3	11.7	412.9
UHG deposit (underground)	—	88.6	69.3	157.9
Total UHG deposit	<u>195.9</u>	<u>293.9</u>	<u>81.0</u>	<u>570.8</u>

Notes:

- (1) *These numbers have been prepared in accordance with the JORC Code.*
- (2) *For our deposit, “open-pit” refers to coal deposits shallower than 300 m from the surface and “underground” refers to coal deposits deeper than 300 m from the surface.*
- (3) *Resources are a less accurate measure when compared to reserves. See “Risk Factors – Risks Relating to our Business and Industry – The accuracy of our resources and reserves estimates are based on a number of assumptions and we may produce less coal than our current estimates”.*

According to Norwest, bulk sampling and drill-hole sampling programs by Russian-Mongolian geologists and later by other international exploration and mining companies have accumulated sufficient data to identify significant coking coal resources in the Tavan Tolgoi coal formation. The Tavan Tolgoi coal formation is one of the few remaining largely unexploited sources of high-quality coking coal in the world. Of the 13 coal seams identified in our UHG deposit, five seams (0C, 3, 4, 8 and 9) are known to have favorable coking properties. Norwest has further distinguished between coking and thermal coal in our resource estimates. They have assumed that the traditional Tavan Tolgoi coking coal seams, namely seams 0C, 3, 4, 8 and 9, will principally be of coking quality in our UHG deposit. Additional testing and study within our UHG deposit may reveal that other seams also have coking qualities.

The following table sets out the proportion of our resources that are of coking and thermal quality, as of December 31, 2011:

	<u>Measured</u>	<u>Indicated</u>	<u>Inferred</u>	<u>Total</u>
	(Mt)			
UHG deposit (open-pit)				
Coking coal	126.1	164.2	–	290.3
Thermal coal	69.8	41.1	11.7	122.6
Subtotal	195.9	205.3	11.7	412.9
UHG deposit (underground)				
Coking coal	–	50.7	42.2	92.9
Thermal coal	–	37.9	27.1	65.0
Subtotal	–	88.6	69.3	157.9
Total	195.9	293.9	81.0	570.8

We are continuing exploration activities, such as a program to increase the drilling density across the entire UHG deposit to a 500 m by 500 m spacing, with a view to establish a more detailed understanding of our deposit and in order to determine whether additional seams contain coking coal or coal that can be blended with coal from other seams to produce hard coking coal products.

Coal Production and Ramp-Up Schedule

The following table sets forth our production volumes, sales volumes, overburden strip and stripping ratio for the periods indicated:

	<u>Year ended December 31,</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>
	(Mt, except for ratio)		
ROM coal production	1.8	3.9	7.1
Average stripping ratio (BCM/t)	3.4	5.1	5.2
Coal sales	1.4	3.9	4.8

The following table sets forth our ramp-up schedule for coal production capacity:

<u>Year Ending December 31,</u>	<u>Estimated ROM Coal Production</u>
	(Mt)
2012	10.7
2013	14.7
2014	15.2

Coal Products

The coal in our UHG deposit is Permian coal, the majority of which we wash before selling to make it more marketable. Coking coal is produced as the primary product after washing and processing, providing a quantity of thermal coal from the remainder as a secondary product, known as middlings. Thermal coal is also available without processing from seams with lesser coking qualities. We currently use the middlings we mine in our onsite power plant. In the future we may blend coal from our different seams in order to optimize the economics of the coal we sell.

The first and second modules of our CHPP, each with ROM coal nameplate processing capacity of 5.0 Mtpa, have been in operation since June 2011 and February, 2012, respectively. We began constructing the third module with ROM coal nameplate processing capacity of 5.0 Mtpa in August 2011 and expect to complete construction by the end of 2012. We are able to produce HCC, SHCC and thermal coal from our UHG mine. The type of coal we produce will depend on the specific seam being mined at the time and adjustments to our CHPP. We produce HCC from the coal mined from seams 0C, 3A, 3B, 3C, 4A, 4B, and 4C and thermal coal from our other seams and from the middlings produced by our CHPP. Our UHG deposit contains a significant amount of high quality thermal coal which we may mine and sell in the future depending on transportation costs and market prices.

We currently produce washed HCC at our UHG mine. We believe that our HCC is viewed by most consumers as high-quality coking coal and is readily used by coke manufacturers and steel producers both in China and abroad. The Chinese classification of coking coal differs from common international standards, with many of the attributes for which we test omitted. The following table compares our UHG coking coal with two well-known coking coal brands in China which share the same testing parameters as our UHG coking coal:

Quality Attribute	HCC			SSCC		
	UHG	Liulin, Shanxi	Australia	BN	Linfen, Shanxi	Australia
Ash %	9.4%	10.3%	8%	10%	8%	10.5%
Volatile Matter % (ad)	25%	21.6%	24%	30-32%	32-36%	32%
Total Sulfur % (ad).	0.6%	0.36%	0.55%	0.5-0.6%	0.6%	0.8%
G Index	85	86	85	70-90	75-85	82
Y Index	14	16	15	11-14	11-12	12
CSR ¹	64.8	70	65	30	35	36

Source: Shanxi Fenwei

Our HCC competes directly with these (and similar) coking coal in the Chinese market. According to Shanxi Fenwei, there are no outstanding quality characteristics that justify significant discounts (or premiums) to these premium brands of Chinese coking coal.

Extensive exploration and coal quality assessment indicate that our coal compares favorably with international coal. Our HCC ranks high in the CSN parameter. Conversely, our coal ranks at the lower end of sulfur content. With the exception of phosphorus content, our coal falls within the acceptable-to-premium quality parameter ranges. According to Shanxi Fenwei, our coking coal competes favorably within a defined TMR in China which includes major steel mills which are the principal consumers of coking coal. In addition, according to Shanxi Fenwei, while our thermal coal is of high quality, it is less competitive (cost-wise) than thermal coal supplied by existing Chinese suppliers.

Mining Operations

We engage in open-pit mining at our UHG deposit with primary overburden stripping and coal mining being handled by hydraulic excavators and trucks. The typical open-pit mining process begins with land clearing. We then strip the top soil from the area to be mined and the waste dump area. We remove the top 10-15 meters of soft waste materials without drill and blasting, depending on the hardness of the waste materials. A combination of drilling and blasting is then used to fragment the overburden, which is removed by excavators and rear dump trucks. Coal is loaded by excavators into rear-dump trucks and deposited at our CHPP ROM coal stockpile for processing. Mining operations are conducted through two 12-hour shifts, 7 days a week, 365 days a year, subject to weather conditions. Since our operations commenced in 2009, our mining activities had been suspended for a total of eight days due to weather conditions.

We cooperate with Leighton, our mining contractor, and work closely with it in all aspects of our coal mining operations at our UHG mine. Leighton has over 30 years of experience in Asia and we believe it is a world-class mining operator. As of December 31, 2011, we were the largest customer of Leighton in Mongolia. In January 2009, we signed the currently effective UHG coal mining agreement with Leighton through January 31, 2016 to conduct coal mining operations at our UHG mine. Leighton provides us with consulting and support services, which include full technical review of mining proposals from any stage of development, pre-feasibility and budget mining studies, pit, dump and hauling optimization, mine design, planning and budgeting, and resources at the site, comprising of expatriate personnel, mining fleet, appliances and other equipment. Actual mining activities are supervised by Leighton and conducted by our employees who have been trained by Leighton personnel. We pay Leighton on a monthly basis for manpower, general costs incurred, equipment rent and maintenance. These fees are recorded as mining costs under our cost of revenue. See “Financial Information – Factors Affecting Results of Operations and Financial Condition”. Costs relating to Leighton include plant rate, wages of Leighton’s expatriate staff and overhead, hourly usage fees and contractor fees. Plant rate primarily includes costs related to the depreciation, repair and maintenance of the mining equipment used at our UHG mine and also includes costs associated with major repair provisions, insurance and financing costs. The contractor fee is proportional to Leighton’s agreed investment in the mining equipment, supplies and infrastructure used at our UHG mine. Additional incentive payments are based on key performance indicators, which may be adjusted mutually by the parties, such as safety, environment, production and costs maintenance. In addition, Leighton has agreed to work with us to build out our coal production capacity from 10.0 Mtpa to 15.0 Mtpa. The agreement may be terminated by either party for cause or after four years and includes the right to reset the contract period if our mine capacity is expanded and an equipment buyback mechanism.

Substantially all of the principal mining equipment used in our UHG mine is owned by Leighton. Leighton is one of the world’s largest purchasers of mining equipment and is able to realize significant savings in equipment purchase cost. Leighton sources a large proportion of the mining equipment from internationally recognized equipment manufacturers such as Caterpillar, Liebherr and Hitachi. Leighton has agreed to acquire such additional equipment to support the production ramp-up at our UHG mine. This additional equipment will also be owned by Leighton. We pay an hourly usage fee for the use of the equipment owned by Leighton at our UHG mine on a monthly basis. Pursuant to the equipment buyback mechanism provided in the agreement with Leighton, we have the option to buy all the equipment, spare parts and consumables Leighton has provided to us for our mining operations. We are able to acquire such assets at their carrying value after depreciation and pay the break costs of the leases and other associated expenses. Our contractual arrangement with Leighton allows us the flexibility to amend and renegotiate the agreement based on our further ramp-up and increase in coal production volumes and Leighton’s investment in the equipment used at our UHG mine. Critical to our production capacity expansion to approximately 15.2 Mtpa in 2014 will be the ability to acquire sufficient mining equipment. Leighton has agreed to procure the necessary amount of

equipment to support this expansion. Our arrangement with Leighton has historically allowed us to ramp up our UHG production in a relatively short period of time without having to incur equipment capital costs. See “Risk Factors – Risks Relating to Our Business and Industry – We rely on our contractors to perform key aspects of our operations”.

We generally use larger excavators and mining trucks to extract and transport overburden and use smaller excavators and mining trucks for coal extraction and transport. While some of the smaller equipment will be slowly replaced, we will continue to use excavators and mining trucks of different sizes depending on practical necessity. Given our mine production ramp-up plans, we have worked together with Leighton to implement an equipment procurement and use schedule to maximize the use of the existing equipment.

Leighton is responsible for the repair and maintenance of all the equipment it procures for our operations. Leighton has signed maintenance and repair contracts with Liebherr, Caterpillar and Hitachi to provide on-ground support. The equipment manufacturers have pledged to support their products within Mongolia, and have provided Leighton with preferential maintenance and repair contract pricing.

Coal Handling and Preparation Plant

We cooperate with Sedgman to operate our CHPP designed as a customized washing plant coal to maximize our coking coal product yield. We contracted with Sedgman to construct the plant in three modules each with a ROM coal nameplate processing capacity of 5.0 Mtpa. We have completed construction of and commissioned the first and second modules of our CHPP. The first and second modules of our CHPP, each with a ROM coal nameplate processing capacity of 5.0 Mtpa have been in operation since June 2011 and February 2012, respectively. We began constructing the third module with ROM coal nameplate processing capacity of 5.0 Mtpa in August 2011 and expect to complete construction by the end of 2012. The ramp-up of our CHPP coincides with the ramp-up of our coal mine production at our UHG and BN mines. Our CHPP is designed to operate year round in Mongolia’s weather conditions. With the commencement of operations of our CHPP, we have shifted our production from raw coal to washed coal, which we sell directly to end-use customers under our own brand, thereby increasing our market recognition and competitiveness. According to Shanxi Fenwei, the design of our CHPP is equivalent to those of BHP and Rio Tinto in Australia.

We signed our first EPCM contract with Sedgman in March 2009 for the construction of the first module of our CHPP, and in June 2010 and August 2011, we signed contracts with Sedgman for the second and third modules of our CHPP, respectively. Our payments to Sedgman are based on the actual costs incurred, including costs relating to the front-end engineering, engineering design, procurement management, construction management and plant commissioning stage of the project. Each EPCM contract expires on the practical completion date of the respective module. We also signed a contract for operations management services (“Operations Management Contract”) with Sedgman in December 2010 for the first module of our CHPP for a term of three years beginning in January 2011. Under the Operations Management Contract, our employees will be trained by Sedgman and will operate our CHPP under the management of Sedgman personnel. We have agreed to pay Sedgman fixed site-management labor costs, off-site technical support and variable costs such as management fee and disbursements. The management fee that we pay Sedgman is subject to key performance indicators that are tied to process efficiency, plant utilization rate, operation availability rate, consumables and utility rates, in-feed rates and operating hours. A production performance penalty arrangement has been included in the Operations Management Contract to incentivize Sedgman to meet and surpass our CHPP production targets. We are in the process of negotiating with Sedgman to include the second and third module of our CHPP in the Operations Management Contract.

In 2011, our CHPP processed a total of approximately 2.5 Mt of ROM coal to produce approximately 2.0 Mt of total coal products, representing an average combined yield of 78.7%. Our washed coal production was approximately 1.6 Mt and thermal coal production in the form of middlings was approximately 0.4 million, representing primary product yield of 63.3% and secondary by-product yield of 15.4%, respectively. Our washed coal product yield of 63.3% compares favorably to the 55.0% yield that most Chinese producers are able to achieve.

Power Plant

In October 2011, we commenced operation of a 3x6 MW on-site coal fired power plant, which is principally used to power our CHPP and also provide excess power to areas around the mine. We cooperate with MCS International to operate our power plant. Our power plant uses a mix of thermal coal and middlings from our CHPP and is designed to comply with applicable environmental regulations of the World Bank and other international institutions. Our power plant has been fully operational since October 2011 and supplies substantially all of the power supply at our UHG mine and is backed up by our 4x2 MW diesel power generators to provide additional power during peak use periods. The Tavan Tolgoi area is expected to be connected to the central power grid via transmission line built with government funds by the end of 2012, thus expanding our power source options.

Water Supply Facility

We commenced operations of our water supply facility, which principally supplies water to our CHPP, in 2011. Our operations currently depend on a single source of water in the Naimant depression which is located approximately 20 kilometers north of our UHG mine. We have the right to extract water from the aquifer for 20 years (extendable for an additional five years upon the satisfaction of certain conditions) under the Water Use Agreement signed in May 2011 between the Governor of Tsogttsetsii soum and Ukhaa Khudag Water Supply LLC. Water is piped from the aquifer to our water supply plant at our UHG mine which can supply up to 117 liters per second. The majority of our water use is by our CHPP, which uses the water to wash coal. The processing scheme at our CHPP is designed to ensure optimum water use efficiency with a target of approximately 95% of the used water being recycled. We have signed a consultancy service contract with Aquaterra, under which it designs the local control measures to manage contaminated water at individual process facilities.

We plan to expand capacity by approximately 100 liters per second in 2012 to meet the increased demand of water for the third module of our CHPP, dust suppression, power stations and domestic use. We plan to extract water from a second water supply in Naimdain Khundii. We have conducted a survey of the Naimdain Khundii area and expect to extract approximately 25% of the water in the aquifer. Our subsidiary, Khangad Exploration LLC, previously held three water usage certificates. The term of one certificate (for purpose of minerals exploration) has expired and has not been extended or renewed, because Khangad Exploration LLC has not commenced washing coal. We believe the other two water usage certificates for mine camp operations are adequate for the operations of Khangad Exploration LLC. See “Risk Factors – Risks Relating to Our Business and Industry – We currently rely on a single source of water for all of our operations”.

Suppliers

We have established a network of over 600 local and international suppliers who provide us with contracting services, fuel, equipment and other ancillary materials and services. For years ended December 31, 2009, 2010 and 2011, our five largest suppliers accounted for approximately 59.1%, 48.0% and 46.1%, respectively, of our total purchases, while, Leighton, our largest supplier for years ended December 31, 2009, 2010 and 2011 accounted for approximately 25.1%, 18.2% and 21.9%, respectively, of our total purchases for the same periods. Our five largest suppliers in 2011 were:

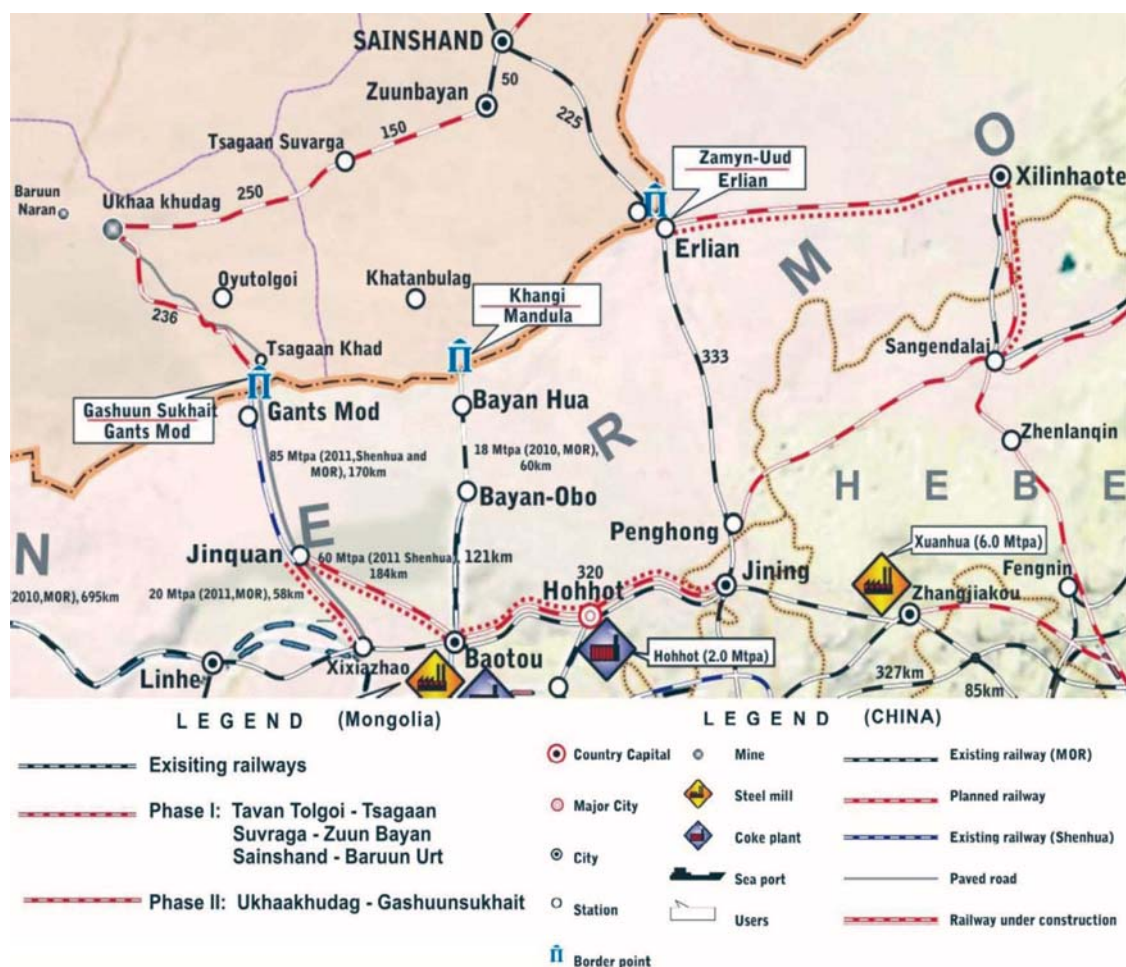
- *Leighton.* Leighton is our mining contractor at our UHG mine and assists in mine planning, training of mining personnel and the supervision of mining activities, and sources a large proportion of the mining equipment used to mine our coal. See “– Mining Operations” for further information on our relationship with Leighton.
- *NIC.* NIC, a leading oil product importer and retailer in Mongolia, supplies us with fuel. We expect NIC to complete a 6-million-liter fuel storage facility at UHG by September 2012 which will store on-site fuel required for approximately one month of our operations. NIC also stores 20 million liters of fuel at its own storage facility to provide us with two to three months of backup fuel in the event of a fuel shortage or large price increase. See “Risk Factors – Risks Relating to our Business and Industry – Increases in the costs, or our accessibility to sources, of fuel could negatively affect our operating costs or disrupt or delay production”.
- *Sedgman.* We engaged Sedgman to assist in the on-going construction and operation of our CHPP. See “– Coal Handling and Preparation Plant” for further information on our relationship with Sedgman.
- *SINOTRUK Export & Import Co.* Sinotruk supplied us with 300 heavy haul road trucks in 2011 for our coal transportation.
- *MCS International.* MCS provides operational, maintenance and engineering services for power and heat generation and distribution, and acts as our representative for the construction and commissioning of our CHPP.

Logistics and Transport

We, together with third-party trucking companies, haul our coal by truck to GM, located on the Chinese side of the Sino-Mongolian border, where our customers pick up and further transport the coal to their final destinations in China. The total length of the transportation is approximately 250 km between our UHG mine and GM.

We completed construction of a paved road parallel to the existing coal transport gravel road from our UHG deposit to GS in September 2011 and commenced operation of the road in October 2011. Our paved road is the only paved road in the Tavan Tolgoi area that connects from a mine field to the Sino-Mongolian border. The paved road has capacity for up to 18.0 Mtpa of coal per year, while we currently transport approximately 10.0 Mtpa. We have commenced construction of a paved road, which we expect to complete in the fourth quarter of 2012, that will connect our UHG and BN mines. In January 2012, we, together with Erdenes MGL, completed and commissioned an expansion of the Mongolian side of the border crossing at GS. Once operations at the border crossing are fully ramped up, we believe the border crossing capacity will increase from 10 Mtpa prior to expansion to approximately 20-30 Mtpa and it will be able to handle approximately 1,200 trucks in a single direction per day, compared to 400 per day prior to the expansion. In order to further improve

reliability and reduce transportation costs and increase transportation capacity, we plan to commence construction of a railway directly from our UHG deposit to GS in 2012. Our UHG-GS railway is expected to have a capacity of 15.0 Mtpa once completed, upgradeable to 30.0 Mtpa. While our UHG-GS railway is intended to primarily serve our own operations, any excess will also be able to serve other mines. See “Risk Factors – Risks Relating to our Business and Industry – Our UHG-GS railway is subject to various risks and uncertainties; we are not sure when we can commence and complete construction of the railway, what the actual cost of the project will be, or whether the project will be successful” and – Railway”.



Once our coal crosses the Sino-Mongolian border, it is transported via Jinquan, Inner Mongolia, then to the city of Baotou, Inner Mongolia and other destinations. Proximity to Baotou is of strategic importance to Mongolian coking coal producers for its railway network which provides access to the largest steel-producing provinces of China, such as Hebei, Shandong and Jiangsu. Through Baotou, our coal can be transported by rail to the ports in Bohai Sea such as Tianjin, Qinhuangdao, and Huanghua, which potentially allows our coal to be sold in other coastal areas of China or the international seaborne market, subject to obtaining requisite approvals and licenses to export coal from China.

We have established a customs-bonded yard at our UHG mine, which allows our coking coal to clear customs onsite, greatly improving the border crossing rate at GS and increasing the total amount of coking coal we are able to sell into China. We have begun sending shipments directly from our customs-bonded yard at our UHG mine to GM and plan to gradually increase these shipments in 2012.

To assess the feasibility of expanding our product penetration to other markets, in July 2011 we conducted trial exports by railway to Germany and to the far eastern Russian port of Nachodka for shipment to seaborne markets, which in the future could possibly include Japan, South Korea and India.

Trucking fleet

We and our hauling contractors transport most of our coal sold into China from UHG to the Mongolian side of the border at GS and then on to GM where customers are responsible for arranging transportation to their final destinations. We operate a transshipment and handling stopover at TKH, approximately 21 kilometers from GS, where a majority of the coal transported by double-trailer trucks from UHG to TKH is first stockpiled and then sent to GM in single-trailer trucks in order to maximize the efficiency of our truck fleet. A portion of our coal is delivered directly from UHG to GM in double-trailer trucks. In 2011, we expanded our truck fleet by acquiring 300 heavy haul double-trailer trucks, each capable of carrying up to 140 metric tonnes of coal. This expansion allows us to significantly increase our coal haulage capacity while reducing dependency on trucking contractors. The estimated capacity of our own trucking fleet as of December 31, 2011 for coal hauling from our UHG mine to GM was approximately 2.7 Mtpa. We may consider acquiring an additional 100 trucks in 2012.

We plan to continue to increase the amount of coal we directly haul to GM, while maintaining a stockyard and handling base at TKH in order to mitigate the risk of traffic jams at or a closure to the border crossing due to public holidays, weather conditions or other reasons. Our subsidiary Trans Gobi is permitted to carry out transportation across the Sino-Mongolian border to deliver coal to GM and our third party trucking contractors are also permitted to carry out cross-border transportation. We do not deliver our coal to any locations in China other than GM and our customers are responsible for the transportation of our coal from GM to the end destination.

Paved Road

Prior to the completion of our paved road, we used a gravel road for coal trucking which was also used by the small coal mine operated by Small TT. In order to increase transportation capacity, improve reliability and reduce transportation costs, we constructed a 245 km paved road parallel to the existing coal transport gravel road from our UHG mine to GS. This two-lane heavy-haul coal transport road bears an axle load of 18-20 tonnes and is designed to accommodate up to 2,000 trucks of daily traffic density with 18.0 Mtpa capacity of coal transportation from our UHG mine to GS. After 10 months of construction, we completed construction of the paved road in September 2011, and it commenced operation in October 2011. All coal originated from our UHG mine is now being transported on the paved road.

We obtained land possession rights for our paved road without paying any consideration, but we are required to pay a MNT1.6 million (US\$1,134.6) land fee per annum for our paved road. The paved road was built under the license awarded to Gobi Road LLC, an indirect wholly owned subsidiary of us, by the Government of Mongolia under Government Resolution No. 83 of 2010 dated March 31, 2010 and the subsequent Build-Operate-Transfer Agreement (the “BOT Agreement”) executed by and between Gobi Road LLC and the Ministry of Road, Transportation and Urban Development of Mongolia on June 9, 2010. Under the BOT Agreement, Gobi Road LLC was granted a right to build,

operate and use the paved road for a period of ten years after the date on which it is commissioned for service. Upon the expiration of the BOT Agreement, we will be required to transfer all of our rights and obligations with respect to the operation and maintenance of the paved road under the BOT Agreement to the Government of Mongolia for no consideration.

Out of the 18.0 Mtpa capacity of coal transportation of the paved road, we intend to use up to 15.0 Mtpa. If excess capacity is available, Gobi Road LLC may allow any other third parties licensed to engage in transportation activities under the relevant Mongolian laws to use the paved road on a toll fee basis. We are in negotiation with third-party users with respect to the use of excess capacity on a toll fee basis. We intend to use a portion of these tolls to offset the costs we incurred in constructing, maintaining and operating this paved road. Gobi Road LLC, its investors and contractors have the priority to use the paved road.

Upon the expiration of the BOT Agreement in 2020 and transfer of all the rights and responsibilities with respect to the operation and maintenance of the paved road to the Government of Mongolia, we expect to be able to continue to use the paved road by paying the tolls and tariffs determined by the Government of Mongolia. Prior to the completion of our UHG-GS railway project, we anticipate using the paved road as our primary transportation link to China.

The paved road has significantly increased the amount of coal we are able to transport for sale into China and reduced our transportation costs, thereby having a direct positive impact on our profitability. The paved road has also reduced the negative environmental and social impact caused by coal trucking operations on the gravel road we previously used.

We plan to transport coal from BN to our CHPP at UHG for processing. We have completed all surveys, design and licensing for an approximately 30 km paved road connecting our UHG and BN mines and commenced construction in 2011. We expect to complete construction in the fourth quarter of 2012.

Border Expansion

In January 2012, we, together with Erdenes MGL, completed and commissioned an expansion of the GS border crossing, in order to alleviate bottlenecking at the border crossing and support our ramp-up plan. The expansion will increase the current border crossing capacity at GS from approximately 10 Mtpa to 20-30 Mtpa. It consisted of adding eight truck crossing lines and associated facilities and infrastructure to the existing four lines and will now be able to handle 1,200 trucks in a single direction per day, compared to 400 per day prior to the expansion. In January 2012, the expansion was commissioned by the state authorities of Mongolia and commenced operations on the Mongolian side.

Railway

In order to lower our transportation costs and increase reliability and operational efficiency, we intend to commence construction of a railway directly from our UHG mine to GS in 2012. See “Risk Factors – Risks Relating to our Business and Industry – Our UHG-GS railway is subject to various risks and uncertainties; we are not sure when we can commence and complete construction of the railway, what the actual cost of the project will be or whether the project will be successful”.

Government policy

In 2010, the Government of Mongolia presented a new policy paper to the Parliament regarding the proposed expansion and development of railway network in the country. The policy paper discussed the need for new railway infrastructure for new mining projects being developed or planned around the country. As Mongolia is a broad gauge country using Russian railway technology, and the railways proposed for construction at that time mainly planned to use standard gauge rail, the Ministry of Road Transport of Mongolia and Urban Development also intended to set a clear policy on the efficient interconnectivity and interoperability of the country's rail systems. Although at that time we had already obtained the key licenses to proceed with construction of our UHG-GS railway, we decided to delay construction to allow the Government of Mongolia to present its policy paper.

In June 2010, the Parliament passed Resolution No. 32 announcing its railway development policy. According to the policy, railway development will be conducted in three stages: (1) Tavan Tolgoi-Sainshand-Choibalsan railway, (2) our UHG-GS railway and other railways that go directly to the border of Mongolia and (3) railways going to western Mongolia from Tavan Tolgoi. The policy also specified that broad gauge rails would be used for crossing or connecting to existing railways, and use of standard gauge rails at the border will be discussed and decided by the Parliament at a later time. The policy left uncertain the starting time for construction and the gauge of those railways in the second stage. In June 2011, the Government of Mongolia announced that construction of second stage railways may proceed simultaneously with construction for the first stage. As of the date of this offering memorandum, the Parliament has not selected which gauge to use for our UHG-GS railway. We plan, subject to the additional requirements described in “– License and Land Use” below, to begin constructing our UHG-GS railway after the Government of Mongolia announces which rail gauge must be used for our UHG-GS railway.

Licenses and land use

The Government of Mongolia issued Resolution 252 dated June 18, 2008 granting us the license to build our UHG-GS railway base infrastructure between UHG and GS for an initial three-year term beginning from January 19, 2009 and subsequently extended for three years beginning from January 19, 2012. We entered into the license agreement for railway construction with the Railway Authority of Mongolia on September 5, 2008 and a detailed supplement to the license agreement on January 19, 2009. The terms of such license agreement include, among others: (1) our preemptive right to use our UHG-GS railway; (2) if excess capacity is available, we have the right to allow third parties to use our UHG-GS railway; (3) tariffs for the access of infrastructure and transportation will be set by us in accordance with Mongolian laws based on commercial principles; and (4) the majority ownership of our UHG-GS railway infrastructure will be transferred to the Government of Mongolia after 30 years. After the Government of Mongolia has selected which gauge must be used in our UHG-GS railway as described in “– Government policy” above, we plan to apply to the Railway Authority of Mongolia to amend the license agreement to comply with current Mongolian laws and policies. We will also be required to obtain a construction permit before we can commence construction of our UHG-GS railway.

The commercial principles to be used to guide our tariff settings are demand, cost and competitive alternative considerations. The Government of Mongolia does not have any direct influence on the tariff, aside from stipulating that it must comply with relevant laws and regulations, such as the unfair competition law. However, the Government of Mongolia will set a formula to determine the access fee (tariff) for use of our UHG-GS railway base infrastructure. The formula to be used to calculate the fee has not been set and the Government of Mongolia intends to seek assistance from international experts to help develop such formula. Aside from this formula, railway usage fees will be set independently by us.

According to current agreed terms of such license agreement, the majority ownership of our UHG-GS railway infrastructure will be transferred to the Government of Mongolia 30 years after the date of commissioning. The amount of consideration and other terms relating to this transfer are not currently specified in such agreement, but we expect to engage directly with the Government of Mongolia when the contract term nears completion. There is no renewal clause in such agreement. In addition, the Government of Mongolia may at any time take control of our UHG-GS railway.

We hold the land possession rights for the land strip underlying our planned UHG-GS railway of 6,740 hectares for 60 years commencing August 7, 2009. Upon obtaining these land possession rights, we did not pay any consideration to the Government of Mongolia. Under relevant laws and regulations, we are obligated to pay land fees on a quarterly basis. The land fee associated with the land possession rights for our UHG-GS railway is MNT27.2 million (US\$19,288) per year.

Design and Construction Plan

We engaged Deutsche Bahn, a German national railway company, to conduct a feasibility study for our UHG-GS railway and outline a design. We selected Snowy Mountain Engineering Corporation to develop a detailed railway design and appointed Leighton as the construction contractor for our UHG-GS railway. Our UHG-GS railway will be a single-line heavy-haul freight railway of approximately 240 km in length and will be used to transport coal into China and ultimately to other international seaborne markets through GS. Based on the feasibility study conducted by Deutsche Bahn, we expect to use approximately 500 wagons and 20 locomotives on our UHG-GS railway.

We expect that it will take approximately two to three years from the construction commencement date to complete construction of our UHG-GS railway and that it will support up to 15.0 Mtpa upon completion with the possibility of expanding the capacity up to 30.0 Mtpa in the future. We have the first right to use the capacity of our UHG-GS railway. While our UHG-GS railway is intended to primarily serve our operations, it will be able to serve other mines if excess capacity exists.

In 2011, we completed detailed designs of our UHG-GS railway and final parts of the design are being reviewed by our experts. We have also completed an exploration program for ballast and stone materials for our UHG-GS railway and the results are being analyzed by independent labs.

Pursuant to a feasibility study we conducted in 2009, we estimated the total cost of constructing our UHG-GS railway using standard gauge track will be approximately US\$700 million, which will primarily include costs associated with: (1) construction of our UHG-GS railway, (2) construction of the main terminal, workshop, depots and other ancillary buildings, (3) acquisition and installation of railway signals and communication systems and (4) the ownership or lease of 500 wagons and 20 locomotives. The cost estimate does not include capitalized interests or working capital costs. In addition, we estimate that construction costs will be approximately US\$100 million higher if we use broad gauge rail.

Connection to China and alternative projects

An interconnecting railway to the Sino-Mongolian border from the Chinese side is important to linking our UHG-GS railway to the Chinese railway system, as our coking coal must pass through Baotou in order to reach the largest steel producing provinces of China. However, we plan to proceed with our railway construction if the interconnecting railway to the Chinese side of the border is not built. The Chinese Ministry of Railway has commenced construction of a railway connecting GM to Xixiaozhao that passes through Jinquan, Inner Mongolia. The Chinese Ministry of Railway already operates a railway between Xixiaozhao and Baotou. Completion of the GM-Xixiaozhao railway would allow our coal to travel from GM to Baotou using the Chinese Ministry of Railway's railway. Shenhua Group also has commenced construction of a railway connecting GM to Baotou. In order to use the Shenhua Group railway, we would need to obtain the consent of the Shenhua Group.

Mongolia and China are both members of international conventions and parties to bilateral treaties and have been working together for the last 50 years on railway interconnection, border crossing and transit initiatives. Building and connecting new railway networks to the Sino-Mongolian border are a focus of both governments and they have been successful in connecting railways from both countries at the Sino-Mongolian border crossing at Erlian. A number of bilateral trade, economic and other agreements were entered into in connection with the Erlian border crossing in order to realize its value for both countries. Both the Mongolian and Chinese governments have indicated their interest in replicating the success of Erlian to other border crossings such as GS-GM and SK-Ceke. As evidenced by the commencement of construction of a railway connecting GM and Xixiaozhao by the Chinese Ministry of Railway and the Shenhua Group (as announced in January 2009), we believe the governments will continue to work together to create more railway border crossings between Mongolia and China (including the GS-GM border crossing).

The Government of Mongolia or other parties may seek to develop an alternative railway project to connect the Tavan Tolgoi coal formation to the national railway network and beyond. We may decide to participate or be encouraged to participate in such alternative project or a portion thereof. One such alternative route would be a railway from Tavan Tolgoi to Sainshand, Mongolia and then to Choibalsan in eastern Mongolia. Any such investment or involvement may require significant capital investment and management resources. Any such involvement could be in addition to or in lieu of our UHG-GS railway. Even if we were to invest in any such alternative project, we may not have significant control or influence over the management of such project. There can be no assurance that our investment and involvement in such project, if any, would provide us with an economically attractive transportation route in a timely manner or at all or that our investment in such a project will not be lost.

Capital Expenditures

The following table sets forth our historical and forecast capital expenditures for the periods indicated:

	Year ended December 31,					
	2009	2010	2011	2012	2013	2014
					(Forecast)	
	(US\$'000)					
Capital Expenditures:						
BN coal mine	—	—	11,740	11,795	9,521	61,663
CHPP	13,573	80,218	142,252	95,210	38,675	53,669
Road	—	47,929	49,470	35,688	8,279	13,693
Railway	5,543	2,135	7,256	249,505	374,454	20,108
Water supply facility	8,024	20,658	7,718	51,500	—	—
Power plant	8,137	34,190	15,501	5,175	—	—
Property (camp, airport and workshop)	12,607	8,118	11,850	40,673	19,828	498
Trucks and equipment	7,893	4,957	44,081	—	—	—
Others ⁽¹⁾	7,181	6,836	6,266	—	—	—
Total	62,959	205,041	296,134	489,546	450,757	149,631

Note:

(1) Others include capital expenditures for exploration and expert studies.

Our forecast capital expenditures set forth in the table above represent our current estimates. We will reassess our capital expenditures from time to time in light of the then current circumstances, including without limitation our operational requirements and our financial capacity, and there can be no assurance that our actual capital expenditure will correspond to our current forecast set forth in the table above.

Marketing and Sales

Our primary activities are the mining and exploration of coal in Mongolia and the sale of coking coal. We sell our coal principally to end users which include iron and steel mills and coke and chemical plants, as well as coal traders.

For the years ended December 31, 2009, 2010 and 2011, approximately 22.8%, 39.4% and 74.0% of our coal sales were made to coke plants, respectively, 23.0%, 21.9% and 17.0% to steel mills, respectively, and 54.2%, 38.7% and 9.0% to coal traders, respectively. For the years ended December 31, 2009, 2010 and 2011, our total revenues were derived from four, nine and fourteen customers, respectively. We sell our coal mainly to China with a small amount of coal being sold on trial shipments to seaborne markets such as Japan, Korea and India and via the Transiberia railway to Germany. Our target market regions in China are Inner Mongolia, Hebei, Shandong and Jiangsu. We sell our coking coal into China pursuant to long-term agreements with a diversified group of customers by increasing the portion of end-use customers. For example, we expanded our end-user customer base in China through establishing cooperative relationship with Shenhua Bayannaoer Energy Company to supply our washed coal products to Shenhua Wuhai Energy's coke plant in Wuhai. At the same time, we recognize the importance of coal traders and will continue to cooperate with them in the future in order to support our transportation, logistics and to ensure payment settlement.

We enter into both long-term and short-term contracts with our customers. Our long-term contracts range from one to ten years with end-use customers. The duration of our short-term contracts depends on the volume and prevailing transportation capacity and typically has a term of two to three months. The principal terms of our sales and purchase contracts with customers include, among others: (1) specified volumes, (2) contract prices linked to existing market prices which are subject to periodic review and (3) delivery to TKH or GM. We may extend credit, generally for periods not exceeding 90 days, to certain of our customers with whom we have long-term contracts. In addition, our credit risk committee performs individual credit evaluations on our customers with whom we have credit exposure. Evaluations of our customers focus on each customer's financial strength, credit history, current ability to pay, as well as the economic environment in which such customer operates. The terms of our coal sales contracts result from competitive bidding and negotiations with customers. As a result, the terms of these contracts vary by customer. We have entered into long-term contracts with each of our top ten customers for the years ended December 31, 2009, 2010 and 2011, pursuant to which we and our customers determine the amount of coal to be delivered on an annual basis and the price on a quarterly or monthly basis. For a description of our key customers, see "– Customer Base" below.

We recognize revenue when ownership of the coal has passed to the customer, which is typically upon delivery of the coal to the customer. We price our coal by adopting a netback calculation of the main benchmark products with similar quality and demand sourced from Baotou, Tangshan, Shanxi and Jiangsu in China and Australia. For long-term agreements, we agree on annual target volumes and adjust prices quarterly or monthly. For one-time agreements, we adopt a netback calculation referring to the prevailing spot prices at Chinese main coal ports such as Tianjin, Caofeidian and Tangshan and the prevailing prices at the major iron and steel mills in Hebei and Jiangsu.

For the years ended December 31, 2009 and 2010, we sold only raw coal. In 2011, we sold both raw coal and washed coal. We plan to sell only washed coal and middlings beginning in the second quarter of 2012. With our CHPP, we believe we are able to produce washed coal at consistent quality levels. As a result, we are selling directly to end-use customers under our own brand. We believe this increases our average selling price and profitability compared to selling raw coal and enhances our market recognition and competitiveness.

Customer Base

The table below sets forth our top five customers by revenue for the years ended December 31, 2009, 2010 and 2011. In 2009 we had fewer than five customers. All the customers in the table below are located in China.

			Year ended December 31, 2009	
			Revenue	Percentage of Total Revenue
Customer			Customer Type	
			(US\$ in millions)	%
1.	Customer 1	Coal trading company	26.1	39.0
2.	Customer 2	Iron and steel mill	15.4	23.0
3.	Customer 3	Coke plant	15.2	22.8
4.	Customer 4	Coal trading company	10.3	15.2
Total.....			67.0	100.0

			Year ended December 31, 2010	
			Percentage of Total Revenue	
Customer		Customer Type	Revenue	
			(US\$ in millions)	%
1.	Customer 1	Coke plant	105.2	37.9
2.	Customer 2	Coal trading company	92.7	33.4
3.	Customer 3	Iron and steel mill	33.5	12.0
4.	Customer 4	Iron and steel mill	27.3	9.8
5.	Customer 5	Coal trading company	4.9	1.8
Total			<u>263.6</u>	<u>95.0</u>

			Year ended December 31, 2011	
				Percentage of Total Revenue
Customer		Customer Type	Revenue	
			(US\$ in millions)	%
1.	Customer 1	Coke plant	185.0	34.1
2.	Customer 2	Coke plant	148.6	27.4
3.	Customer 3	Iron and steel mill	73.6	13.6
4.	Customer 4	Coke plant	44.0	8.1
5.	Customer 5	Coal trading company	25.5	4.7
Total			<u>476.7</u>	<u>87.9</u>

For the years ended December 31, 2009, 2010 and 2011, revenue from our single largest customer represented 39.0%, 37.9% and 34.1%, respectively, of our revenues for that year. For the years ended December 31, 2009, 2010 and 2011, our five largest customers accounted for approximately 100.0%, 95.0% and 87.9%, respectively, of our total revenues. Our major customers include Baotou steel, Shagang, Qinghua, Risun, Elion, Winsway and Shenhua.

As of December 31, 2011, we have entered into long-term agreements with most of our end-use customers. We have entered into ten-year sales contracts with each of Baotou Steel, Shagang and Qinghua, a five-year sales contract with Risun and a three-year sales contract with Tangshan Jiahua Coke and Chemical Plant. For the year ended December 31, 2011, we generated approximately 81.2% of our revenue from sales of coking coal under our long-term coal sales contracts, and we expect to continue selling a significant amount of our coking coal under long-term coal sales contracts in the future. We have already contracted to sell all of our scheduled production of coal for the year ending December 31, 2012 pursuant to the terms of our long-term agreements. However, our customers are allowed to adjust the amount of coal they will purchase, subject to mutual agreement. In 2011, the average selling price was US\$155.6 per tonne for our washed coal, US\$95.0 per tonne for our raw coal and US\$34.0 per tonne for our middlings.

Quality and volumes for the coal are stipulated in our coal sales contracts, and in some instances our customers have the option to vary annual or monthly volumes. All of our coal sales contracts contain provisions requiring us to deliver coal within certain ranges for specific coal characteristics such as total moisture, ash, volatile matter and sulfur content. Some of our coal sales contracts specify approved locations from which coal must be sourced. Failure to meet these specifications can result in economic penalties, suspension or cancellation of shipments or ultimately termination of the agreements. Some of our contracts set out mechanisms for temporary reductions or delays in coal volumes in the event of a force majeure, including events such as fire, flood, war, conflict, military actions, quarantine, natural disaster, strikes, uprising, rioting, demonstration, epidemic, explosion, introduction of a ban or prohibition, or any other conditions beyond the control of any party. The party who is not able to perform its obligation due to force majeure shall deliver within five working days after the occurrence of the force majeure factor a confirmation issued by a relevant authority of the relevant country to the other party in writing. Subject to notice requirements and grace periods, if we fail to honor the agreed sales volume, customers have the right to terminate the contracts.

Competition

We sell substantially all of the coal we produce into China. Competition in the Chinese coal industry is based on many factors including, price, production capacity, coal quality and characteristics, and transportation capability and costs. There are over 600 large mines supplying coal into our TMR. Most of our competition in coking coal comes from mines in central and western Shanxi, northeast Hebei, eastern Heilongjiang, Wuhai in Inner Mongolia and Muli in Qinghai. Some of our Chinese competitors may have lower transportation costs than we do due to their location. In addition, the Chinese coal market is highly fragmented and we face price competition from some small local coal producers that produce coal for significantly lower costs than us due to various factors, including their lower expenditure on safety and regulatory compliance. Outside of China, our main competition in the Chinese coal market comes from Australia. Some of our international competitors may have greater coal production capacity as well as greater financial, marketing, distribution and other resources than we do and may benefit from more established brand names in international markets.

According to Shanxi Fenwei, our coal is likely to be most competitive and used in the following provinces in China: Inner Mongolia, Hebei, Gansu, Ningxia, Shandong and Jiangsu. These regions include the major Bohai Sea coal loading ports of Jingtang, Caofeidian and Tianjin.

We believe that our cost of production is lower than our principal competitors serving China, namely coking coal producers from China and Australia. Coking coal from China is predominantly produced from underground mines. In general, underground mining is significantly more capital intensive, costly and more operationally challenging than open-pit mining. In the last several years, mine production costs have significantly increased in Australia due to high levels of taxation, increased labor, operational and infrastructure costs, transportation capacity bottlenecks, inflation and currency appreciation. Furthermore, the mining operations in Australia are becoming increasingly mature which results in higher stripping ratios thereby yielding higher costs per tonne of coal produced.

The Government of Mongolia has publicly announced its intention to develop other coal deposits in the Tavan Tolgoi coal formation and decided to separately develop the East Tsankhi deposit and West Tsankhi deposit, which are located approximately 5 km from our UHG mine and will produce coking coal with similar qualities as our coking coal. The eastern part of the Tsankhi deposit is being developed by Erdenes Tavan Tolgoi, a subsidiary of Erdenes MGL which is a state-owned enterprise. The Government of Mongolia has announced that the western part of Tsankhi deposit is to be leased to an international consortium of miners selected through a bidding process.

BN Mine

On June 1, 2011, we completed the acquisition of our BN mine, our second mine, through the acquisition of 100% of the equity interests in Baruun Naran Limited (formerly named QGX Coal Limited).

The acquisition provided us with a unique opportunity to purchase a coking coal asset strategically located adjacent to our UHG mine in an advanced development stage and allows us to expand our existing footprint in Mongolia. We expect the sizable coking coal resources and reserves in our BN mine will allow us to target a larger customer base and to expand our product offerings to include semi-soft coking coal and high calorific value thermal coal. In addition, we believe the proximity between our BN mine and our UHG mine will enable synergies such as sharing of mining, processing and transportation infrastructure and marketing resources. We commenced operations at our BN mine in February 2012.

We acquired our BN mine from QGX Holdings Ltd., which was 90% owned by Kerry Mining (Mongolia), one of our significant shareholders, and 10% owned by MCS Minerals LLC. MCS Minerals LLC was 51% owned by Mr. Odjargal Jambaljamts (one of our executive directors and the chairman of the Board) and 49% owned by MCS Holding LLC (our controlling shareholder) at the time of the acquisition.

We hold Mining License 14493A for our BN deposit, which covers 4,486 hectares and extends for a period of 30 years from December 1, 2008 and is extendable twice, each for an additional 20 years, subject to certain conditions. We pay US\$5 per hectare annually as a license fee.

Consideration

The total consideration was US\$464.5 million, consisting of US\$100.0 million in cash, the promissory note of US\$279.5 million and the issuance of convertible bonds in the aggregate principal amount of US\$85 million (the “QGX Convertible Bonds”). See “Description of Other Material Indebtedness – QGX Convertible Bonds” for a summary of the terms thereof.

Pursuant to the acquisition agreement, the consideration may be adjusted if, approximately 18 to 21 months from the date of the acquisition agreement, May 31, 2011, an additional payment may be payable by us to the seller or a clawback may be payable by the seller to us in the amount of US\$3.00 per tonne to the extent that the total proved and probable reserves (as defined under the Australian Code for Reporting of Mineral Resources and Ore Reserves) contained in our BN deposit exceeds 150 Mt or is less than 150 Mt, respectively (the “reserve adjustment”). Pursuant to this reserve adjustment, the maximum amount payable by us to the seller will be US\$105.0 million and the maximum amount payable by the seller to us will be US\$90.0 million. We are currently obtaining a reserve report which we expect to be completed by the end of 2012 in order to determine the reserve adjustment. The consideration may also be adjusted by an additional life of mine, or royalty, payment of US\$6.00 per tonne in the event that the actual amount of coal extracted from our BN deposit exceeds a specified semiannual production target fixed on the date of the determination of total proved and probable reserves in each semiannual period after June 1, 2011 commencing on January 1 and ending on June 30 and commencing on July 1 and ending on December 31 (the “royalty provision”).

Taking into account the reserve adjustment and the royalty provision, the total amount of payment we are obligated to pay to the seller for the sale of our BN mine is not to exceed US\$950.0 million over the life of our BN mine.

Location

Our BN deposit is located in southern Mongolia, Umnugobi Aimag (Southgobi province) approximately 500 km south of Ulaanbaatar, the capital of Mongolia, and approximately 60 km east of Dalanzadgad, the provincial center. It is located approximately 30 km southwest of our UHG mine. See “– Our Location and Licenses” for a map showing the location of our BN deposit.

Reserves

According to the MBGS Resource Report, as of February 2010, our BN deposit had measured, indicated and inferred resources of 209.1 Mt, 72.6 Mt and 0.5 Mt, respectively, or total JORC-compliant coal resources of 282.2 Mt. According to the SRK Reserve Report, as of February 2011, BN deposit had 148 Mt of proved reserves and 37.3 Mt of probable reserves, or total JORC-compliant coal reserves of 185.3 Mt.

CSN	6-8
Volatile Matter %	30-32 (ad)
Ash (ad,%)	10
Sulphur (% , ad).....	0.5 – 0.6

Coal Products

We intend to produce premium semisoft coking coal at BN for processing at our CHPP at UHG. In addition, we plan to produce thermal coal for domestic and export markets at our BN mine.

According to Shanxi Fenwei, our BN coking coal is comparable to those of Shanxi and Australian 1/3 JM.

Status

We commenced operations at our BN mine in February 2012. We plan to manage and operate our BN mine with a combination of our own and leased mining equipment. We have engaged technical consultants to conduct a life-of-mine study, including an evaluation of equipment to be used at our BN mine to determine whether to mine ourselves or contract out to third party operators. ROM coal mined from our BN mine is transported to our CHPP at UHG for further processing. We plan to produce approximately 1.0 Mt in 2012 and 2013 and approximately 3.0 Mt in 2014 of ROM coal from our BN mine. ROM coal production figures at our BN mine for 2013 and 2014 are subject to completion of a life-of-mine study which is expected to be completed by the end of 2012.

Quality Control

The ability to produce coal of a consistent high quality is critical to the success of our business. We implement quality control measures from the exploration stage through the mining, hauling and loading stages of our coal production.

We engage in mine planning activities from 500 m by 500 m exploration drilling to 50 m by 50 m field test drilling for day-to-day mine planning. Core samples taken from the holes undergo an analysis covering all major coal quality parameters. Representative samples are also chosen for trace minerals analysis. This coal quality data is then entered into the geological database and ultimately incorporated into our mining plans. We take coal quality into account when we prepare mining plans to ensure consistent coal quality throughout the life of the mine. During mining, samples are taken for short-term quality projections from coal seams exposed at each operating face to confirm the data that had been collected during the exploration phase. The data is then incorporated into our short-term mining plans, which include using selective mining methods to exclude coal that does not comply with quality specifications.

We have a quality assurance department which has established procedures and guidelines to oversee and assures the quality of our geological laboratories and their exploration data. In addition, we have engaged Alex Stewart Assay Laboratories Ulaanbaatar to conduct quarterly independent audits of our coal laboratory testing procedures and accuracy and to provide training for our laboratory personnel.

Properties

As of December 31, 2011, our principal properties consisted of (1) land possession rights of 26 parcels of land in Mongolia with an aggregate site-area of approximately 23,000 hectares, used for our mining operations and supporting infrastructure, (2) plants and office buildings developed by us and leased properties such as office and equipment and (3) the properties acquired as part of the BN acquisition.

Pursuant to land possession certificates issued by the governor of South Gobi Province and relevant soums, we are permitted to use our 26 parcels of land to conduct our mining activities and to build and operate our CHPP, airport, camp, apartments, offices, planned railway, workshops, customs-control office, water supply pipelines, power plants, power lines, hard paved roads and cellular communication antenna. Economic & Legal Consultancy LLC, our legal advisors as to Mongolian law, has confirmed all of our land uses are in compliance with the relevant Mongolian laws and regulations.

In addition to the infrastructure mentioned elsewhere in this section, we have built a dedicated airstrip and terminal, as well as mine-site accommodations for project personnel. Our private airstrip is

fully operational and licensed with the Mongolian Civil Aviation Authority. Our employees and foreign consultants are typically transported to our mine sites from Ulaanbaatar by air.

Safety and Environmental Matters

We apply international standards of industrial health and safety and work with Leighton to ensure that our mining activities are conducted in such a way as to provide a safe and healthy working environment while satisfying Mongolian legal requirements, industry best practices and clients' expectations. We have not experienced any fatalities at our UHG and BN mines since their respective commencement of operations in 2009 and 2012. Our heavy machinery operators undergo extensive on-site simulator training conducted by Leighton's personnel in order to minimize potential damage from equipment failure or accidents. We provide training and appropriate resources for our employees to work safely and effectively, and all of our employees have undertaken safety and hygiene training in compliance with Mongolian labor law. We have implemented an occupational health and safety policy that sets out standard approaches to risk minimization and operating procedures. We require our contractors and subcontractors to meet our occupational health and safety standards and policies. In addition, they are required to report all accidents and violations of occupational healthy and safety standards.

We are committed to complying with Mongolian environmental laws, regulations and international environmental standards. By carefully designing mining plans, conducting studies, implementing pollution control recommendations from internal and external sources, monitoring the effects of mining and carefully designing land rehabilitation and mine closure plans, we seek to minimize the impact of our activities on the environment. We plan to introduce an ISO 14001 environmental management system which will provide better guidance on our environmental protection activities.

We have an environmental team who are responsible for the compliance of our activities with national laws, regulations and international requirements. In addition, we have conducted over 30 studies and engaged international consultants to monitor our environmental protection activities and provide professional assistance.

According to a 2010 environmental and social impact assessment study produced by Environmental Resources Management, a leading global provider of environmental, health, safety, risk, and social consulting services, together with other national and international consulting companies, there were no major socioeconomic issues that threaten the feasibility of our mines. Nonetheless, we have taken several measures to mitigate the socioeconomic impact of our mines, which include (a) improving local healthcare and educational facilities; (b) establishing monitoring programs to ensure that pit dewatering and other water sourcing for the mine does not adversely affect shallow groundwater sources that are used by herders; (c) implementing controls to verify contracts and adjust designs and behaviors to minimize risks of depleting shallow groundwater sources that are used by herders; and (d) developing and implementing action plans to provide compensation for herders affected by the mining activities and other infrastructure construction activities.

We have also implemented several measures to specifically mitigate various aspects of our mine and supporting infrastructure. During construction of our transportation infrastructure, we ensure that quarry rock and in-fill materials are sourced from areas that will not adversely affect cultural heritage and monitor contractors to ensure that they use appropriate quarry sites to exploit construction materials. In connection with our water supply project we have developed procedures for monitoring the levels of hand-dug shallow wells to assess if our use of water sources has any impact on wells used by herders near our UHG mining area.

In general, the large amount of earthworks planned for mine expansion, including the creation of large waste rock dumps and topsoil stripping and stockpiling increases dust generation in addition to

the ambient dust level. We have implemented specific mitigation and management measures to reduce dust impact, and provide compensation for economic displacement to all those affected by our expanding mining activities.

Community Development

Our community development initiatives are aimed at supporting the sustainability of the local communities where we operate. We have invested approximately MNT1 billion in each of the three years ended December 31, 2011 in community development programs, focusing mainly on community education and healthcare, cultural heritage preservation, small and medium-sized enterprises and entrepreneurship development, environment and employment generation. We invest in programs based on results of socio-economic baseline studies of impacted soums and herder households, and recommendations of social and environmental management plans and public consultation events.

We have conducted surveys on tangible and intangible cultural heritage and mining-induced population influx in Tsogttsetsii soum. In line with these surveys, we plan to develop and implement programs on cultural heritage preservation and population influx management. We conducted a social and economic baseline study and organized public consultation in Khankhongor soum prior to the start-up of our BN project. A memorandum of understanding was signed with the soum governor, which defined our main areas of cooperation in improving healthcare and education for soum residents, preserving local cultural heritage and promoting local small business development and training.

We aim to provide employment opportunities to members of local communities. Our human resource policy encourages employing local residents where possible and contributing to their capacity building. As of December 31, 2011, approximately 30% of total employees were residents of Tsogttsetsii, Bayan-Ovoo, Manlai, Dalanzadgad and Tsagaan-Ovoo soums of South Gobi Province.

We have completed several community infrastructure development projects in Tsogttsetsii soum. In order to minimize dust generation in the soum, we have built a 12 km paved road across the soum center. In addition, soum residents and businesses enjoy access to our electricity and filtered drinking water. In order to mitigate an adverse impact associated with population influx to Tsogttsetsii soum and to support local education sector, we agreed to jointly finance with South Gobi Province to build a new secondary school and kindergarten complex which will provide better access to education for more than 800 children of the local community. In recognition of our effort, the Mongolian Mining Journal awarded us its grand prize in 2011.

Employees

As of December 31, 2011, we had a total of 2,177 employees. The table below sets forth the number of our employees by function as of December 31, 2011:

Functions	Total
Management and administration	286
Production	
Employees at UHG mine	1,233
Employees at BN mine	131
Sales and marketing	26
Transportation and logistics	501
Total	<u><u>2,177</u></u>

The total workforce of our contractors at our UHG and BN mines as of December 31, 2011 was approximately 1,000 personnel.

The majority of our employees have signed employment contracts with us which provide, among other things, the employee's responsibilities, remuneration and grounds for termination of employment. Our mine operates 24 hours a day, seven days a week and 365 days a year, subject to weather conditions. Our mine operators work 12-hour shifts and are on a three-week rotation: (1) first week, day shift; (2) second week, evening shift; and (3) third week, off.

We have maintained good working relationships with our employees and have not encountered any difficulties in recruiting and retaining experienced staff. In April 2010, we entered into a memorandum of understanding with the newly established Mine Worker's Trade Union of Mongolia, pursuant to which we agreed to cooperate with any trade union or organization existing under applicable labor laws, regulations and requirements. We believe this memorandum will further improve our relationships with employees by providing them with a formal platform through which to communicate with us about their questions and concerns.

Employee Remuneration Policy

Our remuneration policy is designed to attract, retain and motivate highly skilled individuals to ensure the capability of our workforce to implement our business strategy. Key principles of the remuneration policy are to:

- set competitive rewards to attract, retain and motivate highly skilled people;
- provide detailed feedback to develop employees' skills and critically analyze employees' contributions;
- establish short- and long-term incentive programs, including the equity incentive plan;
- ensure remuneration planning continues to be integrated within our business planning process; and
- ensure total reward levels and performance targets are set at appropriate levels to reflect the competitive market in which we operate, the prevailing economic environment and the relevant performance of similar companies.

We seek to accomplish the above goals by conducting annual remuneration reviews which take into account individual performance, the economic environment, the unique requirement for certain employees to travel and spend time in Mongolia, particularly at mine sites and relevant job and industry comparisons. We value the contribution of both individuals and teams in achieving the goals and objectives of our business.

We adopted a share option scheme in September 2010 and granted to certain eligible participants a total of 35,200,000 share options in October 2011.

Benefit Schemes

We maintain benefit schemes for our employees as required by relevant laws in Mongolia.

Injuries

Exploration, development and production operations on mineral properties and transportation of mineral products involve numerous risks and hazards. While we have not had any large scale accidents that material affected our results of operations, from time to time we have had transportation accidents which have resulted in fatalities to persons other than our employees. See “Risk Factors – Risks Relating to our Business and Industry – Our mining activities are subject to operational risks, hazards and unexpected disruptions”.

Insurance

We maintain insurance coverage for our employees, officers and board of directors. As of December 31, 2011, we have obtained insurance coverage from leading global insurers including Zurich, Munich Re and Swiss Re on property damage for our mining properties and business interruption. In addition, we have the following insurance coverage:

- motor and third liability insurance for us and our subsidiaries;
- cargo insurance;
- personal accident insurance for our employees;
- truck insurance, truck driver’s liability and personal accident insurance;
- Tavan Tolgoi airport liability insurance; and
- directors’ and officers’ liability and prospectus insurance.

The insurance policies arranged by us do not cover liability or damage arising from acts of war and terrorism, and other customary exclusions from coverage.

Under our operating agreements with our mining contractors, the contractors are responsible for their own employees and they and their employees must also be covered by appropriate insurance including insurance for property and vehicles, loss and damage and third party claims.

See “Risk Factors – Risks Relating to our Business and Industry – Our insurance may not be adequate to cover losses or liabilities that may arise”.

Intellectual Property

We own over 27 trademarks, including those related to our corporate logo and names, which are registered in Mongolia. We also own trademarks to three of our logos, “”, “” and “”, which are registered in Hong Kong.

Legal Proceedings

We are not currently involved in any litigation or legal proceedings which could be expected to have a material adverse effect on our business, results of operations or financial position.

REGULATIONS

Mongolian Laws and Regulations Relating to Exploration for Minerals and Mining

Between July 1997 and August 25, 2006, Mongolian minerals policies and practices were governed by the 1997 Minerals Law. On July 8, 2006, the Parliament enacted the 2006 Minerals Law, superseding and replacing the 1997 Minerals Law. The 2006 Minerals Law became effective as of August 26, 2006.

The Parliament also enacted supplementary implementation and procedural legislation (the “2006 Implementation Law”) to address various technical issues, including the issues on re-registration of exploration licences under the new 2006 Minerals Law.

Under the 1997 Minerals Law, exploration licenses were granted by the DGMC, a subordinate agency of MRAM, which at the time was a subordinate agency of the former cabinet level Ministry of Industry and Trade. In 2006, the Petroleum Authority of Mongolia was merged with the MRAM – creating the Minerals Resources and Petroleum Authority of Mongolia – and the name of the DGMC was changed to the Cadastral Registration Center. To remain effective, all exploration licenses granted by the DGMC under the 1997 Minerals Law were required to be re-registered with the Cadastral Registration Center under the 2006 Minerals Law within five months following the effective date of the 2006 Minerals Law.

In December 2008, the Government of Mongolia again made changes to its regulatory bodies in connection with the mineral industry. The MRAM and the Petroleum Authority of Mongolia became separate subordinate agencies of the MMRE, and the name of the Cadastral Registration Center was changed back to the DGMC.

Registration with the DGMC is the definitive record of the holders of minerals license rights under the 2006 Minerals Law. Pledges and transfers of exploration licenses must be registered with the DGMC to be effective. Pledges, transfers and certain other transactions are recorded on endorsement sheets that are separate from, but considered to be an integral part of, each exploration license certificate. The DGMC does not maintain records of other liens or encumbrances to which a license may be subject.

Effective as of August 15, 2009 – the effective date of Mongolia’s new Nuclear Energy Law – the minerals defined under the 2006 Minerals Law no longer includes radioactive minerals, i.e. minerals that contain radioactive isotopes of the uranium or thorium families. All subsequent references to minerals and licenses to explore or mine minerals will be limited to minerals other than radioactive minerals as so defined.

Note that references to “mineral reserves” and “mineral resources” in this section entitled “Mongolian Laws and Regulations Relating to Exploration for Minerals and Mining” are not references to mineral reserves and mineral resources determined in accordance with the JORC Code.

Mongolian Exploration Licenses

The holder of an exploration license has rights to conduct exploration activities in the license area, to construct temporary structures within the license area related to its exploration activities, and if gaining access to its exploration license area requires passing over land which is owned or possessed by others, to traverse such land subject to terms and conditions negotiated with such owners or possessors. If a mineral resource is identified by exploration activities, the exploration license

holder has the right to apply for a mining license for any part of the exploration license area. Pursuant to the 2006 Minerals Law, exploration licenses granted on or after August 26, 2006 have an initial term of three years. The holder of such an exploration licenses may apply for an extension of the license for two successive additional periods of three years each. Thus, the maximum period that an exploration license may be held by one or more holders is nine years from the date of issue. Exploration licenses granted prior to August 26, 2006 also have an initial term of three years, and the holder may apply for an extension of the license for two successive periods of two years each, for a maximum overall period of seven years. Holders of such exploration licenses that became eligible for extension following August 26, 2006 have, in many instances, been given the benefit of the longer extension terms under the 2006 Minerals Law, but the policies and practices of the DGMC in this regard have been inconsistent.

Each exploration license is subject to cancellation if applicable license fees are not paid on time or if the holder fails to comply with certain other requirements of the 2006 Minerals Law or other relevant laws. Only Mongolian legal entities are entitled to hold exploration licenses.

Annual fees are payable per hectare of exploration license area as follows:

Year	Annual fee per hectare
Initial term – Year 1	US\$0.10
Initial term – Year 2	US\$0.20
Initial term – Year 3	US\$0.30
First extension (3 years).	US\$1.00 each year
Second extension (3 years).	US\$1.50 each year

Exploration license holders must spend the following minimum amounts annually on exploration activities per hectare within the license area:

Year	Annual amount per hectare
Initial term – Year 1	No expenditure required
Initial term – Year 2	US\$0.50
Initial term – Year 3	US\$0.50
First extension (3 years).	US\$1.00 each year
Second extension (3 years).	US\$1.50 each year

The tables above show the required annual fees and expenditure amounts for each of the first three years, as well as for the succeeding three years (i.e., the “first extension”) and the last three years (i.e., the “second extension”). There are no applicable fees or amounts due after the second extension since the exploration license will have expired.

Exploration license holders are also subject to various environmental protection obligations. Within 30 days of receiving an exploration license, the holder must prepare, and submit to the relevant authorities, an environmental protection and reclamation plan. Once the plan has been approved by the relevant authorities, the holder of the exploration license must deposit funds equal to 50% of its environmental protection budget for that particular year in a bank account established by the governing authority of the soum (district) in which the exploration license area is located. Holders of exploration licenses must also submit to relevant authorities an exploration plan and annual reports of exploration activities.

On February 9, 2011, the Parliament enacted the Law on Prohibition of Granting New Exploration Licenses which prohibited the granting of new exploration licenses until April 30, 2011. The prohibition was subsequently extended to December 31, 2012.

Reserves

In Mongolia, the tonnage and coal quality of a mineral reserve that has been defined by exploration activities must be recorded in official archives. Under the 2006 Minerals Law, a mining license holder must extract all of the mineral reserves that are within the license area. The purpose of this provision is to prevent “high-grading”, but the net effect is to mandate mining practices that are not consistent with practices in countries where free market principles prevail and the concept of mining mineral reserves on an economically viable basis is recognized and understood. It is unclear what consequences, if any, may follow from non-compliance with this provision.

Mining Licenses

If a commercially viable mineral resource is defined within the license area of an exploration license, the holder of the exploration license is entitled to apply for a mining license covering the relevant portion of the license area defined by specific longitude and latitude coordinates in the mineral exploration license. A mining license holder has the right to conduct mining activities throughout the license area and to construct structures within the license area that are related to its mining activities. All such activities must be conducted in compliance with the 2006 Minerals Law and relevant Mongolian laws pertaining to health and safety, environment protection and reclamation. Mining licenses are granted by the MRAM for an initial term of thirty years and are renewable for two successive periods of twenty years each based upon remaining reserves, for a maximum overall period of seventy years. Upon the expiration of a mining license, the license and the rights under such license revert to the Government of Mongolia. Only Mongolian legal entities are entitled to hold mining licenses. In the case of all minerals other than coal and common construction minerals (e.g., sand and gravel), annual license fees of US\$15.0 are payable per hectare of the relevant mining license area. In the case of coal and common construction minerals, the per hectare annual license fee is US\$5.00. A mining license is subject to cancellation if applicable license fees are not paid on time or other requirements under the 2006 Minerals Law or other relevant laws are not satisfied.

To receive a mining license, an exploration license holder must submit an application to the MRAM together with, among other documents, an environmental impact assessment and a resource report. Holders of mining licenses must also prepare environmental protection and reclamation plans and satisfy various reporting and security deposit requirements.

Pre-Mining Agreements

After a mineral reserve has been defined and recorded, an exploration license holder may apply to the MRAM for a pre-mining agreement. During the term of this agreement, which may not exceed three years, Mongolian-law compliant final feasibility studies must be completed, mine facilities must be developed, and the mine must be brought into production.

Local Government Approval of Exploration Licenses and Mining Licenses

Pursuant to the Licensing Law of Mongolia enacted on February 1, 2001, and effective from January 1, 2002, as the same may be amended and supplemented from time to time (“Mongolian Licensing Law”), the granting of each exploration license and mining license by the MRAM must be approved by the governor of the aimag (province) in which the relevant license area is located. The 2006 Minerals Law also provides that the holder of an exploration license has an exclusive right to obtain a mining license covering all or any relevant portion of the exploration license area, however, under the relevant Mongolian Licensing Law, obtaining a mining license by such exploration license holder is still subject to the approval of the aimag governor.

If the aimag governor wishes to deny the grant of an exploration license, he must submit his reasons to the MRAM within thirty days following receipt of notice of the license application from MRAM. The 2006 Minerals Law provides that the reasons for the denial must be based on the laws of Mongolia. However, there is no clear guidance as to what legal grounds will suffice to warrant denial of a license application. If the aimag governor does not timely submit his reasons for denial of the grant, it will be deemed that he has approved the grant.

Note that the thirty-day notice and response requirements of the 2006 Minerals Law do not apply to the grant of a mining license, but that the Mongolian Licensing Law requirements clearly apply to both exploration and mining licenses. It is not clear how these issues will be resolved in the case of mining licenses.

Approval to Commence Mining Operations

Pursuant to the 2006 Minerals Law, before a mining license holder can bring a mine into production, the MMRE appoints a commission (the “Commission”) to review and audit pre-mining requirements compliance by the mining license holder that proposes to commence operation. The Commission consists of the following members: (i) the head of the Geological and Mining Department of the MMRE; (ii) the head of the Technology and Environmental Division of MRAM; (iii) representatives from the inspection agencies of the relevant aimag in which the mine is located; and (iv) any other experts appointed by the MMRE. In particular, the Commission reviews to determine whether the license holder has all pre-mining requirements under the 2006 Minerals Law. It also reviews the following key documents (among others) to determine whether they have been prepared in compliance with applicable laws and regulations:

- a certified copy of the mining license;
- a feasibility study and mining plan complied with relevant Mongolian Law and reviewed by the relevant authority;
- the environmental impact assessment;
- the environmental protection plan;
- any minerals sales agreement and any lease agreement relating to the mining assets;
- records on establishing and marking the boundary of the mining area; and
- any agreement on land and water usage.

In addition, the Commission makes an on-site inspection of the mine and relevant supporting facilities, such as electrical power generators, mining equipment, water supply facilities, maintenance shops and health and safety equipment.

Upon completion of its review of all relevant documentation and its on-site inspection, if all requirements have been satisfied, the Commission will issue an approval (signed by all of its members) approving the commencement of mining operations by the mining license holder. After the approval is issued, the mining license holder can commence mining.

Deposits of Strategic Importance

Either the Government of Mongolia or the Parliament may initiate proposals to declare a mineral resource as a Mineral Deposit of Strategic Importance, but the Parliament must approve any such proposal. If a deposit is designated as a Mineral Deposit of Strategic Importance, the Government of Mongolia may acquire certain percentage of the equity stake of such deposit from the license holder on terms agreed by the Government of Mongolia and the license holder under the 2006 Minerals Law. A deposit is a Mineral Deposit of Strategic Importance if (i) it may potentially impact the national security of Mongolia, or the economic and social development of the country or the relevant region, or (ii) it may generate or has the potential to generate a revenue more than 5% of Mongolia's GDP in any given year.

Pursuant to the Parliament Resolution No. 27 dated February 6, 2007, the Parliament has published the Strategic Deposits List, which identifies 15 deposits as Mineral Deposits of Strategic Importance (the "Strategic Deposits List"). This resolution also identifies a further 39 deposits in the Tier 2 Deposits List (the "Tier 2 Deposits List") and instructs the Government of Mongolia to further evaluate such deposits and determine if one or more of these deposits should be recommended by the Government of Mongolia to the Parliament for designation as a Mineral Deposit of Strategic Importance. In addition to the deposits on the Strategic Deposits List and the Tier 2 Deposits List, Parliament may at any time designate other deposits that are not currently on either list to be Mineral Deposits of Strategic Importance. The Government of Mongolia is not obligated to complete negotiation with the relevant licence holders and finalize the status of the 54 deposits currently identified as Mineral Deposits of Strategic Importance.

The 15 Mineral Deposits of Strategic Importance specified by Parliament in the Strategic Deposits List have no defined "edges". They each consist of concentrations of mineralization in a general area that is identified only by a name and not by a set of specific coordinates. License areas, on the other hand, are precisely defined by specific coordinates. Thus, it is not feasible to definitively determine whether or not any given license area is within or overlaps a Mineral Deposit of Strategic Importance. A government working group has defined the edges of 12 of the 15 Mineral Deposits of Strategic Importance listed in the Strategic Deposit List. However, the defined areas have not yet been approved and confirmed by the Government of Mongolia.

Funded from the State Budget

During the 1970s and 1980s, teams of geologists from the former Soviet Union and other Soviet-Bloc countries, working in conjunction with Mongolian geologists, conducted extensive exploration work throughout Mongolia. Following the collapse of the Soviet Union in 1991, Russia attributed the cost of the exploration to be part of the overall debt owed to Russia by Mongolia. Mongolia negotiated a settlement of this debt, thus the cost attributable to the exploration are deemed to have been funded from the Mongolian state budget (the "State Budget"). Mineral resources that have been explored (in whole or part) by such activities are also considered to be deposits that have been funded from the State Budget. In addition, expenses incurred by the Government of Mongolia in connection with subsequent survey and exploration activities are also deemed to be expenses funded from the State Budget. To the extent that such expenditures incurred in exploring a specified deposit, they may be regarded as debt owed to the Government of Mongolia by the relevant license holder.

Under the 2006 Minerals Law, the encumbrance issue may be claimed to have been addressed by the payment of these costs by the license holder.

Both the designation of mineral resources as Mineral Deposits of Strategic Importance and the claims that such mineral resources have been funded – at least to some extent – by the State Budget are essentially decisions that are rather arbitrary.

During the 1970s and 1980s, state fund were used by Russian-Mongolian scientific teams to conduct some of the exploration activities of our deposit. On September 12, 2008, we entered into an agreement with the MRAM, which required us to repay US\$1.18 million, being the amount of state fund used in the exploration activities of our deposit, within five years of the date of the agreement. In the year ended December 31, 2008, we repaid US\$0.28 million and in the six months ended June 30, 2010, we repaid the remaining of US\$0.9 million to the MRAM. We have no further payment obligations under the agreement.

State Participation in Mineral Deposits of Strategic Importance

The 2006 Minerals Law provides that the Government of Mongolia may acquire up to 50% equity interest if the relevant exploration is state financed, such as funded from the State Budget or up to 34% equity interest, if the relevant exploration is privately financed. The terms and conditions of such participation are subject to negotiation between the Government of Mongolia and the license holder and may not necessarily adhere to the 50% or 34% limitations. The 2006 Minerals Law does not provide any guidelines as to the form such negotiations should take. The 2006 Minerals Law further provides that any company which holds a Mineral Deposit of Strategic Importance is required to list at least 10% of its shares on the Mongolian Stock Exchange. To our knowledge, this provision has not yet been enforced with respect to any of those companies with deposits on the Strategic Deposit List, including us, and it is not clear whether the provision would be enforced in the future.

Investment Agreements

A mining license holder that undertakes to invest more than certain threshold amounts over the first five years of its activity may apply to the Government of Mongolia to enter into an Investment Agreement concerning the stability of tax rates, the right to sell products at international market prices, a guarantee that the license holder may receive and dispose of income from such sales at its own discretion, and provisions with respect to the amount and term of the license holder's investment. On April 27, 2010, we applied for an Investment Agreement with the Government of Mongolia. Under Article 30.3 of the 2006 Minerals Law, the Government of Mongolia will review the application within three months upon receipt of the draft agreement and required documents. If third party consideration or a specialist opinion is required, the review period may be extended to an additional three months. The Government reserves discretion regarding the timing of draft document review and its negotiation procedures. As of the date of this Offering Memorandum, we are waiting for the response from the Government of Mongolia relating to our application for an Investment Agreement. We anticipate that the major terms of the Investment Agreement will include the following matters: stability of tax rates, the right to sell products at international market prices, a guarantee that we may receive and dispose of income from such sales at our own discretion, and provisions with respect to the amount and term of our investment. While we voluntarily applied for an Investment Agreement, it is less essential for us now as it would be if we were at the early stage of our mine development. As our operations have developed without such an Investment Agreement in the early stage of our mine development, an Investment Agreement at this stage would be beneficial but not necessary for our future development and prospects. Without signing the Investment Agreement, we are still free to sell our products at market prices and receive and dispose our income from such sales at our own discretion.

The term of each Investment Agreement will depend on the monetary amount of the five year commitment as follows:

Minimum investment (US\$)	Agreement term
50 million	10 years
100 million	15 years
300 million	30 years

Royalties

A royalty at the rate of 5% is payable in respect of the sales price of all products extracted pursuant to a mining license (other than domestically sold coal and construction minerals) that are sold, shipped for sale, or otherwise used. Part of the royalty goes to the central treasury, while the remaining part goes to local governments. The royalty rate for domestically sold coal and construction minerals is 2.5%, whereas the rate for international exports of these materials is 5%.

An additional progressive royalty rate, which is calculated based on the degree to which coal is processed is also payable. The level of the progressive royalty rate depends on the level of processing of coal and is set forth in the table below.

Raw Coal Progressive Royalty Rate		Processed Coal Progressive Royalty Rate	
Price Range (US\$/tonne)	Progressive Royalty %	Price Range (US\$/tonne)	Progressive Royalty %
0-25	–	0-100	–
25-50.	1.00	100-130	1.00
50-75.	2.00	130-160	1.50
75-100.	3.00	160-190	2.00
100-125	4.00	190-210	2.50
125+	5.00	210+	3.00

Sales and Transfers of Exploration Licenses and Mining Licenses

In accordance with the 2006 Minerals Law, the holder of an exploration license may not sell the license itself. The holder may, however, sell the underlying “original materials and reports on prospecting and exploration work” (the “license area data”) in respect of the license. Upon completion of the sale of the license area data, and payment of applicable taxes (evidenced by a document showing payment of such tax), the holder may transfer the license, but for no consideration.

In accordance with the 2006 Minerals Law, the holder of a mining license may not sell the license itself. The holder may, however, sell “the mine, together with its machinery, equipment and documents” that is located within the relevant license area. Upon completion of the sale of the mine, and payment of applicable taxes (evidenced by a document showing payment of such tax), the holder may transfer the license, but for no consideration.

Law on Subsoil was adopted on November 29, 1988. In addition to the 2006 Minerals Law, the Law on Subsoil regulates issues regarding use and protection of subsoil. As in the Constitution of Mongolia, Article 3 of the Law on Subsoil provides that the subsoil is owned by the country or the whole nation.

The Law on Subsoil contains provisions that grant power to the State Great Hural, the Government of Mongolia, the Ministries of Geology, Nature and Environment and local authorities to protect and regulate the use of subsoil. In addition to mining and geological exploration, subsoil may

be used for building facilities underground including burying of oil, gas, other poisonous substances and industrial waste or waste water drainage system. Local authorities shall provide permits to use the subsoil depending on the nature of the project. Article 19 of the Law on Subsoil provides that the subsoil shall be allocated for use for 30 years extendable for another 20 years.

Chapter 3 of the Law on Subsoil provides requirements and procedures regarding development of design and building facilities underground and plants that would be used for mining of minerals. Even though Article 10.2 of the Law on Subsoil provides that issues regarding exploration and mining of minerals from the subsoil shall be regulated by the 2006 Minerals Law, Chapter 4 of the Law on Subsoil regulates the procedures for using the subsoil for purposes of mining of minerals and it deals with the procedures for the entity to mine the subsoil, and requirements of the legal entity during the mining operations, including effective and full use of the deposit and imposing obligations not to selectively mine not to damage the neighboring deposits and general requirements for rehabilitation, ensuring safety of the employees and the population in the area (Article 32.8).

Chapter 5 of the Law on Subsoil regulates the use of subsoil for purposes other than the mining of minerals. The Law on Subsoil also regulates issues related to the safety, use and protection of the subsoil, maintenance and registration of minerals reserve deposits and monitoring of the use and protection of subsoil and geological studies conducted in the subsoil.

Mongolian Laws Relating to Additional Permits

Various aspects of mine construction and operation require permits from relevant central and regional governmental authorities. For example, permits must be obtained before proceeding with a general mine development plan and at various stages during the construction of mining facilities and mine start-up. A permit is similarly required for the use of water and for the use of explosives for blasting. In addition, work undertaken pursuant to permits is subject to ongoing review and verification by relevant authorities.

Under the Environmental Protection Law of Mongolia (the “EPL”), originally enacted in 1995 with certain relevant amendments in 2005, business entities and organizations have the following duties with respect to environmental protection:

- to comply with the EPL and the decisions 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 within 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.

The EPL is enforced at both national and local levels. Both national and local government can require a business entity to desist from and to eliminate the effects of certain actions. The Government of Mongolia has the power to require a business entity to limit or refrain itself from using, importing or exporting natural resources for certain period of time, and in accordance with the recommendation of the local governor and the Ministry of Environment, to prohibit citizens, business entities and organizations from conducting production or other activities which would have an adverse effect on human health or environment, regardless of the form of ownership.

Mongolian state inspectors are provided with a range of powers pursuant to the EPL, including the supervision and implementation of environmental legislation, obtaining information and data required for supervision of such legislation from the relevant individuals, business entities, or organizations, and requiring individuals, business entities, and organizations to eliminate adverse environmental impact and to suspend their activities for certain period of time in the event of an adverse environmental impact in breach of the EPL, accepted standards, and permissible levels.

Local government is also responsible for administering the implementation of the EPL and supervising the activities of business entities within their jurisdiction. Local government also has the power to take measures to eliminate any breach of the EPL by business entities and, if necessary, to require the suspension of activities of business entities which have an adverse environmental impact.

The 2006 Minerals Law provides three chapters of guidance relating to further environmental protection obligations imposed on mineral license holders. Under the 2006 Minerals Law, mineral rights are divided into exploration and mining rights, each with separate licensing and attendant environmental protection requirements.

In addition to those duties imposed on them by the EPL, mining license holders are required to prepare an initial environmental impact assessment analysis before the mine comes into production. A mining license holder must also annually develop and implement an environmental protection plan (including reclamation measures) in cooperation with the Ministry of the Environment, which should take into account the results of the environmental impact assessment. A license holder is also required to record all instances of adverse environmental impact resulting from its mining activities and prepare and send an annual report to the Ministry of Environment. In order to ensure compliance with environmental protection obligations. A license holder must deposit 50% of its environmental protection budget for a given year in a bank account established by the Ministry of the Environment. This amount is refundable at the end of each year if the license holder have complied with its obligations under the environmental protection plan. The 2006 Minerals Law further provides that, in the event a license holder fails to fully implement any of the measures outlined in the environmental protection plan, the relevant authority shall use the deposited fund as part of the environmental protection budget to implement those measures and the license holder shall provide any additional fund required.

The 2006 Minerals Law also provides for the following administrative sanctions that may be levied against license holders found in violation of environmental protection obligations:

- MNT500,000 – 1,000,000 fine for failure to comply with legitimate requirements imposed by an authorized Mongolian state inspector regarding the elimination of deficiencies discovered in the course of an inspection;
- in the event a license holder continues to be in violation of the EPL or the 2006 Minerals Law, the exploration and mining activities of the license holder shall be suspended for up to two months, and if the deficiencies are not eliminated within this period, the relevant minerals license may be revoked; and
- if a mining license holder causes serious damage to the environment, fauna, or human health by failing to implement safety rules or a technological regime while using toxic substances for its operations, its license shall be revoked and no license shall be issued to such holder for 20 years.

On July 16, 2009, Parliament enacted Mining Prohibition in Specified Areas Law, which prohibits minerals exploration and mining in the following described areas:

- headwaters of rivers and lakes;
- forest areas as defined in the Forest Law of Mongolia; and
- land areas adjacent to rivers and lakes as defined in the Water Law of Mongolia.

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. It is not clear whether such termination will only apply to the overlapping areas. Government Resolution No. 299, dated November 17, 2010, provides that affected license holders will be compensated for the termination of previously granted licenses. We do not expect the implementation of this law to affect the operations at our UHG and BN mines. Government Resolution No. 174, dated June 8, 2011, has determined a portion of the boundaries of certain areas containing gold deposits where exploration and mining operations are prohibited according to the Mining Prohibition in Specified Areas Law. On October 20, 2011, the Supreme Court of Mongolia ruled that the Government must take action to enforce the Mining Prohibition in Specified Areas Law.

The Law on Special Permit for Business Activities (the “Licensing Law”) was adopted on February 1, 2001. The Licensing Law provides for governing relations regarding granting, suspending and revoking special permits for certain business activities that may have impact on the public interest, human health, environment and national safety or that may require certain conditions and qualification. However Article 2.3 of the Licensing Law states that licenses to be granted under the Laws on Land, on Subsoil, on Specially protected territories and natural plants, on Games and Hunting, on Flora and Forest, on Water, on Endangered Species, Trading with the Species or with Items Originating from Them, on Minerals, on Nuclear Energy and on Modified Live Organisms shall be governed by those laws.

According to Article 6.1 of the Licensing Law, the licenses usually are granted not less than three years unless otherwise stated by the Law and the licenses are extendable for the same terms as the initial term. According to the Article 6.3 of the Law unless otherwise stated by Law and conditions specified in the Article 13.1 of the Law are not discovered the term of the license shall be extended within 3 working days upon application of the license holder. Article 7 of the Licensing Law provides procedures for granting the licenses. According to Article 7.1, licenses are usually granted by the central administrative body unless otherwise specified by Law. Central administrative bodies usually mean ministries. However according to Article 7.3, detailed procedures for governing special licenses shall be regulated under the relevant industry Laws. Article 12 provides procedures for granting license for the first time and unless otherwise specified by Law the licensing authority shall grant the license within 21 working days upon receiving the application. If the application for license is denied, the reasons for denial shall be explained in writing. The license authority also has the power to have a relevant organizations to verify the submitted documents. In case if the term, conditions and requirements of the license are violated then the initially granting authority may suspend the license up to 3 months term based on the expert opinion of the professional inspection authority. Under Article 14 of the Licensing Law, a license may be revoked under the following circumstances:

- 14.1.1 The license holder requests so.
- 14.1.2 The legal entity has been liquidated.
- 14.1.3 It was determined the documents were falsified when applying for the license.

- 14.1.4 The conditions and the requirements of the license were violated repeatedly or seriously violated.
- 14.1.5 The demand to remedy the violations were not remedied during the suspension period of the license.

Article 15 of the Licensing Law lists the type of business activities that require special permits or licenses:

- 15.6.2 Protection of poisonous or dangerous chemical substance other than explosive material.
- 15.6.3 Importing exporting transporting over the border use trading and liquidation of poisonous chemical or dangerous substances.
- 15.6.5 Discharging polluting substances, in which acceptable amount is not determined under the standards.
- 15.6.6 Conducting detailed environmental impact assessment, importing, trading and servicing poisonous chemical or dangerous substance that may negatively impact the environment.
- 15.8.2 Construction of electricity power source or transmission line, production of electricity transmission dispatching coordination distribution, supply and sales of electricity. Assembly and maintenance of boilers pressure tanks and park lines.
- 15.10.4 Production of explosive substance and explosive equipment for explosions and conducting explosions.
- 15.10.5 Minerals exploration.
- 15.10.6 Minerals mining.
- 15.10.11 Activities related to oil.
- 15.10.13 Production, wholesale and trade of oil products.
- 15.14.6 Designing construction and facilities, conducting construction activities production of construction material, production assembly and maintenance of lifting equipment and its spare parts.
- 15.15.1 Construction and use of railway base structure.
- 15.15.2 Conducting civil aviation operation.
- 15.15.3 Conducting railway transportation activities.
- 15.15.4 Construction and maintenance of road and road facilities.
- 15.15.11 Production assembly and maintenance of railway base structure and rolling stock.

- 15.16.1 Using radio wave and setting up communication service network and its use and provision of services.

The Law on Environmental Impact Assessment was adopted on February 22, 1998. The purpose of this law is to govern issues regarding environment protection prevention of ecological imbalance, coordinating use of mineral resource, assessing environmental impact projects and making a decision to whether implement the projects.

The general environmental impact assessment shall be made for projects that include construction of new plants, service, building facility or expansion of existing premises or other projects that would use natural resources. Preliminary impact that the projects would cause to the environment shall be assessed during such assessment. For mineral resources mining projects, the environmental impact assessment shall be obtained before obtaining the use right of land and commence the project. The local environmental monitoring inspector, the citizen's representative's Hural's and the presidiums of aimag, capital city, soum and district shall monitor whether the environmental impact assessment has been conducted for mining projects that are being implemented.

The Ministry of Nature and Environment shall approve the methodological instructions for conducting environmental impact assessment for projects. The impact assessment shall be conducted by an expert within 12 working days and shall include conclusions on following matters (Article 4.5):

- 4.6.1 Whether it's possible to implement the project without conducting detailed environmental impact assessment.
- 4.6.2 Whether it's possible to implement the project with certain conditions and terms.
- 4.6.3 Whether it's necessary to conduct environmental impact assessment.
- 4.6.4 To return projects that do not comply with the Laws and regulations or equipment and technology to be used deter mental to the environment or the project is not included in the general land organization plan.

Once it is considered that a detailed impact assessment is necessary then the legal entity that has this license according to Article 9 of the Law on Environmental Impact Assessment shall conduct the assessment. Article 5 of the Law on Environmental Impact Assessment provides the components of the environmental impact assessment report. Under Article 6.3 of the Law, on Environmental Impact Assessment, any organization that is implementing a project (including mining project) shall deposit not less than 50% of the funds to be used a given year for environmental rehabilitation activities. Once a detailed environmental impact assessment report is complete the report shall be submitted to the authority that has conducted the general impact assessment and an expert of the authority shall review the assessment within 18 working days. The central administrative authority in charge of environmental matters shall resolve whether to allow the project implementation based on the expert opinion of the environmental impact assessment and also the comments of the citizen's of a place where the project is to be implemented.

The Railway Transportation Law was adopted on June 5, 2007 and its purpose is to define the principles of the railway transportation operation and ensure safety of the railway traffic. According to Article 4 of the Railway Transportation Law, it shall govern all types of railway transportation operation irrespective of the type and form of ownership.

Article 5 lists the principles that shall apply to the railway transportation operation which are:

- 5.1.1 There should be unified coordination of a schedule
- 5.1.2 There should be permanent monitoring
- 5.1.3 Access quality and safety of the services should be ensured
- 5.1.4 The operation shall be uninterruptible
- 5.1.5 Market competition condition shall be created
- 5.1.6 Operations with other transportation industry shall be coordinated

Article 6.2 states that a railway base structure may be created with a condition that the railway is owned by a legal entity of state property or prevailing state property or to be transferred to the ownership of such an entity after a certain period of use and this railway base structure shall have significantly important for the economy and the society of the nation. Alignment of such railway base structure and railway shall be determined by the Government. Article 7.1 states that the railway transportation services, fees and tariffs of the railway entity related to natural monopoly and market dominating works and services shall be set according to this Law and Law on Prohibiting Unfair Competition.

Article 7.2 of the Railway Transportation Law states that international transportation tariff shall be set according to international agreement to which Mongolia is a party. And according to Article 7.3, any changes in tariff shall be published to the general public not less than 10 days before such change become effective.

According to Article 9.1.2 of the Railway Transportation Law, the Government shall grant and revoke the license to build railway base structure whereas the Government's administrative authority in charge of railway transportation matters shall grant extend the term suspend or revoke licenses for use of base structure railway transportation operation and production assembly maintenance of railway base structure and rolling stock (Article 12.4.4).

According to Article 13 of the Railway Transportation Law there shall be a railway transportation monitoring department which shall implement the administrative monitoring of the safety of railway, transportation quality of such services, labor protection and safety.

Under Article 13.5.3 of the Railway Transportation Law, the monitoring department has the power to limit or suspend the use of railway in case of potential conditions for accident and defaults. The department also has the power to propose to relevant authorized body to suspend or revoke the relevant license and certificate (Article 13.5.5). According to Article 15 of the Railway Transportation Law, the railway authority shall approve the package of general procedures.

Article 16 of the Railway Transportation Law describes the types of railway licenses and also provides procedures for issuing such licenses especially under Article 16.4 (verification of an application by the Government administrative body), 16.5 (verification and opinion of the central Government administrative body regarding certain issues), 16.6 (allowing the applicant an opportunity to extend the term of the application review due to need to comply with additional requirements), 16.7 (the Government administrative body making a decision of either granting the license or refusing to grant the license), 16.8 (the Government administrative body (the "RAM") review the application within 14 days and shall submit its opinion to the central Government administrative body (the

“Ministry”)), the relevant authority shall review and make a decision on granting the licenses within 21 days (except the railway base structure construction license which requires 45 days) and if necessary may extend the term another 14 days. Article 16.10 stated that the license holder shall apply 21 days before expiry of the license to the authorized body, and that body shall resolve the extension of the license term within 14 days. Any response to granting or refusing to grant a license shall be provided in writing within the timeline provided by this Law (16.11).

Under Parliament Resolution No. 68, dated November 25, 2010, the Government is instructed to take measures, among others, to support economic growth by increasing the capacity of the border ports, railways and auto roads where overwhelming amount of exported and imported raw material and goods are transported.

In addition, under Parliament Resolution No. 15, dated February 10, 2011, the Government is instructed to fund projects such as the construction of railways according to the State Policy on Railway (adopted on June 24, 2010), Sainshand Industrial Complex project (adopted on July 07, 2010) and other projects funded through public and private partnership.

The Law on Water was adopted on April 22, 2004 and its purpose as stated in Article 1 is to govern issues regarding proper use of water and water bed area protection and rehabilitation. Article 19 of the Law on Water provides that water bed area council shall be set up to involve local population in management of the local water in order to protect, restore properly and use the water resources. Article 23 titled ‘Water user’ states that any citizen, legal entity or organization shall obtain the right to use the water by entering into an agreement and obtaining the permission of the relevant authorities. According to Article 23.2, the agreement to use water shall be entered for a term of 20 years and as long as the user complied with its obligations, the agreement can be extended for another 5 years. Articles 24-28 deal with the requirements for the water user and procedures for entering into water use agreement and granting the permission to use water. Chapter 4 deals with the protection of water resources its quality and rehabilitation of environment. Chapter 5 deals with the requirements to be imposed on water use facilities, such as approval of the design construction and use of the facilities.

Law on Energy was adopted on February 1, 2001. The purpose of it is to govern the issues regarding production, transmission, distribution, dispatching coordination and services using energy reserves and construction of energy infrastructure and use of energy. Chapter 2 deals typically with the Government powers including the State Great Hural, the Cabinet, the Ministries and local governments regarding the policy determination and enforcement of the Law on energy. Chapter 3 deals with the special permits or licenses to be granted under this Law:

- 12.1.1 Production of energy
- 12.1.2 Production of heat
- 12.1.3 Transmission of electricity
- 12.1.4 Transmission of heat
- 12.1.5 Providing dispatching coordination
- 12.1.6 Distribution of electricity
- 12.1.7 Distribution of heat
- 12.1.8 Regulated supply of energy

- 12.1.9 Unregulated supply of energy
- 12.1.10 Importing and exporting electricity
- 12.1.11 Construction of energy related buildings and facilities

Chapter 4 deals with the setting of price and tariff. Chapter 5 deals with the relations between the supplier and consumers and Chapter 6 deals with the monitoring and imposing liabilities under the Law.

The Law on Construction was adopted on February 15, 2008. The purpose of the Law is to govern the issues regarding development of design for buildings and facilities, production of construction material, use of construction works and rendering technical supervision over construction work. Article 3.1.4 (Definitions) states that the “building and facilities” shall mean accommodation, buildings for public and industrial use, facilities for energy communication, roads, bridges, water channel, dams and shields and other engineering networks built by a licensed legal entity based on design and drawing accredited and developed according to construction norms and rules.

Chapter 2 deals with the powers of the Government institutions including the State Great Hural, the Government, the Ministry and local Governments. Chapter 3 provides clauses regarding requirements to be imposed on design, construction material, product and construction agreements for building facilities and accrediting construction design. Chapter 4 provides for rights and obligations of investor, client, contractor, and designer and construction material producer. Chapter 5 provides requirements to be imposed on use of buildings and facilities and also norms and normative documents, registration and information regarding buildings and facilities.

The Law on Protection of Nature and Environment was adopted on March 30, 1995. The purpose of the Law is to govern the issues regarding ensuring the right of a human being to live in healthy and safe environment, to coordinate social and economic development along with the environmental balance, to protect the nature and environment for the interests of the current and future generations, to properly use natural wealth, and restoring the possible natural wealth. Article 7.2 of the Law states that any citizen, legal entity or organization that is willing to use natural wealth for industrial purposes shall have the environmental assessment conducted for its own costs or if such assessment has been already done then shall pay for the related costs. Chapter 3 of the Law deals with the powers with the Government organizations including the State Great Hural, the Government, The Ministry and local Governments. Chapter 4 describes actions for protecting nature and environment, using natural wealth and rehabilitation works.

Chapter 5 deals with the environmental inspection and monitoring including the powers and the obligations of the environmental inspectors. Article 27.1.10 states that the environmental inspector shall have the right to revoke or suspend licenses, permissions and other rights of legal entity and organizations who has caused damages to the nature and environment due to violations of Laws, regulations and the technology. Under Article 27.1.3, the inspector also has the right to suspend operations of citizens, legal entities and organizations who have negatively impacted nature and environment due to violations of the Laws, regulations, standards and acceptable levels. Chapter 6 deals with the obligations of legal entities and organizations with respect to protection of nature and environment and the natural wealth. Chapter 7 deals with the form of the information regarding nature and environment.

Law on Monitoring Explosive Substances and Turnover of Explosion Equipment was adopted on May 6, 2004. The Law deals with the detailed procedure insuring safe operation dealing with explosive substances and explosion equipment. Chapter 3 of the Law deals with the data pool regarding explosive substance and explosion equipment. Chapter 4 deals with the supervision of the substances and equipment.

The Law on Poisonous Chemicals and Dangerous Substances was adopted on May 25, 2006. This Law has the same importance as the Law on Explosive substances and Explosion Equipment.

The Law on Arbitration was adopted May 9, 2003. Article 3 (Scope of the Law) states that the decisions of foreign arbitration shall be acceptable in Mongolia and enforcement actions shall be regulated according to the New York Convention of 1958 on acceptance and enforcement of decision of the foreign arbitration and Chapter 8 of the Law (Article 3.2).

On October 6, 2011, the Law of Drivers Insurance was approved and became effective on January 1, 2011 and provides that liability insurance for drivers and owners of vehicles is mandatory.

Mongolian Law Relating to Concessions

The Mongolian Parliament defined 'State Policy on Public and Private Partnership' in 2009 by Resolution No.64, where it specifically considered legal framework for a concession. In accordance with that policy the Concessions Law was adopted by the Parliament in January 28, 2010, which came into effect since March 1, 2010. Based upon on the 2010 Concessions Law, the Government approved list of concessions in July 21, 2010, by the Resolution No.198, which remains valid and up to date.

In accordance with the 2010 Concessions Law, a concession means a special right to transfer possession and operations of state-owned property, for the creation and improvement of state and locally owned property, for the purpose of rendering basic social and infrastructure services to the public, based on an agreement, according to conditions and regulations specified in the Concessions Law.

Unlike other countries which limit concessions only to foreign investors, the 2010 Concessions Law defines a concessionaire as a Mongolian or foreign legal entity or their consortium that has obtained a concession according to the procedures set forth in the Concessions Law.

The purpose of the Concessions Law is to regulate issues regarding the organization of tenders for granting to investors the rights of possession, operation, creation, and renovation of state and local own properties under concession agreements, conclusion, modification, and termination of concession agreements and settlement of disputes. The 2010 Concessions Law not only does not limit concessions to either foreign investors or domestic entities, but also does not provide preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labor.

A concession agreement is a written agreement that implements a concession between the authorized entity and a concessionaire. The agreement specifies the scope of works and services to be performed by a concessionaire, the rights and duties of the parties, fees, charges and tariffs for concessionaire's services, terms and conditions for the transfer of a controlling package of shares of the concessionaire, financing issues, duties of the governmental authority to issue necessary permits, approval and licenses in connection with the concession, compensation and indemnification issues, reimbursement of additional costs incurred by the concessionaire, substitution of the concessionaire, terms and conditions relating to the transfer of concession items and other issues the parties deem it necessary to include in the concession agreement. The term of the concession agreement is agreed between the parties.

The 2010 Concessions Law specifies seven types of concessions:

- “Build-Operate-Transfer” – the concessionaire must build the concession object by using its own or raised funds, commission it, and operate it within the period specified in the agreement and transfer it, after the completion of the agreement period, to the state or local ownership in compliance with conditions stated in the agreement.
- “Build-Transfer” – the concessionaire shall build the concession object by using its own or raised funds, commission it and transfer it to state or local ownership, in accordance with the conditions stated in the agreement.
- “Build-Own-Operate” – the concessionaire must build the concession object by using its own or raised funds, commission it, own and operate in compliance with conditions and obligations stated in the agreement.
- “Build-Own-Operate-Transfer” – the concessionaire shall build the concession object by using its own or raised funds, commission it, operate and own it within the period specified in the agreement and transfer it after the completion of the agreement period to the state or local ownership, in compliance with conditions stated in the agreement.
- “Build-Lease-Transfer” – the concessionaire shall build the concession object by using its own or raised funds, commission it, give it to the possession of the authorized entity under a financial lease as specified in the agreement and transfer it to state or local ownership once the lease duration is complete.
- “Design-Build-Finance-Operate” – the concessionaire shall design and build the concession object by using its own or raised funds; operate it within the period specified in the agreement and transfer it after the completion of the period to state and/or local ownership in accordance with the conditions stipulated in the agreement.
- “Renovate-Operate-Transfer” – the concessionaire shall renovate the concession object by using its own or raised funds, operate it within the period specified in the agreement and transfer it together with the renovation to state or local ownership in accordance with the conditions stipulated in the agreement.

The objects eligible for concessions are not explicitly referred to in this law. The 2010 Concessions Law states that the government or the local parliament shall create a list of objects offered for transfer as concessions and the list of objects for a concession will be publicly announced. This announcement contains the title and description of the concession object, concession type, work, and services to be rendered, and specify whether financial assistance from budget funds shall be provided and guaranteed and whether a tender is to be organized as specified in the law or an agreement will be concluded directly.

Concessions may be publicly tendered or in specific cases can be contracted directly with a concessioner. If the concession right were to be granted through a tender, the authorized entity would advertise for tenders through national daily newspapers and other means of media, and proposals need to be submitted within two months of the announcement. Apart from meeting general requirements for tender submission, selection and evaluation of proposals will be based on the participant’s financial capacity, existence of an experienced and professional working team with technical and technological capacity, satisfaction of conditions necessary to obtain the special permits in accordance with the law on special permit for business entities, and other criteria deemed necessary by the authorized entity. If tendering conflicts with national security or rights relating to intellectual property necessary for

implementing the concession are in the ownership of the one or more entities with a common interest, or no proposal received in response to a tender invitation, or no qualifying proposals were received and it was deemed that there is little probability of proposals being received within the required period in case of a re-invitation, or the concession item has been transferred to other entities as part of the rights of the concession financier, then a concession right could be granted by concluding a direct agreement.

The 2010 Concessions Law also requires that the government shall publicly announce its decision on granting a concession. A concession agreement is required to be issued in written form and the term shall be mutually agreed by the parties, considering the specifics of the industry, period of implementing the investment plan, amount of investment, its recuperation time, profits and the period of the concession item usage.

In regards to the ownership rights related to a concession object, profits earned during the possession and operation of the concession, belong to the concessionaire. However, the tangible property and intellectual values created during the use of the concession shall remain state and local property. Besides this the concessionaire's may not pledge concessions objects as collateral for financing and prohibited to transfer its controlling shares to others, unless the concession agreement stipulates otherwise.

The state may provide financial support to the concessionaire either by providing tax credit or exemption according to relevant laws, issuing a loan guarantee, providing a certain part of concession financing, insurance coverage, issuing a guarantee for the minimum amount of the concessionaire's profit according to the concession agreement or providing compensation where this law and the concession agreement specify, etc. The amount, terms and conditions and requirements for state support will be specified by the concession agreement.

The state or local government may agree to reimburse the difference if actual costs exceed the service payment and tariff rates for works and services under the concession agreement. Taking into consideration the nature of the specific sector and the concession item, the reimbursement may be granted to the concessionaire until such time when the concessionaire can operate profitably.

Dispute settlement between the parties of a concession agreement may be resolved by the way of mutual reconciliation. The Concessions Law implies that international arbitration is possible for parties to a concession agreement. Only, disputes caused between the concessionaire and customer is subject to the legally defined procedures via courts, in Mongolia.

List of Other Applicable Mongolian Laws

Law on Auto Road was adopted on January 2, 1998.

The Law on Auto Transportation was adopted on June 4, 1999.

The Law on Civil Aviation was adopted on January 21, 1999.

The Law on using Air Space for Aviation was adopted on May 30, 2003.

Mongolian Laws and Regulations Relating to Labor, Health and Safety

The Mongolian Labor Law (1999) (“Labor Law”) and the Labor Safety and Sanitary Law (2008) (“Labor Safety Law”) contain provisions of general application in relation to labor, health and safety.

Labor legislation in Mongolia includes the Law on Setting up Minimum Labor Wage (2010) according to which the Government (Cabinet) and National Trilateral Committee of Labor and Social Consensus shall set the minimum labor wage, and the minimum labor wage in April 2011 was MNT140,400.

The Labor Law provides general provisions and detailed provisions regarding collective bargaining and contract, detailed clauses regarding independent contract and provisions regarding the grounds for terminating employment agreement, provisions governing wage and allocation of wages including the overtime, holiday and afterhours wages or day-off time, provisions regarding the labor condition, safety and health standards, the labor of women, juveniles, disabled and senior citizen’s and foreign citizens in Mongolian entities. The Labor Law also deals with the collective and individual dispute resolution.

An employer is responsible for maintaining a safe working environment that meets applicable safety and sanitation requirements. Furthermore, if the nature of an employee’s work so requires, the employer must provide special work garments and arrange for such employees to receive regular, preventative health examinations related to their work. Mining companies must create a special department, or appoint an officer, dedicated to overseeing matters of safety and sanitation. The Ministry of Social Welfare and Labor is responsible for adopting regulations governing labor safety and sanitation.

The Labor Law and the Labor Safety Law provide that in the event of an industrial accident the employer, at its own expense, must immediately transport injured employees to a hospital and take steps to eliminate any causes of harm created by the accident. Employers are obligated to investigate and report all industrial accidents. Regardless of whether an employee was covered by insurance for injuries sustained during an industrial accident, the employer must reimburse the employee in an amount determined as a percentage of the average salary of the employee. If the employee died as a result of the accident, the employer must reimburse the employee’s family in an amount equal to not less than the deceased employee’s average compensation for 36 months. Reimbursement under these provisions of the Labor Law and Labor Safety Law do not affect the employee’s entitlement to pensions or other benefits under social insurance or other laws.

If a company’s activities are proven to have an adverse impact on the health and safety of its employees, the State Professional Inspection Agency of Mongolia or other authorized official may take steps to force the company to remedy the breaches. If the company fails to remedy such breaches, it may be ordered to wholly or partially suspend business activities until the labor safety and sanitation requirements are satisfied. Additionally, failing to comply with labor safety and sanitation regulations, causing or concealing an industrial accident, or failing to pay requisite compensation for an industrial accident, may result in the imposition of administrative fines. In extreme cases, criminal sanctions may be imposed for violating the applicable Labor Law provisions.

The 2006 Minerals Law provides that local administrative and self-governing bodies are responsible for monitoring compliance with respect to health and safety regulations for workers and local residents. A mining license holder must carry out activities that ensure (i) safety for the citizens of the relevant soum or district and (ii) labor safety and proper sanitary conditions for its employees. The license holder must also submit an annual report on safety to the State Professional Inspection Agency and the MRAM.

If a license holder is found to have continually violated mining operation safety regulations, its license(s) may be suspended by a State inspector for up to two months, and if the deficiencies are not eliminated within this period, the license(s) may be revoked. If a mining license holder causes serious damage to human health through failure to implement safety rules and appropriate technical standards while using toxic chemicals and substances, its license may be revoked and no new license issued for a period of up to twenty years. Criminal sanctions may also be imposed for violating the health and safety provisions of the 2006 Minerals Law, in extreme cases.

Under the Subsoil Law of Mongolia (1988), a special mining rescue unit has been established by the Government of Mongolia, and mine operators are required to pay fees to support and maintain the services of this unit. Also under this law, the Ministry of Environment and Tourism of Mongolia and the MMRE are responsible for ensuring compliance with applicable safety rules and standards while conducting subsoil-related activities. If a mine operator is not in compliance with these safety rules and standards, it may be ordered to suspend its activities.

The Mongolian Fire Safety Law (1999) requires companies to observe fire prevention and extinguishing regulations, norms and standards and to train employees in fire fighting skills.

Specific provisions of the regulations implemented by the Ministry of Social Welfare and Labor pursuant to the Labor Law, newly amended and supplemented by the Labor Safety Law, effective from June 16, 2008, as the same may be amended and supplemented from time to time, govern:

- the air quality structure and permitted levels of poisonous gas in the atmosphere;
- fire prevention measures; permitted levels of dust in the atmosphere;
- provision of amenity rooms for mine operating personnel, medical and first-aid care, and a clean water supply;
- establishment of ancillary facilities for the health and welfare of mine operating personnel; and
- compliance with radiation safety norms and permitted levels of radioactive exposure.

Mine operators, as well as all employees working at a mine site, are responsible for complying with these regulations. A breach of the regulations, regardless of whether or not it results in an industrial accident, may result in disciplinary, administrative or criminal liability depending on the severity of the breach.

Law on Sending Work Force Abroad and Accepting Work Force and Specialists From Abroad was adopted on April 12, 2001. As the Article 1 states the purpose of the Law is to govern the issues regarding sending Mongolian citizens abroad and accepting foreign citizens to Mongolia for the purposes of employment and for protecting their right and interests.

Chapter 2 and especially Article 7 deals with the general conditions of a contract under which the work force and specialists are received in Mongolia and according to Article 9, business entity, organization or individual citizens shall pay a fee equal to two times of the minimum monthly wage for employing a foreign citizen in Mongolia and that fee is per month per each foreign citizen. Article 9.3 of the Law states that if a mining license holder employs foreign citizens in numbers more than stated in Article 43.1 of the 2006 Minerals Law than the fees stated in Article 43.2 of the Law shall be paid each month. (Article 43.1 of the 2006 Minerals Law states that the license holder is obliged to employ the citizens of Mongolia and up to 10 percent of the employees may be foreign citizens.

Article 43.2 provides that if the number of foreign citizens employed exceeds the percentage set forth in Article 43.1 the license holder shall pay 10 times the minimum monthly salary for each foreign citizen every month.)

Government Resolution No. 376, dated December 28, 2011 sets the percentage of foreign labor force and personnel allowed in mining and other companies. The percentage depends on the company's main operational direction, equity fund and number of total employees. For a company whose operation is exploration and mining of raw petroleum and natural gas and whose total equity fund is up to 50 million togrog, the percentage of foreign labor force and personnel may be up to 60%, if the total number of employee is from 51 to 100, the percentage may be up to 70%, if the total number of employee is more than 100, the percentage may be up to 75%. For a company whose equity fund is more than 51 million togrog, the percentage of foreign labor force and personnel may be up to 75% regardless of the total number of employees. For other mining and exploration companies, the percentage of foreign labor force and personnel may be up to 25% regardless of the company's equity fund and total number of employee.

Mongolian Laws Relating to Coal Export Requirements

A Mongolian mining company holding a valid mining license that extracts and processes coal has the right to export and sell the coal on the international market. There is no additional export license required. There are, however, certain requirements that must be complied with and procedures that must be followed in order to lawfully export coal.

First, a coal mining company must pay the appropriate royalty (addressed in more detail above) and obtain a document evidencing such payment from the relevant tax office. The royalty rate is based on the sales value, which in turn is dependent on a deemed sales price. In order to provide a uniform standard in this regard, the Ministry of Finance and the MMRE have issued a joint order to the effect that the prices to be used in calculating the royalty are those published in China Coal Weekly, a publication that is widely accepted as a definitive source of reliable information concerning the coal market in China. Coal is not subject to Mongolian export tax.

Second, the coal producer/exporter must obtain a certificate of origin from the Mongolian Chamber of Commerce and Industry in respect of each shipment of coal. This certificate of origin certifies that the source of the coal is from within Mongolia.

Finally, the producer/exporter must obtain a certificate from the Mongolian National Centre of Standardization and Measurement certifying that the coal to be shipped is properly classified. A representative from the Centre examines each shipment of coal and attests that it corresponds to a specified class of coal, for example thermal coal or coking coal.

In order to complete the coal export process, the coal producer/exporter must present the three aforementioned documents, along with the following additional documents, to the customs authority at the border crossing:

- a copy of the producer's mining license (to establish that the coal has been extracted and processed by a duly authorized Mongolian entity);
- a copy of the coal sales contract;
- a copy of the shipping contract; and
- other standard commercial shipping documentation.

Mongolian Laws Relating to Borrowing and Lending Activities

The Civil Code of Mongolia allows citizens, legal bodies and organizations to borrow money or other property in two ways: from other citizens, legal bodies or organizations or from banks or financial institutions. Article 281.1 of the Civil Code regulates the regular loan relationship between legal bodies while Article 451.1 of Civil Code regulates loan relation between legal bodies and banks or financial institutions. There is no restriction in the laws and legislation of Mongolia on borrowing from any individual, who might be considered connected persons of the borrower, but special decision making requirements defined by the 2011 Company Law pertains to contracts that involves conflict of interest.

Mongolian Laws and Regulations Relating to Land Tenure

Land Tenure

Land tenure in Mongolia is divided into: (i) ownership rights; (ii) possession rights; and (iii) use rights. Only Mongolian citizens can own land. Mongolian citizens, organizations and legal entities that are not deemed to be a business entity with foreign investment (“BEFI”) are entitled to possess land, which entitles them to pledge their interest and to transfer or lease it, all subject to approval by relevant authorities. BEFIs may only acquire use rights over land, which may not be transferred, pledged or leased.

Land possession and land use rights are evidenced by certificates issued by the local government authority in the city, aimag (province) or soum (district) in which the relevant property is located. Such certificates are issued in conjunction with a document that provides for the term of the land possession or land use rights and the requirements for maintaining such rights in good standing, most notably the payment of recurring fees to the local government (together a “Land Use or Possession Certificate”).

To engage in mining activities the license holder, if it is a BEFI, must acquire land use rights to the relevant land area. Under the Land Law of Mongolia enacted on June 7, 2002, and effective from January 1, 2003, as the same may be amended and supplemented from time to time (the “Land Law”), land use rights can be granted for a period of up to sixty (60) years, although in practice Land Use Certificates are typically issued for shorter terms. The Land Law provides that renewals may be made once or more than once, but that the maximum term of any renewal may not exceed a period of forty (40) years. The Foreign Investment Law of Mongolia enacted on May 10, 1993, effective from July 1, 1993, and amended May 29, 2008, as the same may be amended and supplemented from time to time (“Mongolia’s Foreign Investment Law”) further provides, in respect of BEFIs, that such renewals may not be made more than once.

Land Use or Possession Certificates are issued for a specific number of years and for a specific purpose stated in the relevant land use or possession agreement, and are usually renewable if the holder has complied with relevant requirements. Land possession and land use rights are subject to revocation by the issuing authority if the holder fails to comply with i) applicable provisions of the Land Law, ii) the terms of the relevant Land Use or Possession Certificate (most notably failure to make timely payment of recurring land use fees), or iii) applicable environmental protection obligations.

A mining license holder must enter into either a land possession or land use or possession agreement with relevant land owners, possessors, or the governing authorities of soums and districts and obtain the Land Use or Possession Certificate.

An exploration license is also not a real property interest and does not convey either land possession or land use rights to the holder. But it is not clear whether an exploration license holder must obtain a Land Use or Possession Certificate before conducting minerals exploration activities. The 2006 Minerals Law does not specifically provide that such holders must obtain such Land Use or Possession Certificates. All minerals in the ground are owned by the Government of Mongolia on behalf of the people of Mongolia. The holder of a mining license is entitled to extract and sell the minerals located within the land area covered by the license, and is eligible to hold them for up to a maximum of 70 years so long as it complies with all applicable legal requirements. We may sell minerals extracted from the relevant license area, subject to the payment of applicable royalties and income taxes. The mining license will be issued at first for 30 years and is extendable two times for 20 years each.

Government Resolution No. 302, dated September 30, 2009, states that the term of land use for a foreign investment enterprise holding a mining license relating to a Mineral Deposit of Strategic Importance shall be 30 years, extendable one time for 20 years.

Land Use for Special Needs

The Land Law provides that land can be taken for special needs by the relevant local government body for the purpose of turning the land into: (i) specially protected areas; (ii) lands allocated for ensuring national defense and security; (iii) land granted to foreign diplomatic and consular offices and representative offices of international organizations; (iv) sites reserved for conducting scientific and technological tests and experiments; (v) permanent environment and weather prediction and observation sites; (vi) pastures and hayfields; (vii) areas designated for oil exploration pursuant to production sharing agreements and (viii) free trade zones. Pursuant to the 2006 Minerals Law, the DGMCM may revoke a license on the grounds that the exploration or a mining area has been designated as special needs territory and the license holder has been fully compensated. Mongolia's Foreign Investment Law provides that the property of a foreign investor may be expropriated exclusively for public purposes or interests and only in accordance with due process of law on a non-discriminatory basis and with payment of full compensation. The 2006 Minerals Law further provides that a government agency which has issued a decision to take the land for special needs shall be obligated to compensate the license holder. If the parties fail to reach agreement, the amount of compensation shall be determined based on an adequate compensation amount determined by an authorized independent body. The 2006 Minerals Law provides that disputes relating to compensation shall be decided by a court.

Mongolian Laws Relating to Business Entities

On October 6, 2011, the State Great Hural adopted new edition of the Company Law of Mongolia. The Company Law introduces governance requirements for all companies. The Company Law provides general and detailed provisions regarding the legal status of a company and its establishment including, but not limited to, reorganization and liquidation, share capital of a company, dividends and transfer of a company's property, company's management and responsibilities of a company's authorized officials, and the provisions of major transactions or conflict-of-interest transactions.

Pursuant to Article 6.5 of the Company Law, controlled and subsidiary companies shall not be liable for the debts of its parent company and, unless otherwise provided by law and by an agreement, the parent company shall not be liable for debts of its controlled and subsidiary companies.

Mongolian Laws Relating to Business Entities with Foreign Investment

Where twenty-five percent (25%) or more of the paid-in-capital of a Mongolian company is contributed from foreign sources, such company is deemed to be a BEFI and the company must

register with the Foreign Investment Agency, a department under the umbrella of the Ministry of Foreign Affairs and Trade, and obtain a document certifying the company's status as a BEFI.

Mongolia's Foreign Investment Law defines the BEFI concept and provides for the duties and powers of the FID. In August 2008, Mongolia's Foreign Investment Law was amended to increase the minimum paid-in capital requirement for BEFIs from the equivalent of US\$10,000 to the equivalent of US\$100,000. In addition, the amendments expand the regulatory authority of the FID, giving it greater bureaucratic discretion in registering and supervising the operations of BEFIs. The FID may now terminate the BEFI status of, or order the cessation of activities by, any BEFI that the FID determines has not met various specified requirements or is deemed by the FID to have violated Mongolian laws.

Mongolian Laws Relating to Payments for Goods and Services in Local Currency

The Law on Implementing Payments in National Banknotes enacted in 2009 provides that (i) all posted tariffs and contracts between two parties within the territory of Mongolia must be stated in MNT; (ii) all payments made between two parties within the territory of Mongolia must be made in MNT; and (iii) parties within the territory of Mongolia are prohibited from including an adjustment mechanism in the terms of a contract that adjusts the agreed MNT price based on changes in foreign exchange rates. The Law of Mongolia on Implementing Payments in National Banknotes does not prohibit an offshore party and a Mongolian party from transacting in the currency of their choice, nor does the law prohibit a Mongolian party from paying into an offshore account or being paid in an offshore account in foreign currency.

Penalties for non-compliance with the Law of Mongolia on Implementing Payments in National Banknotes include confiscation of the proceeds of an illegal payment by the State, other administrative fines and revocation of a non-complying business's operating license.

Mongolian Laws Relating to Auditing

According to Article 7.1 of the Law on Auditing (1997), business entities and organizations with assets amounting to or above MNT50,000,000 and, unless otherwise provided by law and international treaties to which Mongolia is a party, foreign invested business entities and organizations shall procure so that their financial reports are confirmed by an auditing organization which is incorporated and registered in Mongolia. In case of a failure to appoint such auditing organization, the maximum penalty imposed will be approximately US\$524.

Sino-Mongolian Bilateral Treaties

There are several bilateral agreements between Mongolia and China.

Sino-Mongolian Border Railroad Agreement: The agreement has been entered between the Ministry of Infrastructure Development of Mongolia and Ministry of Railroad of China on October 17, 1955 in Ulaanbaatar, Mongolia. The agreement only has a few provisions such as traffic conditions of trains, procedure on arrangement of the cargo and transportation plans, telegraphic and telephone communication between the two parties, the adherence to the time schedule, terms and procedures to use the opposites of the boarder stations, constructions of roads and stations, staying of railroad employees in the other parties territory, procedure for serving trains interchange operations, traffic interruption, maintenance of rolling stock and railway, procedures during accident and breakdown issues regarding passenger transportation cargo transportation, responsibilities of the parties for any damages the transportation of spare parts material communication issues. The agreement also has a number of rules and procedures mainly for coordinating train traffic Zamyn-Uud and Yerlian boarder stations, procedure on maintaining a log book on both sides, procedures on mutual warning on traffic

and other necessary events, and procedures on passing for employees from both sides and their staying on the other territory of the other side. The agreement also has numerous forms for notification and log maintenance.

The Agreement between the Governments of China and Mongolia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income was signed on July 29, 1991 and came into force on January 1, 1993.

The Agreement on Friendly Relations and Cooperation between Mongolia and China was signed on April 29, 1994 and ratified by the State Great Hural on July 4, 1994.

The Intergovernmental Agreement between Mongolian Government and the Government of China on Protection and Use of Border Area Water which was signed on April 29, 1994 was ratified by the State Great Hural on January 3, 1995.

On June 9, 2006, the State Great Hural ratified Intergovernmental Agreement signed between the Government of Mongolia and the Government of China on November 28, 2005 titled 'General Loan Agreement' regarding usage of export soft loan for the amount of US\$300 million.

The Intergovernmental Agreement between the Governments of China and Mongolia on Auto Transportation was signed on June 16, 2011 and approved by the Government on August 24, 2011.

Mongolian Air Pollution Laws

On June 24, 2010, the State Great Hural adopted the Air Pollution Fee Law, which imposes fees on entities that pollute, including persons engaged in raw coal mining, producers and importers of organic absorbent, users of auto vehicles and self-moving equipment, holders of licenses to use significant and stationary sources of air pollution and citizens, business entities and organizations using sources of air pollution.

The fee for extracting raw coal is between MNT1 to 2 per kilogram of coal and for producing and importing organic absorbent between MNT10 to 30 per kilogram of organic absorbent. The fee for emission of carbon dioxide by auto vehicles and self-moving equipment that emit more than 120 grams of carbon dioxide per kilometer per year is between MNT1,800 and 9,500 per year per vehicle/equipment, based on the amount of emissions. The fee for waste of significant and stationary sources of air pollution is between MNT1 to 10 per kilogram of waste. Exemptions from fees exist where raw coal is highly processed and new fuel is produced that meets standard requirements. Business entities and organizations extracting raw coal for ensuring national security and protecting public interest and producing power may be exempt from the fee subject to regulations adopted by the Government.

Based upon the range of MNT1 to 2 defined by the 2010 Air Pollution Fee Law, the Government of Mongolia published Resolution Number 273 on October 20, 2010 and specifically defined the air pollution fee for the coal mining industry to be MNT1 for every kilogram of raw coal mined.

Certain Mongolian Tax Laws

This section does not purport to be a comprehensive description of the Mongolian tax system.

Mongolian tax law sets forth a general structure of taxation but in many circumstances fails to provide clear or detailed guidance as to how the general provisions contained in the law are to be applied to specific transactions. This lack of detailed guidance may lead to inconsistent implementation of the law by the tax authorities.

The basic Mongolian tax law is the General Law on Taxation which provides the overall structure of the tax regime and the general rights and obligations of taxpayers and the taxation authorities. This law has been substantially amended, effective as of July 1, 2008. Specific laws, such as the Economic Entity Income Tax Law, the Personal Income Tax Law and the Value-Added Tax Law, address specific areas of the tax law. These three tax laws were substantially amended, effective as of January 1, 2007. Notwithstanding such amendment, these laws remain rudimentary.

A summary of the principal tax legislation that may affect the operations of the Company in Mongolia is as follows:

- The general income tax rate applicable to business entities with Mongolian source income is 10% on the first MNT3 billion of taxable income and 25% on amounts in excess thereof. These rates are applicable to operating and certain other types of income (e.g., capital gains on the sale of shares and equipment). Other types of income (e.g., capital gains on the sale of real property, interest, royalty and dividend income) are subject to other, varying rates of income tax.
- Taxable operating income of a Mongolian business entity is determined by taking into account operating income received less permitted deductions. Mongolian tax law does not always permit all items of expense incurred in the furtherance of the business purpose of the enterprise (as such concept would be understood in more developed jurisdictions) to be fully deducted when determining taxable operating income.
- Effective from January 1, 2010, the Business Entity Income Tax Law has been amended to allow for operating losses accumulated by mining companies as well as companies that are operating in the infrastructure sector to be carried forward and deducted from taxable income for a period of four to eight years following the year in which the loss was incurred, the determination of the carry-forward period applicable to any particular mining company to be determined by the Resolution No. 287 of the Government of Mongolia (2009) after taking into consideration the investment made by such company in its mining operations. In the case of mining companies, the loss carry-forward deduction can be applied to 100% of the taxable income calculated in the relevant tax year.
- In the absence of a tax treaty, (i) dividend income received from a business entity that is registered and operates in Mongolia; (ii) loan interest from a guarantee, royalty income and interest from finance lease; (iii) rental income from tangible and intangible asset lease; and (iv) income resulting from goods sold and services provided within Mongolia, received by a non-resident legal entity from a Mongolian source are subject to Mongolian income tax rate of 20%. The Mongolian legal entity making such payments is obligated to withhold the Mongolian income tax from such payments. Mongolia has entered into double tax treaties with a number of countries. Such treaties may provide for lower rates of taxation in certain circumstances. To date, Mongolia has signed double taxation treaties with 35 countries, out of which 30 treaties are in force or ratified.
- VAT at a rate of 10% is payable in respect of all goods sold, work performed and services provided within Mongolia. VAT is also payable in respect of goods imported into Mongolia and in respect of certain service fee payments made by Mongolian taxpayers to non-resident service providers. If a legal entity is registered as a value-added taxpayer, it can obtain credits for such tax paid to its suppliers of goods and services and can use such credits to offset value-added, or other, taxes owed in Mongolia. However, the Law on VAT provides certain conditions which may limit the ability of a legal entity to register as a value-added taxpayer. On July 21, 2009, the Parliament has passed the Amendment pursuant

to which only exported “finished mineral products” become subject to zero rate VAT. Before the Amendment, there was no distinction between finished and unprocessed mineral products; and all mineral products that were exported were subject to zero rate VAT regardless of their level of processing. As such, an exporter/producer of mineral products could have had the VAT refunded at 10% rate on the purchases of services and goods paid for its operation to produce exported minerals. However, after the enactment of the Amendment on July 21, 2009 as mentioned previously, only so-called finished mineral products are subject to zero rate VAT, and sales of other minerals are exempted from the payment of VAT under newly introduced Article 13.1.16 of Law on VAT. This means that an exporter or producer of mineral products, other than “finished mineral products” for export, are not entitled to have the VAT paid on the purchases of goods and services used for its mining operation refunded. As a result, operating costs of an exporter or producer of mineral ore or unprocessed mineral will increase. The Amendment did not define what constituted exported “finished mineral products”. Instead, it provides that the Government (the Cabinet) shall adopt a regulation on list and category of the finished mineral products. As such, until the Government adopted its regulation on the list of finished mineral products and provided guidance on the implementation of the Amendment, it was unclear whether the Amendment is currently enforceable. The Amendment was passed on July 21, 2009 was silent on its effective date. According to Article 26.3 of the Constitution of Mongolia and Article 43.2 of the Law on State Great Hural (Parliament) of Mongolia, if a law in question does not provide specific date of its entry into force, the law will enter into force ten days after its official publication thereof on a Government gazette called “The Government News” (“Turiin Medeelel”). As the Amendment was published on August 6, 2009, the Law should be in effect commencing on 16 August, 2009. However, the Government has issued on 10 November, 2010 its Resolution No. 286 on the List of Final Mining Products, which includes Coal washed and processed (code 2701.19.00), Briquette and compressed coal generated from the coal and similar solid fuel (code 2701.20.00), Coal coke and semi-coke (code 2704.00.10), and Lignite coke and semi-coke (code 2704.00.20). Finished products that are exported are, however, subject to a zero rate of VAT and VAT paid to produce such products may be claimed back.

- Equipment and other goods imported into Mongolia are also subject to an import duty, generally at the rate of 5%. An additional excise tax is payable on the importation of petroleum products and some motor vehicles. It should be noted that value-added tax is also imposed on them.
- Mongolian employers are required to withhold income tax and social insurance fees owed by their employees from salaries payable to such employees, and to make an additional employer payment to the Mongolian social insurance fund. The relevant laws have been substantially revised, and effective from May 8, 2008 these rules apply to Mongolian and non-Mongolian employees. These rules also apply to independent contractors. Payments to the social insurance fund are to be made in respect of all salary, bonus and benefit payments (e.g., housing and transportation allowances) received by the individual. Employees must pay 10% of such total compensation package (to be withheld by the employer), but such percentage will be applied to a maximum compensation amount which is adjusted annually but which is currently set at MNT1,404,000 per month (i.e., income in excess of this amount is not subject to the 10% assessment). The employer must pay an additional 11-13% (13% in respect of employees engaged in dangerous occupations, such as mining) and such percentage is applied to all compensation paid to the employee with no maximum amount limitation.

- The Company and the Company's Mongolian subsidiaries will be obligated to make other regular payments which do not fall under the above-noted tax laws of Mongolia. For example, fees will be payable in respect of foreign citizens employed in Mongolia, for the use of water, for lease payments in respect of land surface rights, for environmental bonding obligations (addressed in more detail above), for annual mineral license fees and other license renewal fees, for mineral royalties, air pollution fee and for annual vehicle taxes, and fees for usage of auto road.

DESCRIPTION OF OTHER MATERIAL INDEBTEDNESS

US\$180 Million EBRD, FMO and DEG Loan Agreements

ER LLC has entered into an aggregate of US\$180 million loan facility agreements with (i) EBRD dated May 12, 2010, amended and restated on August 11, 2010 and further amended on October 8, 2010, (ii) FMO dated August 11, 2010 and further amended on October 13, 2010, and (iii) DEG dated August 11, 2010 and further amended on October 13, 2010, and each of them further amended on March 5, 2012 (collectively, the “EBRD, FMO and DEG Loan Agreements”), the proceeds of which were applied to the development of our CHPP. As of December 31, 2011, interest was payable semi-annually at the rate of six-month LIBOR plus a margin of 4.75%-6.85% per annum. Pursuant to the March 5, 2012 amendments to the EBRD, FMO and DEG Loan Agreements, interest is now payable semi-annually at the rate of six-month LIBOR plus a margin of 3.25%-3.75% per annum. US\$120 million principal amount of the loans are repayable in 11 semi-annual installments ending on May 15, 2016 and US\$60 million principal amount of the loans are repayable in two equal installments on May 15, 2015 and May 15, 2016. As of December 31, 2011, the outstanding principal amount was US\$169.1 million.

The EBRD, FMO and DEG Loan Agreements are secured by a comprehensive security package including fiducial security over accounts of our subsidiaries, our construction agreement with Sedgman for our CHPP, our coal mining agreement with Leighton, our offtake agreements, our CHPP, our water supply infrastructure assets and our 3x6 MW power plant. ER LLC is obligated to ensure that its debt service coverage ratio is not less than 1.50 to 1, its leverage ratio is less than 3.00 to 1, its current ratio is not less than 1.10 to 1 and total liabilities to tangible net worth ratio is less than 2.00 to 1. In the year ended December 31, 2011, ER LLC was in violation of the debt service coverage ratio, the current ratio and the total liabilities to tangible net worth ratio. EBRD, FMO and DEG each waived these breaches to the EBRD, FMO and DEG Loan Agreements for such period.

Subject to certain exceptions, none of ER LLC nor its subsidiaries may (i) pay any dividends at any time when a default has occurred and is continuing, (ii) spend more than US\$30 million per year on any capital expenditures other than the coal handling and preparation plant and its related infrastructure, (iii) incur or permit to be outstanding any financial indebtedness if the Borrower is in breach of any financial ratio specified above, (iv) be the creditor in respect of any financial indebtedness or guarantee any obligation of another person, (v) create or allow to exist any security interest over its assets, (vi) enter into any derivative transaction, except in the ordinary course of business with an aggregate open position not exceeding US\$10 million, (vii) dispose of all or a substantial part of its assets or (viii) open or maintain any bank account. The EBRD, FMO and DEG Loan Agreements contain customary events of default.

Existing Standard Bank Facilities Agreement

We entered into an aggregate of US\$400 million loan facility agreement with Standard Bank dated June 24, 2011 (the “Existing Standard Bank Facilities Agreement”), the proceeds of which were used to acquire our BN mine and for our general working capital and capital expenditure requirements. Interest is payable quarterly at the rate of six-month LIBOR plus a margin of 3.25% per annum. The loan matures on March 23, 2012. Energy Resources Corporation LLC has guaranteed our obligations under the loan. We and ER LLC granted a security interest in favor of Standard Bank over certain accounts to secure the facilities. As of December 31, 2011, the outstanding principal amount was US\$298.8 million.

The Existing Standard Bank Facilities Agreement contains customary covenants including, without limitation, on incurrence of financial indebtedness, acquisitions, disposals and capital expenditures and customary events of default.

We plan to repay the outstanding principal amount due under the Existing Standard Bank Facilities Agreement with cash and a portion of the amount we plan to draw down under the New Standard Bank Facilities Agreement.

New Standard Bank Facilities Agreement

We have entered into a term loan facilities agreement with Standard Bank on March 8, 2012, pursuant to which Standard Bank and potentially a syndicate of lenders have agreed to make available to us term loan facilities of up to US\$300 million (the “New Standard Bank Facilities Agreement”). The facilities under the New Standard Bank Facilities Agreement will be split into two tranches of US\$250 million and US\$50 million (increasable to up to US\$100 million if up to US\$50 million is undrawn in the first tranche). The latter tranche will be made available to us when the relevant lenders have confirmed their commitments. We plan to draw down US\$50 million under the facilities on March 14, 2012 for our cash needs and US\$150 million on March 23, 2012 to repay a portion of the outstanding amount under the Existing Standard Bank Facilities Agreement.

Interest is payable quarterly at the rate of the applicable LIBOR plus a margin of 5.25% per annum. The facilities will mature three years after the first draw down date and are repayable in installments on a quarterly basis, commencing on the last business day of December 2012. Each of the Subsidiary Guarantors has guaranteed our obligations under the New Standard Bank Facilities Agreement. In addition, ER LLC and we will grant a security interest in favor of Standard Bank over certain accounts, coal collateral and our rights under certain of our coal sales contracts to secure the facilities. Substantially simultaneous with the issuance of the Notes contemplated hereunder, the Collateral will be charged to secure both our obligations under the Notes and the facilities, on a pari passu basis. Deutsche Bank Trust Company Americas, the Subsidiary Guarantors, the trustee of the Notes and we will enter into an intercreditor agreement regulating the creditors’ rights with respect to the Collateral and the guarantees provided by the Subsidiary Guarantors with respect to the Notes and our obligations under the facilities. See “Description of the Notes – Security – Intercreditor Agreement.”

The New Standard Bank Facilities Agreement contains customary covenants including without limitation on incurrence of financial indebtedness, acquisitions, disposals and capital expenditure and customary events of default. In addition, we will need to comply with certain financial covenants, including maximum leverage ratio, minimum interest coverage ratio, security coverage ratio and minimum consolidated tangible net worth.

QGX Convertible Bonds

The US\$85 million 2.0% QGX Convertible Bonds due December 2012 were issued by us on June 1, 2011 to and QGX Holdings Ltd. We issued the QGX Convertible Bonds as part of our consideration for the acquisition of our BN mine. The QGX Convertible Bonds will mature on December 1, 2012. The maturity date is extendable to March 1, 2013 subject to a reserve adjustment. The QGX Convertible Bonds are convertible into our shares at the bondholder’s option in the four days prior to the maturity date at a conversion rate of HK\$10.92 per share. If our consolidated leverage ratio exceeds 5.5 to 1, the interest rate of the Convertible Bonds will increase to 4.0% per annum.

Khan Bank Loan Agreement

ER LLC has entered into a US\$13 million loan agreement with Khan Bank LLC (“Khan Bank”) dated December 26, 2011 (the “Khan Bank Loan Agreement”). Interest is payable monthly at the rate of 11% per annum. The loan matures on December 30, 2012. Transgobi LLC has granted a security interest in favor of certain our motor vehicles to secure the loan. As of December 31, 2011, the outstanding principal amount was US\$13.0 million.

Intercreditor Agreement

To regulate the application of proceeds of enforcement of the Collateral and the application of proceeds of enforcement of the guarantees provided by the Subsidiary Guarantors with respect to the Notes, our obligations under the New Standard Bank Facilities Agreement and any obligations in respect of any Permitted Pari Passu Secured Indebtedness (together the “**Shared Guarantees**”), the Company, the Subsidiary Guarantors, Standard Bank, the trustee of the Notes and the Shared Security Trustee (amongst others) anticipate entering into the Intercreditor Agreement on the Original Issue Date. See “Description of the Notes – Intercreditor Agreement”

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED 31 DECEMBER 2009, 2010 AND 2011

Independent Auditor's Report.	F-2
Consolidated Statement of Comprehensive Income for the years ended 31 December 2009, 2010 and 2011	F-3
Consolidated Balance Sheet at 31 December 2009, 2010 and 2011.	F-4
Consolidated Statement of Changes in Equity for the years ended 31 December 2009, 2010 and 2011	F-5
Consolidated Cash Flow Statement for the years ended 31 December 2009, 2010 and 2011	F-6
Notes to the Financial Statements	F-7

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Mongolian Mining Corporation
(Incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Mongolian Mining Corporation (the "Company") and its subsidiaries (together referred to as the "Group") set out on pages F-3 to F-6, which comprise the consolidated balance sheets as at 31 December 2009, 2010 and 2011, and the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the years then ended (the "Relevant Period"), and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the consolidated financial statements

The directors of the Company are responsible for the preparation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. This report is made solely to you, as a body and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2009, 2010 and 2011 and of the Group's profit and cash flows for the years then ended and have been prepared in accordance with International Financial Reporting Standards.

Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

6 March 2012

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
for the years ended 31 December 2009, 2010 and 2011

	Note	2009	2010	2011
		USD'000	USD'000	USD'000
Revenue	4	66,983	277,502	542,568
Cost of revenue	5	(38,682)	(164,368)	(336,368)
Gross profit		28,301	113,134	206,200
Other revenue		70	511	435
Other net expenses		(35)	(187)	76
Administrative expenses		(10,427)	(38,685)	(60,303)
Profit from operations		17,909	74,773	146,408
Finance income	6(a)	342	12,335	22,236
Finance costs	6(a)	(3,860)	(4,214)	(13,785)
Net finance (costs)/income	6(a)	(3,518)	8,121	8,451
Share of (losses)/profits of associates		(10)	2	(119)
Profit before taxation	6	14,381	82,896	154,740
Income tax	7	(4,111)	(22,757)	(35,650)
Profit for the year		10,270	60,139	119,090
Other comprehensive income for the year	9			
Exchange differences on re-translation		31	7,601	(79,153)
Total comprehensive income for the year		10,301	67,740	39,937
Profit attributable to the equity shareholders of the Company		10,270	60,139	119,090
Total comprehensive income attributable to the equity shareholders of the Company		10,301	67,740	39,937
Basic earnings per share	8	0.34 cents	1.91 cents	3.21 cents
Diluted earnings per share	8	0.34 cents	1.91 cents	3.07 cents

The notes on pages F-7 to F-56 form part of these financial statements. Details of dividends payable to equity shareholders of the Company attributable to the profit for the year are set out in Note 28(a).

CONSOLIDATED BALANCE SHEET
at 31 December 2009, 2010 and 2011

	Note	2009 USD'000	2010 USD'000	2011 USD'000
Non-current assets				
Property, plant and equipment, net.	11	30,358	76,646	347,109
Construction in progress	12	43,985	232,784	183,229
Lease prepayments	13	105	118	105
Intangible assets	14	–	–	681,352
Interest in associate	15	14	19	4,278
Other non-current assets	16	8,372	26,889	7,423
Deferred tax assets	22(b)	328	1,681	9,698
Total non-current assets		<u>83,162</u>	<u>338,137</u>	<u>1,233,194</u>
Current assets				
Inventories	17	7,661	7,876	57,734
Trade and other receivables	18	20,036	32,350	109,322
Cash at bank and in hand	19	2,371	674,907	227,765
Total current assets		<u>30,068</u>	<u>715,133</u>	<u>394,821</u>
Current liabilities				
Short-term borrowings and current portion of long-term borrowings	20(b)	24,200	85,909	333,568
Trade and other payables	21	17,107	40,315	118,680
Current taxation	22(a)	795	5,455	17,508
Convertible bond	23	–	–	83,508
Obligations under finance leases		–	–	247
Total current liabilities		<u>42,102</u>	<u>131,679</u>	<u>553,511</u>
Net current (liabilities)/assets		<u>(12,034)</u>	<u>583,454</u>	<u>(158,690)</u>
Total assets less current liabilities		<u>71,128</u>	<u>921,591</u>	<u>1,074,504</u>
Non-current liabilities				
Interest-bearing borrowings, less current portion.	20(a)	10,000	165,214	144,661
Long-term payables	25	15,215	16,811	–
Provisions	26	1,705	6,904	11,110
Deferred tax liabilities	22(b)	367	5,381	149,656
Obligations under finance leases		–	–	213
Total non-current liabilities		<u>27,287</u>	<u>194,310</u>	<u>305,640</u>
NET ASSETS		<u>43,841</u>	<u>727,281</u>	<u>768,864</u>
CAPITAL AND RESERVES				
Share capital	27	–	37,050	37,050
Reserves	28	43,841	690,231	731,814
TOTAL EQUITY		<u>43,841</u>	<u>727,281</u>	<u>768,864</u>

Approved and authorised for issue by the board of directors on [6 March 2012].

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) Directors
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The notes on pages F-7 to F-56 form part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the years ended 31 December 2009, 2010 and 2011

	Note	Share capital	Share premium	Other reserve	Exchange reserve	(Accumulated losses)/ retained earnings	Total equity
		USD'000 (Note 27(b))	USD'000 (Note 28(a))	USD'000 (Note 28(b))	USD'000 (Note 28(c))	USD'000	USD'000
At 1 January 2009		—	—	25,819	(1,507)	(9,522)	14,790
Increase in other reserve	28(b)	—	—	18,750	—	—	18,750
Total comprehensive income for the year		—	—	—	31	10,270	10,301
At 31 December 2009		—	—	44,569	(1,476)	748	43,841
At 1 January 2010		—	—	44,569	(1,476)	748	43,841
Share issued upon incorporation	27(c)	—	—	—	—	—	—
Nominal value of share capital of new subsidiaries acquired	27(c)	—	—	(30,000)	—	—	(30,000)
Shares issued pursuant to capitalisation issue	27(c)	30,000	—	—	—	—	30,000
Shares issued pursuant to the global offering and upon the exercise of the over-allotment option, net of share issuing costs	27(c)	7,050	608,650	—	—	—	615,700
Total comprehensive income for the year		—	—	—	7,601	60,139	67,740
At 31 December 2010		37,050	608,650	14,569	6,125	60,887	727,281
At 1 January 2011		37,050	608,650	14,569	6,125	60,887	727,281
Changes in equity for 2011:							
Equity-settled share-based Transactions	24	—	—	1,646	—	—	1,646
Total comprehensive income for the year		—	—	—	(79,153)	119,090	39,937
At 31 December 2011		37,050	608,650	16,215	(73,028)	179,977	768,864

The notes on pages F-7 to F-56 form part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT
for the years ended 31 December 2009, 2010 and 2011

	Note	2009 USD'000	2010 USD'000	2011 USD'000
Cash flows from operating activities				
Profit before taxation		14,381	82,896	154,740
Adjustments for:				
Depreciation and amortisation		1,865	3,204	19,370
Allowance for doubtful debts		—	—	4,145
Share of losses/(profits) of associates		10	(2)	119
Loss on disposal of property, plant and equipment		35	187	438
Net finance costs/(income)		194	(8,280)	(8,451)
Transaction costs in relation to acquisition	32	—	—	4,299
Equity-settled share-based payment expenses		—	—	1,646
Changes in working capital:				
Increase in inventories		(7,646)	(215)	(55,879)
Increase in trade and other receivables		(6,997)	(8,092)	(88,441)
(Decrease)/Increase in trade and other payables		(4,561)	15,088	14,997
Cash generated (used in)/from operations		(2,719)	84,786	46,983
Income tax paid		(1,305)	(15,145)	(25,998)
Net cash generated (used in)/from operating activities . . .		(4,024)	69,641	20,985
Investing activities				
Payments for acquisition of property, plant and equipment and construction in progress		(58,562)	(220,242)	(292,294)
Proceeds from disposal of property, plant and equipment . . .		460	213	3,069
Payment for acquisition of a subsidiary, net	32	—	—	(103,494)
Payment for acquisition of associates		—	—	(4,820)
Amount due from related party		(2,301)	—	—
Time deposits		(2,000)	(344,645)	159,886
Interest received		342	294	22,236
Net cash used in investing activities		(62,061)	(564,380)	(215,417)
Financing activities				
Proceeds from issue of shares		18,750	617,716	—
Proceeds from borrowings		53,331	232,331	143,864
Payments in advance from customers		14,668	—	—
Repayment of borrowings		(22,131)	(11,531)	(201,713)
Interest paid		(1,935)	(6,822)	(19,634)
Payment of transaction costs on issue of shares		—	(2,016)	—
Other borrowing costs paid		—	(6,183)	(2,388)
Net cash generated from/(used in) financing activities . . .		62,683	823,495	(79,871)
Net (decrease)/increase in cash and cash equivalents		(3,402)	328,756	(274,303)
Cash and cash equivalents at beginning of the year		3,791	371	328,262
Effect of foreign exchange rate changes		(18)	(865)	(12,953)
Cash and cash equivalents at end of the year	19	371	328,262	41,006

Major non-cash transactions:

- (a) For the non-cash transactions related to acquisition of subsidiaries, please refer to Note 32.
- (b) According to the relevant tax regulations in Mongolia, the income tax payable can be offset by the value-added tax ("VAT") receivables. During the year ended 31 December 2011, the Group offset the VAT receivables of USD9,470,000 with income tax payable (see Note 22(a)).

Note: For the major non-cash transactions, please refer to Note 32.

The notes on pages F-7 to F-56 form part of these financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 CORPORATE INFORMATION

Mongolian Mining Corporation (“the Company”) was incorporated in the Cayman Islands on 18 May 2010 as an exempted company with limited liability under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. The Company and its subsidiaries are principally engaged in the mining, transportation and sale of coal.

Pursuant to a group reorganisation completed on 17 September 2010 (the “Reorganisation”) to rationalise the group structure for the public listing of the Company’s shares on the Main Board of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”), the Company’s shares were listed on the Stock Exchange on 13 October 2010. Details of the Reorganisation are set out in the prospectus of the Company dated 28 September 2010.

Pursuant to a share purchase agreement dated 31 May 2011, the Group acquired the entire issued share capital of Baruun Naran Limited (formerly named as “QGX Coal Limited”) (“QGX”). Details of the acquisition are set out in Note 32.

2 SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

These financial statements of the Company and of the Group have been prepared in accordance with International Financial Reporting Standards (“IFRSs”), promulgated by the International Accounting Standards Board (“IASB”). IFRSs include all applicable individual International Financial Reporting Standards, International Accounting Standards (IASs) and related interpretations. The financial statements also comply with the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on the Stock Exchange. A summary of the significant accounting policies adopted by the Group (as defined below) is set out below.

The IASB has issued certain new and revised IFRSs that are first effective or available for early adoption during the Relevant Period of the Group and the Company.

(b) Basis of preparation of the financial statements

The consolidated financial statements for the years ended 31 December 2009, 2010 and 2011 comprise the Company and its subsidiaries (together referred to as the “Group”) and its interest in associates.

The Group adopts the use of a principle similar to that for a reverse acquisition, rather than following its legal form, in the preparation of its financial statements for the years ended 31 December 2009 and 2010. The directors consider that Energy Resources LLC is the accounting parent during the years ended 31 December 2009 and 2010. Details of the companies comprising the Group are set in Note 34.

The measurement basis used in the preparation of the financial statements is the historical cost basis except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- Derivative financial instruments (see Note 2(f)); and
- Share-based payments (see Note 2(q)(ii)).

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of IFRSs that have significant effect on the financial statements and major sources of estimation uncertainty are discussed in Note 3.

(c) Subsidiaries and non-controlling interests

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An interest in a subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. Intra-group balances and transactions and any unrealised profits arising from intra-group transactions are eliminated in full in preparing the financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains but only to the extent that there is no evidence of impairment.

Non-controlling interests (previously known as “minority interests”) represent the equity in a subsidiary not attributable directly or indirectly to the Company, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. For each business combination, the Group can elect to measure any non-controlling interests either at fair value or at their proportionate share of the subsidiary’s net identifiable assets.

Non-controlling interests are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity shareholders of the Company. Non-controlling interests in the results of the Group are presented on the face of the consolidated statement of comprehensive income as an allocation of the total profit or loss and total comprehensive income for the year between non-controlling interests and the equity shareholders of the Company. Loans from holders of non-controlling interests and other contractual obligations towards these holders are presented as financial liabilities in the consolidated balance sheet in accordance with Notes 2(n) or (o) depending on the nature of the liability.

Changes in the Group's interests in a subsidiary that do not result in a loss of control are accounted for as equity transactions, whereby adjustments are made to the amounts of controlling and non-controlling interests within consolidated equity to reflect the change in relative interests, but no adjustments are made to goodwill and no gain or loss is recognised.

When the Group loses control of a subsidiary, it is accounted for as a disposal of the entire interest in that subsidiary, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former subsidiary at the date when control is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset or, when appropriate, the cost on initial recognition of an interest in an associate (see Note 2(d)).

In the Company's balance sheet, an interest in a subsidiary is stated at cost less impairment losses (see Note 2(j)), unless the investment is classified as held for sale (or included in a disposal group that is classified as held for sale).

(d) Associates

An associate is an entity in which the Group has significant influence, but not control, over its management, including participation in the financial and operating policy decisions.

An interest in an associate is accounted for in the consolidated financial statements under the equity method, unless it is classified as held for sale (or included in a disposal group that is classified as held for sale). Under the equity method, the investment is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the investee's net assets and any impairment loss relating to the investment (see Note 2(j)(i)). The Group's share of the post-acquisition, post-tax results of the investees and any impairment losses for the year are recognised in profit or loss whereas the Group's share of the post-acquisition post-tax items of the investees' other comprehensive income are recognised in other comprehensive income in the consolidated statement of comprehensive income.

When the Group's share of losses exceeds its interest in the associate, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the investee. For this purpose, the Group's interest is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net interest in the associate.

Unrealised profits and losses resulting from transactions between the Group and its associate are eliminated to the extent of the Group's interest in the investee, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in profit or loss.

When the Group ceases to have significant influence over an associate, it is accounted for as a disposal of the entire interest in that investee, with a resulting gain or loss being recognised in profit or loss. Any interest retained in that former investee at the date when significant influence is lost is recognised at fair value and this amount is regarded as the fair value on initial recognition of a financial asset or, when appropriate, the cost on initial recognition of an interest in an associate (see Note 2(d)).

(e) Goodwill

Goodwill represents the excess of:

- (i) the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the Group's previously held equity interest in the acquiree; over
- (ii) the Group's interest in the net fair value of the acquiree's identifiable assets and liabilities measured as at the acquisition date.

When (ii) is greater than (i), then this excess is recognised immediately in profit or loss as a gain on a bargain purchase.

Goodwill is stated at cost less accumulated impairment losses. Goodwill arising on a business combination is allocated to each cash-generating unit, or groups of cash generating units, that is expected to benefit from the synergies of the combination and is tested annually for impairment.

On disposal of a cash generating unit during the year, any attributable amount of purchased goodwill is included in the calculation of the profit or loss on disposal.

(f) Derivative financial instruments

Derivative financial instruments are recognised initially at fair value. At each balance sheet date the fair value is remeasured. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss.

(g) Property, plant and equipment

Property, plant and equipment, which consist of buildings, plant and equipment, motor vehicles, office equipment, mining structures and mining rights are initially stated at cost less accumulated depreciation and impairment losses (see Note 2(j)(ii)). The cost of an asset comprises its purchase price, any directly attributable costs of bringing the asset to its present working condition and location for its intended use, the cost of borrowed funds used during the period of construction and, when relevant, the costs of dismantling and removing the items and restoring the site on which they are located, and changes in the measurement of existing liabilities recognised for these costs resulting from changes in the timing or outflow of resources required to settle the obligation or from changes in the discount rate.

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other cost is recognised as an expense in profit or loss in the period in which it is incurred.

When proven and probable coal reserves have been determined, costs incurred to develop coal mines are capitalised as part of the cost of the mining structures. Stripping costs incurred during the development of a mine are capitalised into construction in progress. Stripping costs incurred during the 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 capitalised into property, plant and equipment as mining structures. Future benefits arise when stripping activity increases the future output of the mine by providing access to a new ore body.

Expenditure during the initial exploration stage of a project is charged to profit or loss as incurred. Exploration and evaluation costs, including the costs of acquiring licenses, are capitalised as exploration and evaluation assets on a project-by-project basis pending determination of the technical feasibility and commercial viability of the project.

All other expenditures, including the cost of repairs and maintenance and major overhaul, are expensed as they are incurred.

Construction in progress represents property, plant and equipment under construction and equipment pending installation, and is initially recognised at cost less impairment losses (Note 2(j)(ii)). Cost comprises cost of materials, direct labour and an appropriate proportion of production overheads and borrowing costs (Note 2(w)). Capitalisation of these costs ceases and the construction in progress is transferred to property, plant and equipment when the asset is substantially ready for its intended use. No depreciation is provided in respect of construction in progress until it is completed and substantially ready for its intended use.

Gains or losses arising from the retirement or disposal of an item of property, plant and equipment are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in profit or loss on the date of retirement or disposal.

Depreciation is calculated to write off the cost of items of property, plant and equipment, other than mining structures and mining rights, over their estimated useful lives using the straight-line method, after taking into account the estimated residual values.

The estimated useful lives of property, plant and equipment are as follows:

	<u>Depreciable life</u>
– Buildings and plants	10-40 years
– Machinery and equipment	10 years
– Motor vehicles	5-10 years
– Office equipment	3-10 years

Mining structures and mining rights, except for capitalised stripping costs incurred during the production phase, are depreciated on the units-of-production method utilising only proven and probable coal reserves in the depletion base.

Capitalised stripping costs incurred during the production phase are depleted to the extent that the actual waste to ore ratio is lower than the estimated ratio.

No depreciation is provided in respect of construction in progress until it is substantially completed and ready for its intended use.

Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a reasonable basis between parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually.

(h) Intangible assets

Intangible assets (acquired mining rights and operating right related to paved road) acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following the initial recognition, intangible assets are stated at cost less accumulated amortisation (where the estimated useful life is finite) and impairment losses (see Note 2(j)).

Intangible assets (acquired mining right) are depreciated on the units-of-production method utilising only proven and probable coal reserves in the depletion base.

Amortisation of other intangible assets with finite useful lives is recognised in profit or loss on a straight-line basis over the expected useful lives. The operating right related to paved road is amortised over 10 years after the commission of the paved road.

Both the period and method of amortisation are reviewed annually.

(i) Leased assets

An arrangement, comprising a transaction or a series of transactions, is or contains a lease if the Group determines that the arrangement conveys a right to use a specific asset or assets for an agreed period of time in return for a payment or a series of payments. Such a determination is made based on an evaluation of the substance of the arrangement and is regardless of whether the arrangement takes the legal form of a lease.

(i) Classification of assets leased to the Group

Assets that are held by the Group under leases which transfer to the Group substantially all the risks and rewards of ownership are classified as being held under finance leases. Leases which do not transfer substantially all the risks and rewards of ownership to the Group are classified as operating leases.

(ii) Assets acquired under finance leases

Where the Group acquires the use of assets under finance leases, the amounts representing the fair value of the leased asset, or, if lower, the present value of the minimum lease payments, of such assets are included in property, plant and equipment and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation is provided at rates which write off the cost or valuation of the assets over the term of the relevant lease or, where it is likely the Group will obtain ownership of the asset, the life of the asset, as set out in note 2(g). Impairment losses are accounted for in accordance with the accounting policy as set out in Note 2(j)(ii). Finance charges implicit in the lease payments are charged to profit or loss over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

(iii) Operating lease charges

Where the Group has the use of assets held under operating leases, payments made under the leases are charged to profit or loss in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives received are recognised in profit or loss as an integral part of the aggregate net lease payments made. Contingent rentals are charged to profit or loss in the accounting period in which they are incurred.

(iv) Lease prepayments

Lease prepayments represent the costs of acquiring the land use rights. Land use rights are carried at cost less accumulated amortisation and impairment losses (see Note 2(j)(ii)). Amortisation is charged to profit or loss on a straight-line basis over the period of the land use rights.

(j) Impairment of assets

(i) *Impairment of interests in subsidiaries, interest in associate and trade and other receivables*

Interests in subsidiaries, interest in associate and trade and other receivables that are stated at cost or amortised cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. Objective evidence of impairment includes observable data that comes to the attention of the Group about one or more of the following loss events:

- significant financial difficulty of the debtor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- it becoming probable that the debtor will enter bankruptcy or other financial reorganisation;
- significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor; and
- a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

If any such evidence exists, any impairment loss is determined and recognised as follows:

- For interests in subsidiaries and associate (including those recognised using the equity method) (see Note 2(d)), the impairment loss is measured by comparing the recoverable amount of the investment with its carrying amount in accordance with Note 2(j)(ii). The impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount in accordance with Note 2(j)(ii).
- For trade and other current receivables carried at amortised cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets), where the effect of discounting is material. This assessment is made collectively where these financial assets share similar risk characteristics, such as similar past due status, and have not been individually assessed as impaired. Future cash flows for financial assets which are assessed for impairment collectively are based on historical loss experience for assets with credit risk characteristics similar to the collective group.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through profit or loss. A reversal of an impairment loss shall not result in the asset's carrying amount exceeding that which would have been determined had no impairment loss been recognised in prior years.

Impairment losses are written off against the corresponding assets directly, except for impairment losses recognised in respect of trade and other receivables, whose recovery is considered doubtful but not remote. In this case, the impairment losses for doubtful debts are recorded using an allowance account. When the Group is satisfied that recovery is remote, the amount considered irrecoverable is written off against trade and other receivables directly and any amounts held in the allowance account relating to that debt are reversed. Subsequent recoveries of amounts previously charged to the

allowance account are reversed against the allowance account. Other changes in the allowance account and subsequent recoveries of amounts previously written off directly are recognised in profit or loss.

(ii) Impairment of other assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

- property, plant and equipment
- construction in progress
- lease prepayments
- intangible assets
- other non-current assets (excluding receivables)

If any such indication exists, the asset's recoverable amount is estimated.

- Calculation of recoverable amount

The recoverable amount of an asset is the greater of its 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 time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

- Recognition of impairment losses

An impairment loss is recognised in profit or loss whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated to reduce the carrying amount of the assets in the cash-generating unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

- Reversals of impairment losses

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of an impairment loss is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to profit or loss for the year in which the reversals are recognised.

(iii) Interim financial reporting and impairment

Under the Rules Governing the Listing of Securities on the Stock Exchange, the Group is required to prepare an interim financial report in compliance with IAS 34, *Interim financial reporting*, in respect of the first six months of the financial year. At the end of the interim period, the Group applies the same impairment testing, recognition, and reversal criteria as it would at the end of the financial year (see Notes 2(j)(i) and (ii)).

(k) Inventories

Inventories are carried at the lower of cost and net realisable value.

Cost is calculated using the weighted average cost formula and comprises all costs of purchase, an appropriate portion of fixed and variable overhead costs, including the stripping costs incurred during the production phase, and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When coal inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Inventories of ancillary materials, spare parts and small tools used in production are stated at cost less impairment losses for obsolescence.

(l) Trade and other receivables

Trade and other receivables are initially recognised at fair value and thereafter stated at amortised cost using the effective interest method, less allowance for impairment of doubtful debts (see Note 2(j)(i)), except where the receivables are interest-free loans made to related parties without any fixed repayment terms or the effect of discounting would be immaterial. In such cases, the receivables are stated at cost less allowance for impairment of doubtful debts.

(m) Convertible bond

Convertible bond which does not contain an equity component are accounted for as follows:

At initial recognition the derivative component of the convertible bond is measured at fair value and presented as part of derivative financial instruments (see Note 2(f)). Any excess of proceeds over the amount initially recognised as the derivative component is recognised as the liability component. Transaction costs that relate to the issue of the convertible bond are allocated to the liability and derivative components in proportion to the allocation of proceeds. The portion of the transaction costs relating to the liability component is recognised initially as part of the liability. The portion relating to the derivative component is recognised immediately in profit or loss.

The derivative component is subsequently remeasured in accordance with Note 2(f). The liability component is subsequently carried at amortised cost. The interest expense recognised in profit or loss on the liability component is calculated using the effective interest method.

If the bond is converted, the carrying amounts of the derivative and liability components are transferred to share capital and share premium as consideration for the shares issued. If the bond is redeemed, any difference between the amount paid and the carrying amounts of both components is recognised in profit or loss.

(n) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between the amount initially recognised and redemption value being recognised in profit or loss over the period of the borrowings, together with any interest and fees payable, using the effective interest method.

(o) Trade and other payables

Trade and other payables are initially recognised at fair value and subsequently stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(p) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(q) Employee benefits

(i) Short-term employee benefits and contributions to defined contribution retirement plans

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued for the year in which the associated services are rendered by employees. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

(ii) Share-based payments

The fair value of share options granted to employees is recognised as an employee cost with a corresponding increase in a capital reserve within equity. The fair value is measured at grant date using Black-Scholes option pricing model, taking into account the terms and conditions upon which the options were granted. Where the employees have to meet vesting conditions before becoming unconditionally entitled to the options, the total estimated fair value of the options is spread over the vesting period, taking into account the probability that the options will vest.

During the vesting period, the number of share options that is expected to vest is reviewed. Any resulting adjustment to the cumulative fair value recognised in prior years is charged/credited to the profit or loss for the year of the review, unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of options that vest (with a corresponding adjustment to the capital reserve) except where forfeiture is only due to not achieving vesting conditions that relate to the market price of the company's shares. The equity amount is recognised in the capital reserve until either the option is exercised (when it is transferred to the share premium account) or the option expires (when it is released directly to retained profits).

(r) Income tax

Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in profit or loss except to the extent that they relate to items recognised in other comprehensive income or directly in equity, in which case the relevant amounts of tax are recognised in other comprehensive income or directly in equity, respectively.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to interests in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Additional income taxes that arise from the distribution of dividends are recognised when the liability to pay the related dividend is recognised.

Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if, the Company or the Group have the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Company or the Group intend either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(s) Provisions and contingent liabilities

(i) *Contingent liabilities assumed in business combinations*

Contingent liabilities assumed in a business combination which are present obligations at the date of acquisition are initially recognised at fair value, provided the fair value can be reliably measured. After their initial recognition at fair value, such contingent liabilities are recognised at the higher of the amount initially recognised, less accumulated amortization where appropriate, and the amount that would be determined in accordance with Note 2(s)(ii). Contingent liabilities assumed in a business combination that cannot be reliably fair valued or were not present obligations at the date of acquisition are disclosed in accordance with Note 2(s)(ii).

(ii) *Other provisions and contingent liabilities*

Provisions are recognised for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(t) Obligations for reclamation

The Group's obligations for reclamation consist of spending estimates at its mines in accordance with the relevant rules and regulations in Mongolia. The Group estimates its liabilities for final reclamation and mine closure based upon detailed calculations of the amount and timing of the future cash spending to perform the required work. Spending estimates are escalated for inflation, then discounted at a discount rate that reflects current market assessments of the time value of money and

the risks specific to the liability such that the amount of provision reflects the present value of the expenditures expected to be required to settle the obligation. The Group records a corresponding asset associated with the liability for final reclamation and mine closure, which is included in the mining structures. The obligation and corresponding asset are recognised in the period in which the liability is incurred. The asset is depreciated on the units-of-production method over its expected life and the liability is accreted to the projected spending date. As changes in estimates occur (such as mine plan revisions, changes in estimated costs, or changes in timing of the performance of reclamation activities), the revisions to the obligation and the corresponding asset are recognised at the appropriate discount rate.

(u) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Provided it is probable that the economic benefits will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in profit or loss as follows:

(i) Sale of goods

Revenue associated with the sale of coal is recognised when the risks and rewards of ownership of the goods have been passed to the customer. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts and volume rebates.

(ii) Interest income

Interest income is recognised as it accrues using the effective interest method.

(v) Translation of foreign currencies

The presentation currency of the Group is USD. The functional currency of the Company and the investment holding companies is USD and the functional currency of other group entities located in Mongolia is Mongolian Togrog (“MNT”). Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates.

The results of operations in Mongolia are translated into USD at the exchange rates approximating the foreign exchange rates ruling at the dates of the transactions. Balance sheet items are translated into USD at the foreign exchange rates ruling at the balance sheet date. The resulting exchange difference is recognised directly in a separate component of equity.

(w) Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset. Other borrowing costs are expensed in the period in which they are incurred.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditure for the asset is being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

(x) Related parties

- (a) A person, or a close member of that person's family, is related to the Group if that person:
 - (i) has control or joint control over the Group;
 - (ii) has significant influence over the Group; or
 - (iii) is a member of the key management personnel of the Group or the Group's parent.
- (b) An entity is related to the Group if any of the following conditions applies:
 - (i) The entity and the Group are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
 - (iii) Both entities are joint ventures of the same third party.
 - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - (v) The entity is a post-employment benefit plan for the benefit of employees of either the Group or an entity related to the Group.
 - (vi) The entity is controlled or jointly controlled by a person identified in (a).
 - (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

(y) Segment reporting

Operating segments, and the amounts of each segment item reported in the financial statements, are identified from the financial information provided regularly to the Group's most senior executive management for the purposes of allocating resources to, and assessing the performance of, the Group's various lines of business and geographical locations.

Individually material operating segments are not aggregated for financial reporting purposes unless the segments have similar economic characteristics and are similar in respect of the nature of products and services, the nature of production processes, the type or class of customers, the methods used to distribute the products or provide the services, and the nature of the regulatory environment. Operating segments which are not individually material may be aggregated if they share a majority of these criteria.

(z) Changes in accounting policies

The IASB has issued a number of amendments to IFRSs and one new Interpretation that are first effective for the current accounting period of the Group and the Company. Of these, the following developments are relevant to the Group's financial statements:

- IAS 24 (revised 2009), Related party disclosures
- Improvements to IFRSs (2010)

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

The impacts of these developments are discussed below:

- IAS 24 (revised 2009) revises the definition of a related party. As a result, the Group has re-assessed the identification of related parties and concluded that the revised definition does not have any material impact on the Group's related party disclosures in the current and previous period. IAS 24 (revised 2009) also introduces modified disclosure requirements for government-related entities. This does not impact the Group because the Group is not a government-related entity.
- Improvements to IFRSs (2010) omnibus standard introduces a number of amendments to the disclosure requirements in IFRS 7, Financial instruments: Disclosures. The disclosures about the Group's financial instruments in note 29 have been conformed to the amended disclosure requirements. These amendments do not have any material impact on the classification, recognition and measurements of the amounts recognised in the financial statements in the current and previous periods.

3 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

In determining the carrying amounts of certain assets and liabilities, the Group makes assumptions of the effects of uncertain future events on those assets and liabilities at the balance sheet date. These estimates involve assumptions about such items as risk adjustment to cash flows or discount rates used, future changes in salaries and future changes in prices affecting other costs. The Group's estimates and assumptions are based on the expectations of future events and are reviewed periodically. In addition to assumptions and estimations of future events, judgements are also made during the process of applying the Group's accounting policies. Except for those disclosed in Note 24 about equity-settled share-based payment transactions and in Note 30 (c) about the environmental contingencies, other significant accounting estimates and judgements were summarised as follows:

(a) Reserves

Engineering estimates of the Group's coal reserves are inherently imprecise and represent only approximate amounts because of the subjective judgements involved in developing such information. Reserve estimates are updated at regular basis and have taken into account recent production and technical information about the relevant coal deposit. In addition, as prices and cost levels change from year to year, the estimate of coal reserves also changes. This change is considered a change in estimate for accounting purposes and is reflected on a prospective basis in related depreciation and amortisation rates.

Despite the inherent imprecision in these engineering estimates, these estimates are used in determining depreciation and amortisation expenses and impairment loss. Depreciation and amortisation rates are determined based on estimated coal reserve quantity (the denominator) and capitalised costs of mining structures and mining rights (the numerator). The capitalised cost of mining structures and mining rights are depreciated and amortised based on the units produced.

(b) Useful lives of property, plant and equipment

Management determines the estimated useful lives of and related depreciation charges for its property, plant and equipment. This estimate is based on the actual useful lives of assets of similar nature and functions. It could change significantly as a result of significant technical innovations and competitor actions in response to industry cycles. Management will increase the depreciation charges where useful lives are less than previously estimated lives, or will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

(c) Impairment of assets

The Group reviews the carrying amounts of the assets at each balance sheet date to determine whether there is objective evidence of impairment. When indication of impairment is identified, management prepares discounted future cashflow to assess the differences between the carrying amount and value in use and provided for impairment loss. Any change in the assumptions adopted in the cash flow forecasts would increase or decreased in the provision of the impairment loss and affect the Group's net asset value.

In relation to trade and other receivables (including the VAT receivables), a provision for impairment is made and an impairment loss is recognised in profit and loss when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group 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.

An increase or decrease in the above impairment loss would affect the net profit in future years.

(d) Obligation for reclamation

The estimation of the liabilities for final reclamation and mine closure involves the estimates of the amount and timing for the future cash spending as well as the discount rate used for reflecting current market assessments of the time value of money and the risks specific to the liability. The Group considers the factors including future production volume and development plan, the geological structure of the mining regions and reserve volume to determine the scope, amount and timing of reclamation and mine closure works to be performed. Determination of the effect of these factors involves judgements from the Group and the estimated liabilities may turn out to be different from the actual expenditure to be incurred. The discount rate used by the Group may also be altered to reflect the changes in the market assessments of the time value of money and the risks specific to the liability, such as change of the borrowing rate and inflation rate in the market. As changes in estimates occur (such as mine plan revisions, changes in estimated costs, or changes in timing of the performance of reclamation activities), the revisions to the obligation will be recognised at the appropriate discount rate.

(e) Recognition of deferred tax assets

Deferred tax assets in respect of unused tax losses and tax credit carried forward and deductible temporary differences are recognised and measured based on the expected manner of realisation or settlement of the carrying amount of the assets, using tax rates enacted or substantively enacted at the balance sheet date. In determining the carrying amounts of deferred assets, expected taxable profits are estimated which involves a number of assumptions relating to the operating environment of the Group and require a significant level of judgement exercised by the directors. Any change in such assumptions and judgement would affect the carrying amounts of deferred tax assets to be recognised and hence the next profit in the future years.

(f) Derivative financial instruments

In determining the fair value of the derivative financial instruments, considerable judgment is required to interpret market data used in the valuation techniques. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

(g) Exploration and evaluation expenditure

The application of the Group's accounting policy for exploration and evaluation expenditure requires judgement in determining whether it is likely that future economic benefits will flow to the Group. It requires management to make certain estimates and assumptions about future events or circumstances, in particular, whether an economically viable extraction operation can be established. Estimates and assumptions made may change if new information becomes available. If, after expenditure is capitalised, information becomes available suggesting that the recovery of expenditure is unlikely, the amount capitalised is written off in profit or loss in the period when the new information becomes available.

(h) Capitalised stripping costs

The Group capitalises stripping (waste removal) costs incurred during the production phase to the extent that the actual waste to ore ratio is higher than the estimated ratio. This calculation requires the use of judgements and estimates relating to the expected tonnes of waste to be removed over the life of the mining area and the expected economically recoverable reserves to be extracted as a result. Changes in a mine's life and design will usually result in changes to the average life of mine strip ratio. These changes are accounted for prospectively.

4 REVENUE

The Group is principally engaged in the mining, transportation and sale of coal. Revenue represents the sales value of goods sold to customers exclusive of value added or sales taxes and after deduction of any trade discounts and volume rebates. The amount of each significant category of revenue recognised in revenue during the year is as follows:

	2009	2010	2011
	USD'000	USD'000	USD'000
Raw coking coal	66,981	277,444	306,610
Washed coking coal	–	–	235,220
Others	2	58	738
	<u>66,983</u>	<u>277,502</u>	<u>542,568</u>

During the year ended 31 December 2009, the Group had four customers that individually exceeded 10% of the Group's turnover, being USD26,092,000, USD15,439,000, USD15,242,000 and USD10,209,000, respectively.

During the year ended 31 December 2010, the Group had four customers that individually exceeded 10% of the Group's turnover, being USD105,175,000, USD92,742,000, USD33,488,000 and USD27,335,000, respectively.

During the year ended 31 December 2011, the Group had three customers that individually exceeded 10% of the Group's turnover, being USD184,985,000, USD148,540,000, and USD73,563,000, respectively.

Details of concentrations of credit risk arising from these customers are set out in Note 29(b).

5 COST OF REVENUE

	2009	2010	2011
	USD'000	USD'000	USD'000
Mining costs	24,500	78,759	120,326
Processing costs	–	–	21,738
Transportation costs	8,000	60,626	107,928
Others [#]	6,182	24,983	86,376
	<u>38,682</u>	<u>164,368</u>	<u>336,368</u>

[#] Others include USD3,343,000, USD10,116,000 and USD48,232,000 relating to the royalty tax on the coals sold for the years ended 31 December 2009, 2010 and 2011, respectively.

6 PROFIT BEFORE TAXATION

Profit before taxation is arrived at after charging/ (crediting):

(a) Net finance costs/(income):

	2009	2010	2011
	USD'000	USD'000	USD'000
Interest income	(342)	(294)	(22,236)
Foreign exchange gain, net.	—	(12,041)	—
Finance income	<u>(342)</u>	<u>(12,335)</u>	<u>(22,236)</u>
Interest on bank and other borrowings	1,934	10,578	18,403
Fair value adjustment on derivative component of convertible bond (Note 23).	—	—	(7,863)
Interest on liability component of convertible bond (Note 23)	—	—	3,371
Transaction costs	—	3,655	6,495
Unwinding interest on			
– Other long-term payables	70	159	168
– Accrued reclamation obligations	265	332	567
Less: Interest expense capitalised	<u>(1,751)</u>	<u>(10,510)</u>	<u>(9,229)</u>
Net interest expense.	518	4,214	11,912
Foreign exchange loss, net	<u>3,342</u>	<u>—</u>	<u>1,873</u>
Finance costs	<u>3,860</u>	<u>4,214</u>	<u>13,785</u>
Net finance costs/(income)	<u>3,518</u>	<u>(8,121)</u>	<u>(8,451)</u>

* Borrowing costs have been capitalised at a rate of 4%, 8% and 5% per annum for the years ended 31 December 2009, 2010 and 2011, respectively.

(b) Staff costs:

	2009	2010	2011
	USD'000	USD'000	USD'000
Salaries, wages, bonuses and benefits	2,849	9,706	17,584
Retirement scheme contributions	192	1,039	2,201
Equity-settled share-based payment expenses (Note 24)	—	—	1,646
	<u>3,041</u>	<u>10,745</u>	<u>21,431</u>

Pursuant to the relevant labor rules and regulations in Mongolia, the Group participates in defined contribution retirement benefit schemes (“the Schemes”) organised by the Government of Mongolia whereby the Group is required to make contributions to the Schemes at a rate of 7%-13.5% of the eligible employees’ salaries.

The Group has no other material obligation for the payment of pension benefits beyond the annual contributions described above.

(c) Other items:

	2009	2010	2011
	USD'000	USD'000	USD'000
Depreciation and amortisation	1,864	3,204	19,370
Operating lease charges:			
minimum lease payments			
– hire of plant and machinery	1,135	1,525	1,049
– hire of other assets (including property rentals)	308	283	1,107
	1,443	1,808	2,156
Net losses on disposal of property, plant and equipment.	35	187	438
Auditors' remuneration			
– audit services	90	330	780
– tax services	–	87	195
	90	417	975
Listing expenses allocated to profit or loss	–	5,572	–
Cost of inventories [#]	38,682	164,368	336,368

[#] Cost of inventories includes USD3,730,000, USD4,674,000 and USD29,961,000 relating to personnel expenses, depreciation and amortisation and operating lease charges for the years ended 31 December 2009, 2010 and 2011, which are also included in the respective amounts disclosed separately above for each of these types of expenses.

7 INCOME TAX

(a) Income tax in the consolidated statement of comprehensive income represents:

	2009	2010	2011
	USD'000	USD'000	USD'000
Current tax			
Provision for the year			
– Mongolian Enterprise Income Tax (Note 22(a))	2,100	19,371	49,367
Deferred tax			
Origination and reversal of temporary difference (Note 22(b))	2,011	3,386	(13,717)
	4,111	22,757	35,650

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2009	2010	2011
	USD'000	USD'000	USD'000
Profit before income tax	14,381	82,896	154,740
Notional tax on profit before taxation	2,990	19,642	35,725
Tax effect of non-deductible items (<i>Note (iii)</i>)	1,135	1,258	1,508
Tax effect of non-taxable items (<i>Note (iv)</i>)	(83)	(242)	(2,588)
Tax loss not recognised	69	2,099	1,005
Actual tax expenses	4,111	22,757	35,650

Note:

- (i) Pursuant to the income tax rules and regulations of Mongolia, the Group is liable to Mongolian Enterprise Income Tax at a rate of 10% of first MNT 3 billion taxable income and 25% of the remaining taxable income during the Relevant Period.
- (ii) Pursuant to the rules and regulations of the Cayman Islands, the Group is not subject to any income tax in the Cayman Islands. The Group is not subject to Hong Kong and Luxembourg profits tax as it has no assessable income arising in or derived from Hong Kong and Luxembourg during the Relevant Period.
- (iii) Non-deductible items mainly represent the non-deductible expenses and the unrealised exchange losses which are non-deductible pursuant to the income tax rules and regulations of Mongolia during the Relevant Period.
- (iv) Non-taxable items mainly represent the unrealised exchange gains which are non-taxable pursuant to the income tax rules and regulations of Mongolia during the Relevant Period.

8 EARNINGS PER SHARE

(a) Basic earnings per share

For the year ended 31 December 2009, the calculation of basic earnings per share is based on the profit attributable to equity shareholders of the Company of USD10,270,000 and 3,000,000,000 ordinary shares, which is the share capital of the Company immediately after the Reorganisation and assumed to be outstanding throughout the year ended 31 December 2009.

For the year ended 31 December 2010, the calculation of basic earnings per share is based on the profit attributable to equity shareholders of the Company of USD60,139,000 and the weighted average of 3,152,163,310 ordinary shares, calculated as follows:

Weighted average number of ordinary shares

	2010
Issued ordinary shares at 1 January	—
Issued ordinary shares immediately after the Reorganisation and assumed to be outstanding throughout the year	3,000,000,000
Effect of issue of new shares pursuant to the initial public offering and upon the exercise of the over-allotment option	152,163,310
Weighted average number of ordinary shares at 31 December	3,152,163,310

For the year ended 31 December 2011, the calculation of basic earnings per share is based on the profit attributable to equity shareholders of the Company of USD119,090,000 and 3,705,036,500 ordinary shares.

(b) Diluted earnings per share

There were no dilutive potential ordinary shares during the years ended 31 December 2009 and 2010. The calculation of diluted earnings per share for the year ended 31 December 2011 is based on the profit attributable to the equity shareholders of the Company of USD114,716,000 and the weighted average of 3,740,633,369 ordinary shares in issue during the year, calculated as follows:

(i) Profit attributable to ordinary equity shareholders of the Company (diluted)

	2011
	USD'000
Profit attributable to the equity shareholders of the Company.	119,090
After tax effect of:	
– fair value adjustment on the derivative component of convertible bond	(7,863)
– interest on the liability component of convertible bond	3,371
– attributable transaction costs on the derivative component of convertible bond . .	118
Profit attributable to the equity shareholders of the Company (diluted)	<u>114,716</u>

(ii) Weighted average number of ordinary shares (diluted)

	2011
Weighted average number of ordinary shares as at 1 January	3,705,036,500
Effect of conversion of convertible bond.	<u>35,596,869</u>
Weighted average number of ordinary shares (diluted) as at 31 December.	<u>3,740,633,369</u>

The equity-settled share-based payment transactions (see Note 24) are anti-dilutive and therefore not included in calculating diluted earnings per share for the year ended 31 December 2011.

9 OTHER COMPREHENSIVE INCOME

The components of other comprehensive income do not have any significant tax effect for the years ended 31 December 2009, 2010 and 2011.

10 SEGMENT REPORTING

The Group has one business segment, the mining, processing, transportation and sale of coal. The majority of its customers are located in China. Based on information reported to the chief operating decision maker for the purpose of resource allocation and performance assessment, the Group's only operating segment is the mining, processing, transportation and sales of coal. Accordingly, no additional business and geographical segment information are presented.

11 PROPERTY, PLANT AND EQUIPMENT, NET

	Buildings and plants	Machinery and equipment	Motor vehicles	Office equipment	Mining structures and mining rights	Total
	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
<i>Cost:</i>						
At 1 January 2009	318	44	7,689	297	816	9,164
Additions	1,355	1,666	2,703	1,246	1,041	8,011
Transfer from construction in progress (<i>Note 12</i>).	2,215	—	—	—	14,537	16,752
Disposals	(21)	(168)	(247)	(79)	—	(515)
Exchange adjustments	(47)	(9)	(940)	(39)	(138)	(1,173)
At 31 December 2009	3,820	1,533	9,205	1,425	16,256	32,239
At 1 January 2010	3,820	1,533	9,205	1,425	16,256	32,239
Additions	782	997	2,013	1,875	21,740	27,407
Transfer from construction in progress (<i>Note 12</i>).	14,797	123	—	3	—	14,923
Disposals	(64)	(35)	(133)	(242)	—	(474)
Exchange adjustments	1,796	313	1,509	340	4,128	8,086
At 31 December 2010	21,131	2,931	12,594	3,401	42,124	82,181
At 1 January 2011	21,131	2,931	12,594	3,401	42,124	82,181
Additions in relation to the Acquisition (<i>Note 32</i>)	1,521	121	4,498	228	—	6,368
Additions	3,832	2,499	40,019	3,835	51,741	101,926
Transfer from construction in progress (<i>Note 12</i>).	104,399	115,206	—	—	—	219,605
Disposals	(1,606)	(238)	(1,178)	(1,674)	—	(4,696)
Exchange adjustments	(12,265)	(11,311)	(5,394)	(567)	(9,047)	(38,584)
At 31 December 2011	117,012	109,208	50,539	5,223	84,818	366,800
<i>Accumulated amortisation and depreciation:</i>						
At 1 January 2009	6	—	30	14	—	50
Charge for the year	109	74	1,467	115	97	1,862
Written back on disposal	(1)	(2)	(13)	(4)	—	(20)
Exchange adjustments	(1)	—	(7)	(3)	—	(11)
At 31 December 2009	113	72	1,477	122	97	1,881
At 1 January 2010	113	72	1,477	122	97	1,881
Charge for the year	624	216	1,706	424	232	3,202
Written back on disposal	(5)	(4)	(35)	(30)	—	(74)
Exchange adjustments	66	27	351	49	33	526
At 31 December 2010	798	311	3,499	565	362	5,535
1 January 2011	798	311	3,499	565	362	5,535
Additions in relation to the Acquisition (<i>Note 32</i>)	22	7	247	35	—	311
Charge for the year	2,618	6,432	6,189	1,227	646	17,112
Written back on disposal	(239)	(39)	(591)	(320)	—	(1,189)
Exchange adjustments	(305)	(631)	(900)	(145)	(97)	(2,078)
At 31 December 2011	2,894	6,080	8,444	1,362	911	19,691
<i>Carrying amount:</i>						
At 31 December 2011	114,118	103,128	42,095	3,861	83,907	347,109
At 31 December 2010	20,333	2,620	9,095	2,836	41,762	76,646
At 31 December 2009	3,707	1,461	7,728	1,303	16,159	30,358

- (a) All the Group's property, plant and equipment are located in Mongolia.
- (b) Mining structures and mining rights at 31 December 2009, 2010 and 2011 include deferred stripping costs of USD1,041,000, USD19,909,000, and USD60,437,000, respectively.
- (c) Mining structures and mining rights at 31 December 2009, 2010 and 2011 include application fee for the mining rights costs of USD713,000, USD805,000, and USD707,000, respectively.
- (d) The addition of mining structures and mining rights for the years ended 31 December 2009, 2010 and 2011 include reclamation cost of nil, USD4,251,000 and USD4,834,000, respectively (see Note 26).
- (e) As at 31 December 2009, certain of the Group's short-term interest-bearing borrowings were secured by the Group's motor vehicles and buildings with net book value of USD5,026,000 (see Note 20).

As at 31 December 2010, there is no interest-bearing borrowings were secured by the Group's property, plant and equipment.

As at 31 December 2011, certain of the Group's short-term interest-bearing borrowings were secured by the Group's motor vehicles with net book value of USD11,541,000 (see Note 20).

As at 31 December 2011, certain of the Group's interest-bearing borrowings were secured by the Group's coal handling and preparation plant – module I and power plant with a net book value of USD99,483,000 and USD54,627,000, respectively (see Note 20).

12 CONSTRUCTION IN PROGRESS

	2009	2010	2011
	USD'000	USD'000	USD'000
At 1 January	15,129	43,985	232,784
Additions in relation to the Acquisition (<i>Note 32</i>)	–	–	18,582
Additions	47,522	183,984	267,520
Transfer to property, plant and equipment (<i>Note 11</i>)	(16,752)	(14,923)	(219,605)
Transfer to intangible asset (<i>Note 14</i>)	–	–	(95,817)
Exchange adjustments	(1,914)	19,738	(20,235)
At 31 December	<u>43,985</u>	<u>232,784</u>	<u>183,229</u>

The construction in progress are mainly related to coal handling and preparation plant, power plant, paved road and mining related machinery and equipment.

As at 31 December 2010, certain of Group's interest-bearing borrowings were secured by the Group's coal handling and preparation plant and power plant with net book value of USD102,153,000 and USD46,402,000, respectively (see Note 20), which were transferred to property, plant and equipment during 2011.

As at 31 December 2009 and 2011, no interest-bearing borrowings were secured by the Group's construction in progress.

13 LEASE PREPAYMENTS

	2009	2010	2011
	USD'000	USD'000	USD'000
<i>Cost:</i>			
At 1 January	123	108	124
Exchange adjustments	(15)	16	(12)
At 31 December	<u>108</u>	<u>124</u>	<u>112</u>
<i>Accumulated amortisation:</i>			
At 1 January	1	3	6
Charge for the year	2	2	2
Exchange adjustments	—	1	(1)
At 31 December	<u>3</u>	<u>6</u>	<u>7</u>
Net book value:	<u>105</u>	<u>118</u>	<u>105</u>

Lease prepayments comprise interests in leasehold land held for own use under operating leases located in Mongolia, with original lease period from 15 years to 60 years.

14 INTANGIBLE ASSETS

The Group

	Acquired mining right	Operating right paved road	Total
	USD'000	USD'000	USD'000
<i>Cost:</i>			
At 1 January 2010/31 December 2010/1 January 2011	—	—	—
Addition in relation to the Acquisition (<i>Note 32</i>).	596,557	—	596,557
Transfer from construction in progress (<i>Note 12</i>).	—	95,817	95,817
Exchange adjustments	—	(8,978)	(8,978)
At 31 December 2011	<u>596,557</u>	<u>86,839</u>	<u>683,396</u>
<i>Accumulated amortisation:</i>			
At 1 January 2010/31 December 2010/1 January 2011	—	—	—
Charge for the year	—	2,256	2,256
Exchange adjustments	—	(212)	(212)
At 31 December 2011	<u>—</u>	<u>2,044</u>	<u>2,044</u>
<i>Carrying amount:</i>			
At 31 December 2009/2010	<u>—</u>	<u>—</u>	<u>—</u>
At 31 December 2011	<u>596,557</u>	<u>84,795</u>	<u>681,352</u>

Acquired mining right represents the mining right acquired during the acquisition of QGX (see Note 32). As QGX has not commenced the commercial production by 31 December 2011, accordingly there was no amortisation related to the acquired mining right during the year ended 31 December 2011.

According to the Resolution of the Government of Mongolia dated 31 March 2010 and the Built-Operate-Transfer agreement signed between the Government of Mongolia and the Group dated 9 June 2010, the Government of Mongolia granted the Group the land use rights, and to build and operate the paved road running from the mine site to the Mongolia-China border at Gashuun Sukhait. Under the terms of the Agreement, the Group will use its own funds to construct the paved road. In return, it enjoys an unrestricted use right to possess, use, operate the paved road for 10 years period after commission of the road. The Group will use the road primarily for the purpose of transporting coals from its mine site to the Mongolia-China border at Gashuun Sukhait, which is the gate to the designated delivery port of the majority of its customers. In addition, the paved road may be opened to public use subject to certain weight restrictions whereupon the Group may direct users. The Group has completed and commissioned the paved road on 6 October 2011.

15 INTEREST IN ASSOCIATE

	2009	2010	2011
	USD'000	USD'000	USD'000
Share of net assets.	14	19	4,278

On 15 July 2008, the Group invested in Coal Road LLC (the “Coal Road”) and had 25% interest in Coal Road, an entity incorporated in Mongolia with issued and paid up capital of MNT 209,075,133. The principal activities of Coal Road are the provision of road maintenance service and traffic management.

On 14 January 2011, the Group invested in International Medical Center LLC (the “International Medical Center”) and had 25.5% interest in International Medical Center, an entity incorporated in Mongolia with issued and paid up capital of MNT 22,522,500,000. The principal activities of International Medical Center are the provision of health care, diagnostic and treatment services.

On 30 May 2011, the Group invested in International Technical College LLC (the “International Technical College”) and had 33.33% interest in International Technical College, an entity incorporated in Mongolia with issued and paid up capital of MNT 913,500,000. The principal activity of International Technical College is technical education for ensuring the long- term availability of skilled technical workforce.

16 OTHER NON-CURRENT ASSETS

	2009	2010	2011
	USD'000	USD'000	USD'000
Prepayments in connection with construction work, equipment purchases and others	8,263	26,882	7,423
Others.	109	7	–
	<u>8,372</u>	<u>26,889</u>	<u>7,423</u>

17 INVENTORIES

(a) Inventories in the consolidated balance sheet comprise:

	2009	2010	2011
	USD'000	USD'000	USD'000
Coal	6,918	6,607	49,912
Materials and supplies	743	1,269	7,822
	<u>7,661</u>	<u>7,876</u>	<u>57,734</u>

As at 31 December 2009, the Group's long-term interest-bearing borrowings were secured by the total carrying amount of the Group's coal inventory (see Note 20).

As at 31 December 2010, the Group's short-term interest-bearing borrowings were secured by the total carrying amount of the Group's coal inventory. Such short-term interest-bearing borrowings were early repaid in January 2011 (see Note 20).

18 TRADE AND OTHER RECEIVABLES

	2009	2010	2011
	USD'000	USD'000	USD'000
Trade receivables (<i>Note (a)</i>)	8,502	288	41,445
Other receivables (<i>Note (c)</i>)	<u>11,534</u>	<u>32,062</u>	<u>72,022</u>
	20,036	32,350	113,467
Less: allowance for doubtful debts (<i>Note (b)</i>)	<u>—</u>	<u>—</u>	<u>(4,145)</u>
	<u>20,036</u>	<u>32,350</u>	<u>109,322</u>

(a) Ageing analysis

Trade receivables (net of allowance for doubtful debts) are invoiced amounts due from the Group's customers which are due from the date of billing. As at 31 December 2009, 2010 and 2011, all of the trade receivables are aged within one year.

(b) Impairment of trade receivables

Impairment losses in respect of trade receivables are recorded using an allowance account unless the Group is satisfied that recovery of the amount is remote, in which case the impairment loss is written off against trade receivables directly (Note 2(j)(i)).

As at 31 December 2011, an allowance for doubtful debts amounting to USD4,145,000 (2009 and 2010: Nil) was made on a collective basis in respect of the Group's trade receivable balances outstanding at the balance sheet date, which have been included in "administrative expenses" in the consolidated income statement.

(c) Other receivables

	2009	2010	2011
	USD'000	USD'000	USD'000
Amounts due from related parties (Note (i))	3,038	347	455
Security deposit (Note (ii))	1,000	—	—
Prepayments and deposits (Note (iii))	959	7,014	17,695
VAT receivables (Note (iv))	5,738	23,920	43,697
Payment on behalf of the customers	489	—	—
Others (Note (v))	310	781	10,175
	<u>11,534</u>	<u>32,062</u>	<u>72,022</u>

Note:

- (i) As at 31 December 2009, amounts due from related parties mainly represent loan to MCS Holding LLC amounting to USD 2.3 million, at an interest rate of 2% per month and with repayment period of three months and the remaining balances represent other current accounts with related parties (see Note 31(a)). Other than that, amounts due from related parties are unsecured, interest-free and have no fixed repayment terms.
- (ii) The balance as at 31 December 2009 represented the security deposit paid to the mining contractor.
- (iii) Prepayments and deposits mainly represent the prepayments made to the Group's mining contractor.
- (iv) VAT receivables include amounts that have been accumulated to date in certain subsidiaries and were due from the Government of Mongolia Taxation Authority. Based on current available information the Group anticipates full recoverability of such amounts. Further details are stated in Note 29(b).
- (v) At 31 December 2011, others mainly represent the reimbursement receivables due from Erdenes MGL LLC and Government of Mongolia of USD4.5 million each for the construction costs in relation to the expansion project of the border crossing in Mongolian side at Gashuun Sukhait, which are interest-free.

All other receivables were aged within one year and expected to be recovered or expensed off within one year.

19 CASH AT BANK AND IN HAND

	2009	2010	2011
	USD'000	USD'000	USD'000
Cash in hand	39	99	77
Cash at bank	<u>2,332</u>	<u>674,808</u>	<u>227,688</u>
Cash at bank and in hand	2,371	674,907	227,765
Less: time deposits with original maturity over three months	<u>(2,000)</u>	<u>(346,645)</u>	<u>(186,759)</u>
Cash and cash equivalents in the consolidated cash flow statement. .	<u>371</u>	<u>328,262</u>	<u>41,006</u>

As at 31 December 2009, there were no the Group's borrowings which were secured by the Group's cash at bank (see Note 20).

As at 31 December 2010, certain of the Group's borrowings were secured by the Group's cash at bank of USD199,890,000 (see Note 20).

As at 31 December 2011, certain of the Group's borrowings were secured by the Group's cash at bank of USD213,884,000 (see Note 20).

20 BORROWINGS

(a) The Group's long-term interest-bearing borrowings comprise:

	2009	2010	2011
	USD'000	USD'000	USD'000
Bank loan (secured)	30,000	180,000	169,091
Less: Current portion	(20,000)	(10,909)	(21,818)
Less: Unamortised transaction costs	—	(3,877)	(2,612)
	<u>10,000</u>	<u>165,214</u>	<u>144,661</u>

At 31 December 2009, the Group's long-term interest-bearing borrowings from Standard Bank was USD30,000,000, bearing an interest of 3 months London Interbank Offered Rate ("LIBOR") + 7%~8% and was secured by the Group's coal inventory (see Note 17).

At 31 December 2010, the Group's long-term interest-bearing borrowings from European Bank for Reconstruction and Development ("EBRD"), Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V., ("FMO") and Deutsche Investitions-und Entwicklungsgesellschaft mbH ("DEG") were USD120,000,000, USD36,000,000 and USD24,000,000, respectively, bearing interest of 6 months LIBOR + 4.75%~6.85% and were secured by the Group's construction in progress (see Note 12) and cash at bank and in hand (see Note 19).

At 31 December 2011, the Group's long-term interest-bearing borrowings from EBRD, FMO and DEG were USD114,546,000, USD32,727,000 and USD21,818,000, respectively, bearing interest of 6 months LIBOR + 4.75%~6.85% and were secured by the Group's property, plant and equipment (see Note 11) and cash at bank and in hand (see Note 19).

The Group's long-term borrowings are repayable as follows:

	2009	2010	2011
	USD'000	USD'000	USD'000
Within 1 year or on demand	20,000	10,909	21,818
After 1 year but within 2 years	10,000	21,818	21,818
After 2 years but within 5 years	—	95,455	125,455
After 5 years	—	51,818	—
	<u>30,000</u>	<u>180,000</u>	<u>169,091</u>

(b) The Group's short-term interest-bearing borrowings comprise:

	2009	2010	2011
	USD'000	USD'000	USD'000
Bank loans			
– Secured	1,200	75,000	311,750
– Unsecured	1,000	—	—
Other borrowings			
– Third parties	2,000	—	—
Current portion of long-term borrowings			
– Bank loan	20,000	10,909	21,818
	<u>24,200</u>	<u>85,909</u>	<u>333,568</u>

As at 31 December 2009, certain of the Group's short-term interest-bearing borrowings were secured by certain of the Group's property, plant and equipment (see Note 11).

At 31 December 2009, the Group's long-term interest-bearing borrowings from Standard Bank was USD30,000,000. During the year ended 31 December 2010, additional borrowings of USD45,000,000 have been drawn-down. The outstanding loan balances with Standard Bank as at 31 December 2010 was USD75,000,000, bearing an interest of 3 months LIBOR + 7%~8% and was secured by the Group's coal inventory (see Note 17). The Group submitted its early repayment request to Standard Bank in December 2010 to repay USD75,000,000 of its long-term borrowings in early 2011; accordingly, the Group classified the related principal amount from long-term interest-bearing borrowings to short-term interest-bearing borrowings as at 31 December 2010.

As at 31 December 2011, the Group's short-term interest-bearing borrowings from Standard Bank of USD300,000,000 bearing interest of 6 months LIBOR + 3.25%, were secured by the Group's cash at bank and in hand. The attributable transaction cost as at 31 December 2011 amounts to USD1,250,000. The original borrowings from Standard Bank was USD400,000,000, part of which amounted to USD100,000,000 was early repaid in December 2011.

As at 31 December 2011, the Group's short-term interest-bearing borrowings from Khan Bank of USD13,000,000 bearing annual interest of 11%, were secured by the Group's property, plant and equipment (see Note 11).

21 TRADE AND OTHER PAYABLES

	2009	2010	2011
	USD'000	USD'000	USD'000
Trade payables (<i>Note (i)</i>)	1,623	4,772	18,523
Receipts in advance (<i>Note (ii)</i>)	8,537	18,842	9,160
Amounts due to related parties (<i>Note (iii)</i>)	2,052	5,329	9,560
Payables for purchase of equipment	4,163	3,913	36,018
Security deposit on construction work.	—	128	9,259
Interest payable	19	3,776	2,544
Other taxes payables	—	326	21,354
Provisions for contingent considerations (<i>Note 26</i>)	—	—	1,500
Others (<i>Note (iv)</i>)	713	3,229	10,762
	<u>17,107</u>	<u>40,315</u>	<u>118,680</u>

Note:

- (i) All trade payables are due and payable on presentation or within one month.
- (ii) Receipts in advance represent payments in advance made by third party customers in accordance with the terms set out in respective sales agreements.
- (iii) Amounts due to related parties represent management service fee payable and payables for equipment and construction work, which are unsecured, interest-free and have no fixed terms of repayments (see Note 31(a)).
- (iv) Others represent accrued expenses, payables for staff related costs and other deposits.

All of the other payables and receipts in advance are expected to be settled or recognised in profit or loss within one year or are repayable on demand.

22 INCOME TAX IN THE CONSOLIDATED BALANCE SHEET

(a) Tax payable in the consolidated balance sheet represents:

	2009	2010	2011
	USD'000	USD'000	USD'000
At 1 January	–	795	5,455
Provision for the year (<i>Note 7(a)</i>)	2,100	19,371	49,367
Offsetting with VAT receivable (<i>Note 29(b)</i>)	–	–	(9,470)
Income tax paid	(1,305)	(15,145)	(25,998)
Exchange adjustments	–	434	(1,846)
At 31 December	<u>795</u>	<u>5,455</u>	<u>17,508</u>

(b) Deferred tax assets and liabilities recognised

The components of deferred tax assets/(liabilities) recognised in the consolidated balance sheet and the movements during the Relevant Period are as follows:

	Tax losses	Unrealised profits on intra-group transactions	Depreciation and amortisation	Unrealised foreign exchange difference on long-term borrowings	Allowance for doubtful debts	Fair value adjustments in relation to the Acquisition	Total
	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
Deferred tax arising from:							
At 1 January 2009	2,240	–	–	–	–	–	2,240
Credited/(charged) to profit or loss (<i>Note 7(a)</i>)	(1,972)	178	(217)	–	–	–	(2,011)
Exchange adjustments	(268)	–	–	–	–	–	(268)
At 31 December 2009	–	178	(217)	–	–	–	(39)
At 1 January 2010	–	178	(217)	–	–	–	(39)
Credited/(charged) to profit or loss (<i>Note 7(a)</i>)	751	494	(228)	(4,403)	–	–	(3,386)
Exchange adjustments	60	52	(37)	(350)	–	–	(275)
At 31 December 2010	811	724	(482)	(4,753)	–	–	(3,700)
At 1 January 2011	811	724	(482)	(4,753)	–	–	(3,700)
Addition in relation to the Acquisition (<i>Note 32</i>)	–	–	–	–	–	(149,105)	(149,105)
Credit to profit or loss (<i>Note 7(a)</i>)	1,816	3,593	553	6,719	1,036	–	13,717
Exchange adjustments	(251)	(409)	(54)	(156)	–	–	(870)
At 31 December 2011	<u>2,376</u>	<u>3,908</u>	<u>17</u>	<u>1,810</u>	<u>1,036</u>	<u>(149,105)</u>	<u>(139,958)</u>

	<u>2009</u>	<u>2010</u>	<u>2011</u>
	<u>USD'000</u>	<u>USD'000</u>	<u>USD'000</u>
Net deferred tax assets recognised on the consolidated balance sheet	328	1,681	9,698
Net deferred tax liability recognised on the consolidated balance sheet	(367)	(5,381)	(149,656)
	<u>(39)</u>	<u>(3,700)</u>	<u>(139,958)</u>

(c) Deferred tax assets not recognised

In accordance with the accounting policy set out in Note 2(r), at the years ended 31 December 2009, 2010 and 2011, the Group has not recognised deferred tax assets in respect of cumulative tax losses of USD605,000, USD8,949,000 and USD26,973,000, respectively, as it is not probable that future taxable profits against which the losses can be utilised will be available in the relevant tax jurisdiction and entity. The tax losses generated before 31 December 2009 will expire in two years after the tax losses generated under current tax legislation. According to the new amendment to Mongolian Corporate Income Tax Law which is effective on 1 January 2010, for entities engaged in mining or infrastructure construction, the tax losses generated after 1 January 2010 will expire in four to eight years after the tax losses generated under current tax legislation. Other entities will still apply to the two years policy.

Expiry of unrecognised tax losses of group entities located in Mongolia:

	<u>2009</u>	<u>2010</u>	<u>2011</u>
	<u>USD'000</u>	<u>USD'000</u>	<u>USD'000</u>
Year of expiry			
2011	605	553	–
2012	–	368	358
2013	–	–	9,103
2014	–	2,759	2,681
	<u>605</u>	<u>3,680</u>	<u>12,142</u>

In relation to group entities located in the jurisdictions other than Mongolia, the tax losses amounting Nil, USD5,269,000 and USD14,831,000 as at 31 December 2009, 2010 and 2011, respectively, do not expire under current tax legislations.

23 CONVERTIBLE BOND

	The Group and the Company		
	Liability component	Derivative component	Total
	USD'000	USD'000	USD'000
At 1 January 2011	—	—	—
Issuance of convertible bond (<i>Note 32</i>)	80,048	10,292	90,340
Transaction costs	(915)	—	(915)
Interest charged during the year (<i>Note 6(a)</i>)	3,371	—	3,371
Interest payable	(1,425)	—	(1,425)
Fair value adjustment (<i>Note 6(a)</i>)	—	(7,863)	(7,863)
At 31 December 2011	<u>81,079</u>	<u>2,429</u>	<u>83,508</u>

On 1 June 2011, the Company issued the USD 85,000,000 aggregate principal amount convertible bond (“convertible bond”) to QGX Holdings Ltd. (“Bondholder”), related to the acquisition of QGX (see Note 32).

The convertible bond bears interest at 2.0% per annum. If the Group’s consolidated leverage ratio exceeds 5.5:1, the interest rate of the convertible bond shall increase to 4.0% per annum. The initial maturity date of the convertible bond is 1 December 2012 and shall be extended but no later than 21 months from 1 June 2011.

If the total proved and probable reserves (as defined under the Australian Code for Reporting of Mineral Resources and Ore Reserves and to be determined after approximately 18 months to 21 months from the date of the Share Purchase Agreement (see the definition in Note 32)) contained in the Baruun Naran Coking Coal Mine (the “Total Reserves”) are less than 150,000,000 tonnes (“Reserves Shortfall”), the principal amount of the convertible bond shall be reduced by an amount equal to US\$3.00 per tonne of such Reserves Shortfall, subject to a cap of US\$85,000,000.

Pursuant to the bond conversion terms, the initial conversion price shall be HK\$10.92 per share and may change, subject to adjustment in certain circumstances and events. The Group can choose to satisfy its obligation to convert the convertible bond through either (i) delivery of shares or (ii) payment of cash.

The convertible bond has been accounted for as a hybrid financial instrument containing both a derivative component and a liability component. The derivative component was initially recognised at its fair value of USD10,292,000 and the attributable transaction cost of USD118,000 were charged to the profit or loss for the year ended 31 December 2011. The liability component was initially recognised at amortised cost of USD79,133,000, after taking into account attributable transaction costs of USD915,000.

Fair value of the derivative component was valued by the directors with the reference to a valuation report issued by an independent business valuer based on the Black-Scholes option pricing model.

24 EQUITY-SETTLED SHARE-BASED PAYMENT TRANSACTIONS

The Company has a share option scheme (“Share Option Scheme”) which was adopted on 17 September 2010 whereby the board of directors of the Group are authorised, at their discretion, invites eligible participants to receive options to subscribe for shares subject to the terms and conditions stipulated therein as incentives or rewards for their contributions to the Group.

Under the Share Option Scheme, the Company may grant options to employees and directors, suppliers, customers and professional advisers of the Group to subscribe for shares of the Company. The exercise price of the options is determined by the board of directors of the Company at the time of grant, and shall be the highest of the nominal value of the shares, the closing price of the shares at the date of grant and the average closing price of the shares for the five business days immediately preceding the date of grant. The Share Option Scheme remains in force for a period of 10 years commencing on its adoption date and will expire on 16 September 2020.

(i) The terms and conditions of the grants are as follows:

<u>Grant Date</u>	<u>Number of options</u>	<u>Vesting conditions</u>	<u>Contractual life of options</u>
	'000		
12 October 2011 . . .	8,800	12 October 2011 to 12 October 2012	12 October 2011 to 12 October 2019
12 October 2011 . . .	8,800	12 October 2011 to 12 October 2013	12 October 2011 to 12 October 2019
12 October 2011 . . .	8,800	12 October 2011 to 12 October 2014	12 October 2011 to 12 October 2019
12 October 2011 . . .	8,800	12 October 2011 to 12 October 2015	12 October 2011 to 12 October 2019
Total share options .	<u>35,200</u>		

The number of options granted to directors and employees for the year ended 31 December 2011 are 3,000,000 and 32,200,000, respectively.

(ii) The number and exercise price of share options are as follows:

	<u>Exercise price</u>	<u>Number of options</u>
	HKD	'000
Outstanding at 1 January	—	—
Granted during the year	6.66	35,200
Forfeited during the year	<u>6.66</u>	<u>(300)</u>
Outstanding at 31 December	<u>6.66</u>	<u>34,900</u>
Exercisable at 31 December	<u>—</u>	<u>—</u>

The options outstanding at 31 December 2011 had an exercise price of HKD6.66 per share and a weighted average remaining contractual life of 7.8 years.

(iii) Fair value of share options and assumptions

The fair value of services received in return for share options granted is measured by reference to the fair value of share options granted. The estimate of the fair value of the share options granted is measured based on the Black-Scholes option pricing model. The variables of the models included expected life of the options, risk-free interest rate, expected volatility and expected dividend of the shares of the Company.

	2011
Fair value at measurement date	HKD3.3793~HKD3.7663
Share price	HKD6.66
Exercise price	HKD6.66
Expected life	4.5-6 years
Risk-free interest rate	0.755%~1.054%
Expected volatility	61.87%~63.43%
Expected dividends	—

The expected volatility is based on the historic volatility of entities in the same industry (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility based on publicly available information. Expected dividends are based on management estimate. The risk-free interest rate is based on the yield of Hong Kong Exchange Fund Notes corresponding to the expected life of the options as at the grant date. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under a service condition. The condition has not been taken into account in the grant date fair value measurement of the services received. There was no market condition associated with the share option grants.

25 LONG-TERM PAYABLES

	2009	2010	2011
	USD'000	USD'000	USD'000
Receipt in advance from a customer (<i>Note i</i>)	14,658	16,811	—
Payable for mining right (<i>Note ii</i>)	557	—	—
	<u>15,215</u>	<u>16,811</u>	<u>—</u>

Note:

- (i) Receipt in advance represented an advance payment made by a third party customer in relation to a long-term sales contract with this customer within a ten-year period starting from 2009. The Group fully settled the receipt in advance by selling the coal in the first half of 2011 according to the mutual agreement with the third party customer.
- (ii) In September 2008, the Group entered into an agreement with the Government agency of Mongolia to reimburse it in relation to the exploration expenditures incurred by the Government of Mongolia at the Ukhua Khudag (“UHG”) deposit prior to the registration of the UHG mining license. Pursuant to the agreement, the payable for mining right should be settled annually within a five-year period starting from 2009. Nevertheless, the Group made full settlement of the outstanding payable balance in 2010.

26 PROVISIONS

	2009	2010	2011
	USD'000	USD'000	USD'000
Accrued reclamation obligations	1,705	6,904	11,110
Contingent considerations (<i>Note 32</i>)	—	—	1,500
Less: Current portion	—	—	1,500
	<u>1,705</u>	<u>6,904</u>	<u>11,110</u>

The accrual for reclamation costs has been determined based on management’s best estimates. The estimate of the associated costs may be subject to change in the near term when the reclamation on the land from current mining activities becomes apparent in future periods. At the balance sheet

date, the Group reassessed the estimated costs and adjusted the accrued reclamation obligations, where necessary. The Group's management believes that the accrued reclamation obligations at 31 December 2011 are adequate and appropriate. The accrual is based on estimates and therefore, the ultimate liability may exceed or be less than such estimates. The movement of the accrued reclamation cost during the Relevant Period is as follows:

	2009	2010	2011
	USD'000	USD'000	USD'000
At 1 January	1,640	1,705	6,904
Additions (<i>Note 32</i>)	–	–	1,500
Adjustment of estimations	–	4,251	4,834
Accretion expense (<i>Note 6(a)</i>)	265	332	567
Exchange adjustments	(200)	616	(1,195)
At 31 December	<u>1,705</u>	<u>6,904</u>	<u>12,610</u>

Accrued reclamation costs increased during the Relevant Period as the result of a reduction in the discount rate.

27 CAPITAL AND DIVIDENDS

- (a) The board of directors of the Company does not recommend the payment of a final dividend in respect of the years ended 31 December 2009, 2010 and 2011.

(b) Share capital

The Company was incorporated on 18 May 2010 with an authorised share capital of USD50,000 comprising 5,000,000 ordinary shares of USD0.01 each. On 18 May 2010, MCS Mining Group Limited acquired its initial share of one share of USD0.01. By an ordinary resolution passed at the annual general meeting held on 23 August 2010, the Company's authorised ordinary share capital was increased to USD60,000,000 by the creation of an additional 5,995,000,000 ordinary shares of USD0.01 each, ranking pari passu with the existing ordinary shares of the Company in all respects.

The aggregate amount of share capital of the companies now comprising the Group, after elimination of interests in subsidiaries, was included in other reserve during the years ended 31 December 2009, 2010 and 2011 (Note 28(b)).

The Company

	2010		2011	
	No of shares '000	USD'000	No of shares '000	USD'000
Authorised:				
Ordinary shares	<u>6,000,000</u>	<u>60,000</u>	<u>6,000,000</u>	<u>60,000</u>

	Note	2010		2011	
		No of shares '000	USD'000	No of shares '000	USD'000
Ordinary shares, issued and fully paid:					
At 1 January					
Shares issued immediately after the					
Reorganisation	(i)	3,000,000	30,000	3,000,000	30,000
Shares issued pursuant to the initial public					
offering and upon the exercise of the over-					
allotment option	(ii)	705,037	7,050	705,037	7,050
At 31 December		<u>3,705,037</u>	<u>37,050</u>	<u>3,705,037</u>	<u>37,050</u>

(c) Issue of shares

- (i) Upon the incorporation of the Company, one share was subscribed by the initial subscriber (see Note 27 (b)). On 14 September 2010, MCS Mining LLC, Petrovis LLC, Shunkhlai Mining LLC, EBRD, MCS Holding LLC, Tengeriin Tsag Group LLC, Energy Resources Corporation LLC and the Company entered into a share swap agreement, pursuant to which each of MCS Mining LLC, Petrovis LLC, Shunkhlai Mining LLC, EBRD, MCS Holding LLC and Tengeriin Tsag Group LLC transferred its respective shares in Energy Resources LLC to Energy Resources Corporation LLC, in consideration of which the Company allotted and issued, credited as fully paid, 1,715,999,999, 423,000,000, 183,000,000, 150,000,000, 300,000,000 and 228,000,000 shares to MCS Mining Group Limited, Petrovis Resources Inc., Shunkhlai Mining, EBRD, Kerry Mining (UHG) Limited and Ancora Investments No. 2 Limited, respectively.
- (ii) On 13 October 2010, an aggregate of 597,122,500 ordinary shares of USD0.01 each were issued and offered for subscription at a price of HKD7.02 per share upon the listing of the Company's share on the Stock Exchange. On 21 October 2010, an aggregate of 107,914,000 ordinary shares of USD0.01 each were issued and offered for subscription at a price of HKD7.02 per share upon the exercise of the over-allotment option. The Group raised approximately HKD4,778,015,000 in total (equivalent to USD615,700,000), net of the related expenses.

(d) Capital management

The Group's primary objectives when managing capital are to safeguard the Group's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders. The Group defines the capital as total shareholders' equity plus loans and borrowings.

The Group actively and regularly reviews and manages its capital structure to maintain a balance between the higher shareholder returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position.

The gearing ratio (calculated as total bank and other borrowings divided by total assets) of the Group as at 31 December 2009, 2010 and 2011 was 30%, 24%, and 35%, respectively.

28 RESERVES

(a) Share premium

Under the Companies Law of the Cayman Islands, the share premium account of the Company may be applied for payment of distributions or dividends to shareholders provided that immediately following the date on which the distribution or dividend is proposed to be paid, the Company is able to pay its debts as they fall due in the ordinary courses of business.

(b) Other reserve

The other reserve comprises the following:

- the aggregate amount of share capital and other reserves of the companies now comprising the Group after elimination of the investments in subsidiaries; and
- the portion of the grant date fair value of unexercised share options granted to directors and employees of the Company that has been recognised in accordance with the accounting policy adopted for share-based payments in Note 2(q)(ii).

(c) Exchange reserve

The exchange reserve comprises all foreign exchange adjustments arising from the translation of the MNT denominated financial statements of the companies now comprising the Group to the Group's presentation currency. The reserve is dealt with in accordance with the accounting policy set out in Note 2(v).

(d) Distributability of reserves

Pursuant to the Companies Law, Cap.22 (Law 3 of 1961, as consolidated and reserved) of the Cayman Islands, share premium of the Company is distributable to the shareholders. Other than the share premium, there is no other amount available for distribution to equity shareholders of the Company as at 31 December 2011.

29 FINANCIAL INSTRUMENTS

(a) Financial risk management objectives and policies

Management has adopted certain policies on financial risk management with the objective of:

- (i) ensuring that appropriate funding strategies are adopted to meet the Group's short-term and long-term funding requirements taking into consideration the cost of funding, gearing levels and cash flow projections of each project and that of the Group; and
- (ii) ensuring that appropriate strategies are also adopted to manage related interest and currency risk funding.

(b) Credit risk

The Group's credit risk is primarily attributable to cash at bank, trade and other receivables. Management monitors the exposures to these credit risks on an ongoing basis.

Substantially all of the Group's cash at bank are deposited in the reputable banks which management assessed the credit risk to be insignificant.

Trade receivables are presented net of allowance for doubtful debts. In order to minimise the credit risk, the credit management committee, comprising the senior management team of the Group, has established a policy for determining credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. The credit management committee also evaluates and reviews the credit quality and the recoverable amount of each individual trade debt on an ongoing basis. These evaluations and reviews focus on the customer's past history of making payments when due and current ability to pay, and take into account information specific to the customer as well as pertaining to the economic environment in which the customer operates. The Group establishes an allowance for doubtful debts that represents its estimate of losses in respect of trade receivables. The components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loss component established for groups of similar assets. At the end of the reporting period, the Group believes that adequate allowance for impairment has been made in the consolidated financial statements. In this regard, the directors consider that the Group's credit risk is significantly reduced. The Group does not hold any collateral as security for these receivables. The Group has a certain concentration credit risk as three customers accounted for 75% of the total trade receivables as at 31 December 2011.

The Group closely monitors the amount due from related parties.

VAT receivables include amounts that have been accumulated to date in various subsidiaries. According to the prevailing tax rules and regulations in Mongolia, a tax payer may offset future taxes and royalties payable to the Government against VAT amounts receivable from the Government of Mongolia. In July 2009, the Mongolian Tax Laws were amended to preclude producers and exporters of unfinished mineral products from claiming back VAT and any VAT amounts impacted will be prospective from the effective date of the law on 16 August 2009. On 10 November 2010, the Government defined finished mineral products as products which qualify for claiming back VAT. During the year ended 31 December 2010, the Group offset current income tax owing of USD2,604,000 against its VAT receivable balance and also received a cash refund of USD3,314,000 for the VAT receivable balance. During the year ended 31 December 2011, the Group offset current income tax and royalty tax owing of USD9,470,000 and USD8,381,000, respectively, against its VAT receivable balance. Based on currently available information, the Group anticipates full recoverability of amounts due on account primarily relating to finished mineral products at 31 December 2011. 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 31 December 2011, will be available to the Group to offset future taxes and royalty tax or will be refunded by the Government of Mongolia Taxation Authority.

Further quantitative disclosures in respect of the Group's exposure to credit risk arising from trade and other receivables are set out in Note 18.

(c) Foreign currency exchange risk

The Group is exposed to currency risk primarily through sales, purchases and borrowings which give rise to receivables, payables, borrowings and cash balances that are denominated in a foreign currency, i.e. a currency other than the functional currency of the operations to which the transactions relate. The functional currency of the Group's Mongolian entities is MNT and of the Group's overseas entities is USD. The currencies giving rise to this risk are primarily RMB, USD and HKD.

(i) Exposure to currency risk

The following table details the Group's exposure at the end of the reporting period to currency risk arising from recognised assets or liabilities denominated in a currency other than the functional

currency of the entity to which they relate. For presentation purpose, the amounts of the exposure are shown in USD, translated using the spot rate at the year end date.

Exposure to foreign currencies (expressed in United States Dollars)			
2009			
	Renminbi	United States Dollars	Hong Kong Dollars
	USD'000	USD'000	USD'000
Trade and other receivables	7	9,507	—
Cash and cash equivalents	1	2,170	—
Trade and other payables	(4,491)	(4,928)	—
Short-term borrowings and current portion of long-term borrowings .	—	(24,200)	—
Long-term borrowings	—	(10,000)	—
Long-term payable	(14,658)	—	—
Net exposure arising from recognised assets and liabilities	(19,141)	(27,451)	—

Exposure to foreign currencies (expressed in United States Dollars)			
2010			
	Renminbi	United States Dollars	Hong Kong Dollars
	USD'000	USD'000	USD'000
Trade and other receivables	40	293	—
Cash and cash equivalents	3,103	268,285	2,216
Trade and other payables	(9,091)	(16,279)	(14)
Short-term borrowings and current portion of long-term borrowings .	—	(85,909)	—
Long-term borrowings	—	(165,214)	—
Long-term payable	(16,811)	—	—
Net exposure arising from recognised assets and liabilities	(22,759)	1,176	2,202

Exposure to foreign currencies (expressed in United States Dollars)			
2011			
	Renminbi	United States Dollars	Hong Kong Dollars
	USD'000	USD'000	USD'000
Trade and other receivables	3,771	37,629	—
Cash and cash equivalents	2,418	117,234	235
Trade and other payables	(6)	(18,675)	(82)
Short-term borrowings and current portion of long-term borrowings .	—	(34,818)	—
Long-term borrowings	—	(144,661)	—
Net exposure arising from recognised assets and liabilities	6,183	(43,291)	153

(ii) Sensitivity analysis

An 5% strengthening/weakening of other currency against functional currencies defined in Note 2(v) as at the respective balance sheet dates would (decrease)/increase profit after taxation by the amount shown below. This analysis assumes that all other risk variables remained constant.

	2009	2010	2011
	USD'000	USD'000	USD'000
Profit for the year			
5% increase in RMB	(717)	(792)	232
5% decrease in RMB	717	792	(232)
5% increase in USD	(1,030)	44	(979)
5% decrease in USD	1,030	(44)	979
5% increase in HKD	—	109	8
5% decrease in HKD	—	(109)	(8)

(d) Interest rate risk

The Group's interest rate risk arises primarily from short-term borrowings, long-term borrowings and convertible bond. Borrowings issued at variable rates expose the Group to cash flow interest rate risk and fair value interest rate risk respectively.

The following table details the profile of the Group's net borrowings (interest-bearing financial liabilities less interest-bearing financial assets) at the balance sheet date. The detailed interest rates and maturity information of the Group's borrowings are disclosed in Note 20.

	2009	2010	2011
	USD'000	USD'000	USD'000
Net fixed rate borrowings:			
Borrowings	2,200	—	13,000
Obligations under finance lease	—	—	460
Convertible bond	—	—	83,508
Less: Bank deposits (including pledged deposits).	(2,000)	(346,645)	(186,759)
	<u>200</u>	<u>(346,645)</u>	<u>(89,791)</u>
Net floating rate borrowings:			
Borrowings	32,000	251,123	465,229
Less: Bank deposits (including pledged deposits).	(371)	(328,262)	(41,006)
	<u>31,629</u>	<u>(77,139)</u>	<u>424,223</u>
Total net borrowings:	<u>31,829</u>	<u>(423,784)</u>	<u>334,423</u>

As at 31 December 2009, it is estimated that a general increase/decrease of 100 basis points in interest rates, with all other variables held constant, would have increased/decreased the Groups profit after taxation and retained profits by approximately USD240,000.

As at 31 December 2010, it is estimated that a general increase/decrease of 100 basis points in interest rates, with all other variables held constant, would have increased/decreased the Groups profit after taxation and retained profits by approximately USD1,566,000.

As at 31 December 2011, it is estimated that a general increase/decrease of 100 basis points in interest rates, with all other variables held constant, would have decreased/increased the Groups profit after taxation and retained profits by approximately USD3,900,000.

The sensitivity analysis above indicates the instantaneous change in the Group's profit after tax that would arise assuming that the change in interest rates had occurred at the balance sheet date and had been applied to re-measure those financial instruments held by the Group which expose the Group to fair value interest rate risk at the balance sheet date. In respect of the expose to cash flow interest rate risk arising from floating rate non-derivative instruments held by the Group at the balance sheet date, the impact on the Group's profit after tax and retained profits and other components of consolidated equity is estimated as an annualised impact on interest expense or income of such a change in interest rates.

In respect of the convertible bond, as disclosed in Note 23, it bears interest at 2.0% per annum. If the Group's consolidated leverage ratio exceeds 5.5:1, the interest rate of the convertible bond shall increase to 4.0% per annum.

(e) Liquidity risk

The Group has to maintain a suitable level of liquidity to finance the daily operation, capital expenditure and repayment of borrowings. The Group's policy is to regularly monitor current and expected liquidity requirements to ensure that it maintains sufficient reserves of cash and adequate committed lines of funding from major financial institutions to meet its liquidity requirements in the short and longer term.

The following table details the remaining contractual maturities at the balance sheet date of the Group's financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the balance sheet date) and the earliest date the Group can be required to pay:

2009						
Contractual undiscounted cash outflow						
	Within 1 year	After 1 year but within 2 years	After 2 years but within 5 years	After 5 years	Total contractual undiscounted cash flow	Balance sheet carrying amount
	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
Borrowings (Note 20)	26,168	10,309	–	–	36,477	34,200
Trade and other payables (Note 21)	17,071	36	–	–	17,107	17,107
Long-term payables (Note 25).	450	225	225	14,648	15,548	15,215
	<u>43,689</u>	<u>10,570</u>	<u>225</u>	<u>14,648</u>	<u>69,132</u>	<u>66,522</u>
2010						
Contractual undiscounted cash outflow						
	Within 1 year	After 1 year but within 2 years	After 2 years but within 5 years	After 5 years	Total contractual undiscounted cash flow	Balance sheet carrying amount
	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
Borrowings (Note 20)	96,835	31,324	115,706	52,884	296,749	251,123
Trade and other payables (Note 21)	40,315	–	–	–	40,315	40,315
Long-term payables (Note 25).	–	–	16,811	–	16,811	16,811
	<u>137,150</u>	<u>31,324</u>	<u>132,517</u>	<u>52,884</u>	<u>353,875</u>	<u>308,249</u>

	2011					
	Contractual undiscounted cash outflow					
	Within 1 year	After 1 year but within 2 years	After 2 years but within 5 years	After 5 years	Total contractual undiscounted cash flow	Balance sheet carrying amount
	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
Borrowings (Note 20)	348,132	29,997	138,088	–	516,217	478,229
Trade and other Payables (Note 21)	118,680	–	–	–	118,680	118,680
Convertible bond (Note 23)	86,565	–	–	–	86,565	83,508
	<u>553,377</u>	<u>29,997</u>	<u>138,088</u>	<u>–</u>	<u>721,462</u>	<u>680,417</u>

(f) Fair values

(i) Financial instruments carried at fair value

The following table presents the carrying value of financial instruments measured at fair value at the end of the reporting period across the three levels of the fair value hierarchy defined in IFRS 7, Financial Instruments: Disclosures, with the fair value of each financial instrument categorised in its entirety based on the lowest level of input that is significant to that fair value measurement. The levels are defined as follows:

- Level 1 (highest level): fair values measured using quoted prices (unadjusted) in active markets for identical financial instruments
- Level 2: fair values measured using quoted prices in active markets for similar financial instruments, or using valuation techniques in which all significant inputs are directly or indirectly based on observable market data
- Level 3 (lowest level): fair values measured using valuation techniques in which any significant input is not based on observable market data

	Level 3		
	2009	2010	2011
	USD'000	USD'000	USD'000
Derivative financial instruments:			
– Conversion option embedded in convertible bond	–	–	2,429
	<u>–</u>	<u>–</u>	<u>2,429</u>

(ii) Fair value of financial instruments carried at other than fair value

In respect of cash and cash equivalents, trade and other receivables, and trade and other payables, the carrying amounts approximate fair value due to the relatively short term nature of these financial instruments.

In respect of borrowings and the liability component in respect of the convertible bond, the carrying amounts are not materially different from their fair values as at 31 December 2009, 2010 and 2011. The fair values of borrowings are estimated as the present value of future cash flows, discounted at current market interest rates for similar financial instruments. The fair values of the convertible bond are measured using discounted cash flows method in which all significant inputs are directly or indirectly based on observable market data.

The aggregate carrying values of other financial liabilities carried on the consolidated balance sheet are not materially different from their fair values as at 31 December 2009, 2010 and 2011.

30 COMMITMENTS AND CONTINGENCIES

(a) Capital commitments

Capital commitments outstanding at respective balance sheet dates not provided for in the financial statements were as follows:

	2009	2010	2011
	USD'000	USD'000	USD'000
Contracted for	81,097	80,079	14,827
Authorised but not contracted for	–	102,592	80,075
	<u>81,097</u>	<u>182,671</u>	<u>94,902</u>

(b) Operating lease commitments

- (i) As at 31 December 2009, 2010 and 2011, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	2009	2010	2011
	USD'000	USD'000	USD'000
Within 1 year	890	1,340	7,136
After 1 year but within 5 years	1,061	825	2,245
	<u>1,951</u>	<u>2,165</u>	<u>9,381</u>

- (ii) The Group leases certain buildings through operating leases. These operating leases do not contain provisions for contingent lease rentals. None of the agreements contain escalation provisions that may require higher future rental payments.

(c) Environmental contingencies

Historically, the Group has not incurred any significant expenditure for environmental remediation. Further, except for the accrued reclamation obligations as disclosed in Note 26 and amounts incurred pursuant to the environment compliance protection and precautionary measures in Mongolia, the Group has not incurred any other significant expenditure for environmental remediation, is currently not involved in any other environmental remediation, and has not accrued any other amounts for environmental remediation relating to its operations. Under existing legislation, the directors believe that there are no probable liabilities that will have a material adverse effect on the financial position or operating results of the Group. Environmental liabilities are subject to considerable uncertainties which affect the Group's ability to estimate the ultimate cost of remediation efforts. The outcome of environmental liabilities under future environmental legislations cannot be estimated reasonably at present and which could be material.

31 MATERIAL RELATED PARTY TRANSACTIONS

(a) Transactions with related parties

Related parties refer to enterprises over which the Group is able to exercise significant influence or control during the year. During the Relevant Period, the Group entered into transactions with the following related parties.

Name of party	Relationship
MCS Holding LLC (“MCS”)	Shareholder
Uniservice Solution (“Uniservice Solution”, formerly named as “Officenet LLC”)	Subsidiary of MCS
MCS Property LLC (“MCS Property”)	Subsidiary of MCS
MCS Electronics LLC (“MCS Electronics”)	Subsidiary of MCS
Anun LLC (“Anun”)	Subsidiary of MCS
MCS International LLC (“MCS International”)	Subsidiary of MCS
Erchim Suljee LLC (“Erchim Suljee”)	Subsidiary of MCS

Particulars of significant transactions between the Group and the above related parties during the years ended 31 December 2009, 2010 and 2011 are as follows:

	2009	2010	2011
	USD’000	USD’000	USD’000
Interest income (<i>Note (i)</i>)	73	42	–
Interest expenses (<i>Note (ii)</i>)	158	–	–
Ancillary services (<i>Note (iii)</i>)	5,285	25,152	30,326
Purchase of goods (<i>Note (iv)</i>)	830	386	112
Lease of property, plant and equipment (<i>Note (v)</i>)	1,446	1,177	897
(Repayment of loans from)/loans provided to related parties (<i>Note (vi)</i>)	2,306	(2,306)	–
Purchase of equipment and construction work (<i>Note (vii)</i>)	11,673	42,409	24,447
Sales of property, plant and equipment (<i>Note (viii)</i>)	–	–	2,418
Finance lease of equipment (<i>Note (ix)</i>)	–	–	301

- (i) Interest income represents interest earned from loan to MCS. The applicable interest rate is 2% per month.
- (ii) Interest expense in 2009 represented interest incurred in respect of borrowings from MCS. The applicable interest rates range from 18% to 24% per annum.
- (iii) Ancillary services represent expenditures for support services such as consultancy, cleaning and canteen expense paid to Uniservice Solution, MCS and its affiliates. The service charges are based on comparable or prevailing market rates, where applicable.
- (iv) Purchase of goods represents concrete purchased from MCS Property, MCS and its affiliates. The goods are purchased at comparable or prevailing market prices, where applicable.
- (v) Lease of property, plant and equipment represents rental paid or payable in respect of properties and office equipment leased from MCS Electronics, MCS and its affiliates. The rental charges are based on comparable or prevailing market rates, where applicable.
- (vi) The Group provided loans to MCS and MCS Electronics in 2009 and collected back the loans in 2010.
- (vii) Purchase of equipment and construction work represents expenditure relating to equipment and construction service provided by MCS Electronics, Anun, MCS and its affiliates. The purchases are carried out at comparable or prevailing market rates, where applicable.
- (viii) Sales of property, plant and equipment represent sale to Uniservice Solution. The sales are carried out at comparable or prevailing market rates, where applicable.

- (ix) Finance leases of equipment represent expenditure relating to the lease of equipment from MCS Electronics through finance lease. The rental charges are based on comparable or prevailing market rates, where applicable.

Except for the loans provided to and from the related parties and its corresponding interest income and expenses which were terminated before 31 January 2010, the above related party transactions are recurring after the listing of the Company on the Stock Exchange.

The directors of the Company are of the opinion that the above transactions were conducted in the ordinary course of business, on normal commercial terms and in accordance with the agreements governing such transactions.

Amounts due from/(to) related parties

	2009	2010	2011
	USD'000	USD'000	USD'000
Other receivables (Note 18(c)(i))	3,038	347	455
Other accruals and payables (Note 21(iii)).	(2,052)	(5,329)	(9,560)

(b) Key management personnel remuneration

Key management personnel are those persons holding positions with authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including the Group's directors.

Remuneration for key management personnel, including amounts paid to the Company's directors, is as follows:

	2009	2010	2011
	USD'000	USD'000	USD'000
Salaries and other emoluments	786	894	1,500
Discretionary bonus	223	1,898	1,001
Retirement scheme contributions	70	201	140
Equity-settled share-based payment expenses.	—	—	837
	<u>1,079</u>	<u>2,993</u>	<u>3,478</u>

32 ACQUISITION OF SUBSIDIARIES

The Group entered into a share purchase agreement with Quincunx (BVI) Ltd. and its parent, Kerry Mining (Mongolia) Limited (collectively the "Seller") on 31 May 2011 ("Share Purchase Agreement") in relation to the acquisition of the entire issued share capital of Baruun Naran Limited (formerly named as "QGX Coal Limited") ("QGX") (the "Acquisition"). QGX ultimately owns the Baruun Naran Coking Coal Mine ("BN mine"), which is located in southern Mongolia, Umnugobi Aimag (South Gobi province). The Acquisition was completed on 1 June 2011.

The consideration for the Acquisition includes:

- (i) USD100,000,000 immediately paid by the Group to the Seller on 1 June 2011;
- (ii) USD279,465,000 of the cash payable by the Group to the Seller is in the form of a promissory note with a 2-month period;

- (iii) USD85,000,000 by the issue of the convertible bond by the Company to QGX Holdings Ltd, a subsidiary of Kerry Mining (Mongolia) Limited; and
- (iv) USD21,874,000 of intercompany loans transferred to the Group, which were previously owed by QGX to the Seller (the “Intercompany loans”).

The above consideration may be adjusted as follows:

- (i) Approximately 18 months to 21 months from the date of the Share Purchase Agreement, an additional payment may be payable to the Seller or a claw back may be payable by the Seller in the amount of USD3.00 per tonne to the extent to which Total Reserves exceeds 150,000,000 tonnes or are less than 150,000,000 tonnes, respectively (the “Reserve Adjustment”). Under the Reserve Adjustment, the maximum amount payable to the Seller will be USD105,000,000 and the maximum amount payable by the Seller will be USD90,000,000; and
- (ii) An additional life of mine payment of USD6 per tonne in the event that the actual amount of coal extracted from the BN mine exceeds a specified semi-annual production target fixed on the date of the determination of Total Reserves in each semi-annual period after 1 June 2011 commencing on 1 January and ending on 30 June and commencing on 1 July and ending on 31 December (the “Royalty Provision”).

Taking into account the Reserve Adjustment and the Royalty Provision, the total amount of payment to be received by the Seller for the Acquisition is not to exceed USD950,000,000 over the life of the BN mine.

In connection with the Acquisition, transaction costs of approximately USD 4.3 million were incurred, which have been included in the Group’s administrative expenses for the year ended 31 December 2011.

The following summarises the consideration transferred, and the recognised amounts of assets acquired and liabilities assumed at the acquisition date:

Identifiable assets acquired and liabilities assumed as at 1 June 2011:

	Carrying value	Fair value adjustments	Fair value
	USD’000	USD’000	USD’000
Property, plant and equipment	6,206	(149)	6,057
Construction in progress	18,582	–	18,582
Intangible assets	–	596,557	596,557
Other receivables	2,148	–	2,148
Cash and cash equivalents	805	–	805
Intercompany loans	(21,874)	–	(21,874)
Other payables	(3,739)	–	(3,739)
Deferred tax liabilities	–	(149,105)	(149,105)
Total net identifiable assets	<u>2,128</u>	<u>447,303</u>	<u>449,431</u>

Consideration transferred as at 1 June 2011:

	Fair value
	USD'000
Cash	100,000
Fair value of promissory note	279,465
Fair value of convertible bond (<i>Note 23</i>)	90,340
Fair value of contingent considerations (<i>Note 26</i>)	1,500
Less: Fair value of Intercompany loans	(21,874)
Fair value of total consideration	<u>449,431</u>

The initial fair value/acquisition accounting for QGX was determined provisionally. In accordance with IFRS3, adjustments to the fair value of the consideration and the assets acquired and liabilities assumed can be made during the 12 months from the date of acquisition.

An analysis of the payment for the acquisition of subsidiaries is as follows:

	1 June 2011
	USD'000
Cash consideration paid	100,000
Add: transaction costs in relation to the Acquisition	4,299
Less: cash and cash equivalents acquired	(805)
Fair value of total consideration	<u>103,494</u>

In June 2011, the Group obtained the short-term interest-bearing borrowings from Standard Bank of USD400,000,000, among which USD279,465,000 was paid by Standard Bank to the Seller directly to early settle the promissory note as mentioned above.

33 ULTIMATE CONTROLLING PARTY

As at 31 December 2011, the directors consider the ultimate controlling party of the Group to be MCS Holding LLC, which was incorporated in Mongolia. This entity does not produce financial statements available for public use.

34 PARTICULARS OF SUBSIDIARIES

As at 31 December 2011, the Company had direct or indirect interests in the following subsidiaries, particulars of which are set out below:

Name of company	Place of incorporation	Issued and fully paid up capital	Equity attributable to the Company		Principal activities
			Direct	Indirect	
Mongolian Coal Corporation Limited	Hong Kong	HKD1	100%	–	Investment holding
Mongolian Coal Corporation S.a.r.l.	Luxembourg	USD67,126,690	–	100%	Investment holding

Name of company	Place of incorporation	Issued and fully paid up capital	Equity attributable to the Company		Principal activities
			Direct	Indirect	
Energy Resources Corporation LLC	Mongolia	USD103,800,000	–	100%	Investment holding
Energy Resources LLC	Mongolia	USD100,000,370	–	100%	Mining and trading of coals
Energy Resources Rail LLC	Mongolia	MNT10,700,000,000	–	100%	Railway project management
Energy Resources Mining LLC	Mongolia	USD1,000	–	100%	Mining and technical management
Transgobi LLC	Mongolia	MNT9,122,641,836	–	100%	Coal haulage and logistics management
Tavan Tolgoi Airport LLC	Mongolia	MNT3,475,379,135	–	100%	Airport operation and management
Enrestechology LLC	Mongolia	MNT3,466,163,445	–	100%	Coal plant management
Ukhaa Khudag Water Supply LLC	Mongolia	MNT3,001,940,000	–	100%	Water exploration and supply management
United Power LLC	Mongolia	MNT3,025,219,206	–	100%	Power supply project management
Gobi Road LLC	Mongolia	MNT1,000,000	–	100%	Construction of road
Energy Resourecs Road LLC	Mongolia	MNT1,000,000	–	100%	Transportation of coal and construction of road
Public Service LLC	Mongolia	MNT20,000,000	–	100%	Provision of public utility services
Khangad Exploration LLC	Mongolia	MNT42,491,100,000		100%	Exploration and development of coal mine
Baruun Naran Sarl	Luxembourg	EUR24,918,394		100%	Investment holding
Baruun Naran Ltd	Gibraltar	USD1,000		100%	Investment holding

35 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2011

Up to the date of issue of these financial statements, the IASB has issued a number of amendments and new standards which are not yet effective for the year ended 31 December 2011 and which have not been adopted in these financial statements. These included the following which may be relevant to the Group's operations and financial statements.

	Effective for accounting periods beginning on or after
Amendments to IAS 12, Income taxes – Deferred tax: Recovery of underlying assets	1 January 2012
Amendments to IAS 1, Presentation of financial statements – Presentation of items of other comprehensive income	1 July 2012
IFRS 10, Consolidated financial statements	1 January 2013
IFRS 11, Joint arrangements.	1 January 2013
IFRS 12, Disclosure of interests in other entities.	1 January 2013
IFRS 13, Fair value measurement.	1 January 2013
IAS 27, Separate financial statements (2011).	1 January 2013
IAS 28, Investments in associates and joint ventures (2011).	1 January 2013
Revised IAS 19, Employee benefits	1 January 2013
IFRIC 20, Stripping costs in the production phase of a surface mine	1 January 2013
Amendments to IFRS 7, Financial instruments: Disclosures – Offsetting financial assets and financial liabilities	1 January 2013
Amendments to IAS 32, Financial instruments: Presentation – Offsetting financial assets and financial liabilities	1 January 2014
IFRS 9, Financial instruments	1 January 2015
Amendments to IFRS 9, Financial instruments and IFRS 7 Financial instruments: Disclosures – Mandatory effective date and transition disclosures	1 January 2015

IFRIC 20 applies to all types of natural resources that are extracted using the surfacing mining activity process. It considers when and how to account separately for the two benefits arising from the stripping activity, which are 1) the usable ore that can be used to produce inventory; and 2) improved access to further quantities of material that will be mined in future periods, as well as how to measure these benefits both initially and subsequently.

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that, except for IFRIC 20 as mentioned above, the adoption of them is unlikely to have a significant impact on the Group's results of operations and financial position other than additional disclosures may arise.

**UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND
UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST**



Lawrence D. Henchel
Vice President Geologic Services

January 27, 2012

File No. 12-5593

Dr. Battengel Gotov
Chief Executive Officer
Energy Resources LLC
Central Tower (15th Floor)
2 Sukhbaatar Square, SBD 8
Ulaanbaatar, Mongolia

**Subject: 2011 Update of Stated Resources and Reserves
for the Ukhaakhudag Project**

Dear Dr. Gotov,

Norwest Corporation (Norwest) has estimated updated coal resources and reserves for the Ukhaakhudag (UHG) mining license. Energy Resources LLC (ER) authorized Norwest to provide a statement of resources and reserves and report in-place coal quality as of December 31, 2011. These estimates are derived from the most current Norwest UHG geologic model, a detailed pit survey as of December 31, 2011 and monthly 2011 coal production reports provided by ER. The Norwest model is described in detail in the Norwest report "*UHG Coal Project, South Gobi, Mongolia, Independent Technical Report*", (or ITR) dated September 2010.

DEFINITIONS

Definitions of key terms applied in this report are as follows:

- **Resource**— A resource is that part of a deposit in such form and quantity that there are reasonable prospects for eventual economic extraction. The location, quantity, quality, geologic characteristics and continuity of a resource are known, estimated or interpreted from specific geological evidence and knowledge. Resources are subdivided, in order of increasing geological confidence, into Inferred, Indicated and Measured categories.
- **Reserve**— Reserve is that part of a mineral deposit which could be economically and legally extracted or produced at the time of the reserve determination. It is the economically mineable part of a Measured or Indicated coal resource.

**UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND
UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST**



Page 2
January 27, 2012
Letter to Dr. Gotov

- **Proved (Measured) Reserves**– Reserves for which (a) quantity is computed from dimensions revealed from points of observation; grade and/or quality are computed from the results of detailed sampling and (b) the sites for inspections, sampling, and measurement are spaced so closely and the geologic character is so well defined that size, shape, depth, continuity and mineral content of reserves are well-established.
- **Probable (Indicated) Reserves**– Reserves for which quantity and grade and/or quality are computed from information similar to that used for proven (measured) reserves, but the sites for inspection, sampling, and measurement are farther apart or are otherwise less adequately spaced. The degree of assurance, although lower than that for proven (measured) reserves, is high enough to assume continuity between points of observation. A probable reserve is the economically mineable part of an Indicated resource.
- **Marketable Reserves**– Marketable reserves are the tonnages of coal, at specified moisture and quality, available for sale after beneficiation of coal reserves. Marketable reserves may be reported in conjunction with, but not instead of, reports of reserves.

EFFECTIVE DATE

The effective date of this resource and reserve statement is December 31, 2011.

**IN-PLACE RESOURCE
ESTIMATES**

Norwest has compiled detailed tabulations of in-place coal resource tonnes and estimated raw coal qualities for the UHG license area. The resource numbers are reported using the Australasian Code for Reporting of Mineral Resources and Ore Reserves (The JORC Code) as a guideline. The JORC code provides prescribed criteria for the estimation of resources and reserves that are accepted by the international banking and investment communities. Coal resources are inclusive of coal reserves. Coal resources have some potential to be reclassified as reserves in the future, pending the favorable results of additional exploration, investment of capital for project development, improvements in coal markets or mining technology, etc.

**UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND
UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST**



Page 3
January 27, 2012
Letter to Dr. Gotov

Coal resources have been calculated for areas amenable to extraction by both surface and underground mining methods. Table 1 presents the total resource calculated for the UHG mining license as of December 31, 2011.

Table 1 Total In-Place Coal Resources as of December 31, 2011

Category	Mining Method	Resource Volume (m ³) '000	Average Seam Thickness (m)	In Place Tonnes (Mt)	Density (ad) (g/cm ³)
Measured	Surface	128,526	5.29	195.9	1.52
	Underground	-	-	-	-
Indicated	Surface	135,718	5.51	205.3	1.51
	Underground	57,164	6.55	88.7	1.55
Inferred	Surface	7,692	7.36	11.7	1.52
	Underground	45,517	6.46	69.2	1.52
Total		374,617	5.75	570.8	1.52

* Mt = Million metric tonnes (air dried).

Criteria used in the estimation of each type of resource are given below.

Surface Mineable Coal Resource

Surface mineable resources were calculated for ER by Norwest and presented in an ITR finalized in September 2010. The resources stated in the report were current through May 31, 2010. Norwest calculated surface resources for this update report by two methods:

1. Subtracting coal depletions through 2011 (provided by ER) from the ITR estimate.
2. Calculating remaining resources using the geologic model and the December 31, 2011, pit surface derived from UHG end-of-year mine surveys (provided by ER).

Minor differences between estimates using these two methods were noted. The variance in results is most likely attributed to insignificant variances in actual density, but minor losses of coal during operations, minor surveying and modeling errors or some combination of these factors may also have an effect.

**UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND
UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST**



Page 4
January 27, 2012
Letter to Dr. Gotov

The estimate based on depletion of agreed-upon monthly survey quantities has been assumed to be the more accurate, and is the basis of this resource and reserves update.

Surface mineable resources have been limited to a depth from surface of 300m, and at a minimum apparent seam thickness of 0.6m. Coal seam partings greater than 0.6m have been excluded from the resource as these partings are easily separated as waste material using current surface mining practices. Note that 300m is viewed by Norwest as the maximum potential depth limit for surface extraction of coal at UHG.

A depth of weathering limit of 15m below surface has been universally applied and is based on Norwest's observation of drillhole core samples and downhole geophysical log profiles obtained from the 2008 drilling and sampling campaign. All coal within the weathering limit is assumed to be spoiled, and is not included in this resources and reserves estimate. The resource area is further delineated by seam subcrops in the east, the license boundary in the west, and by the margins of the fault-bounded basin to the north and south. The traditional locations of these bounding faults have been used given no conclusive evidence to the contrary, and additional field observations by Norwest have verified non-coal bearing rock formations occurring across these fault boundaries.

The classification of in-place resources into measured, indicated and inferred categories has taken into account the distribution of the validated drillholes as well as the overall confidence in the interpretation of fault locations, structural complexity and coal quality information. The exposures of coal seams in the working pit are considered valid points of observation. Attachment A of this report shows the distribution of the assurance category areas.

Table 2 presents coal resources amenable to surface mining for UHG as of December 31, 2011, divided into Measured, Indicated and Inferred categories of geological assurance.

**UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND
UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST**



Page 5
January 27, 2012
Letter to Dr. Gotov

Table 2 Total Surface Coal Resources as of December 31, 2011

Category	Resource Volume (m ³) '000	Average Seam Thickness (m)	In Place Tonnes (Mt [*])	Density (ad) (g/cm ³)
Measured	128,526	5.29	195.9	1.52
Indicated	135,718	5.51	205.3	1.51
Inferred	7,692	7.36	11.7	1.52
Total	271,936	5.46	412.9	1.52

* Mt = Million metric tonnes (air dried).

There is an estimated total of 412.9Mt of surface mineable coal resources within the UHG mining license. Measured and Indicated resources account for 401.2Mt (97%) of the total surface resource. Estimated coal quality for the total surface resource is given by assurance category in Table 3.

Table 3 Surface Resource Quality - December 31, 2011

Category	Moisture Content % (ad)	Ash Content % (dry)	Sulphur Content % (dry)	Calorific Value kCal/kg (dry)	Volatile Matter Content % (dry)
Measured	0.54	25.89	0.63	6,118	23.36
Indicated	0.60	24.93	0.69	6,103	27.72
Inferred	0.56	25.45	0.65	6,057	26.00
Total	0.57	25.40	0.66	6,109	25.60

The coal quality values given in Table 3 are for raw (unwashed), in-place coal. UHG coal is predominantly beneficiated through coal processing in order to produce a marketable product. The surface mineable resource is considered a resource for immediate extraction.

Table 4 shows the ratio of in-place potential coking versus thermal surface coal resources estimated for UHG as of December 31, 2011.

Table 4 In-Place Potential Coking Versus Thermal Surface Resources as of December 31, 2011

Category	Coking Coal* (Mt)	Thermal Coal** (Mt)	Total (Mt)
Measured	126.1	69.8	195.9
Indicated	164.2	41.1	205.3
Inferred		11.7	11.7
Total	290.3	122.6	412.9

*Includes Seams 0C, 3, 4, 8, and 9.

**Includes both proven thermal only seams and seams with unknown coking potential.

**UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND
UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST**



Page 6
January 27, 2012
Letter to Dr. Gotov

UHG is estimated to contain an estimated 290.3Mt of potential coking coal resources above 300m from ground surface, being comprised entirely within the Measured and Indicated category of assurance. Classified as thermal coal are coal seams that have shown poor or no coking characteristics or seams that have yet to undergo rigorous testing to define their coking potential. A total of 122.6Mt of thermal coal are calculated for the UHG mining license, with 110.9Mt being classified as Measured and Indicated and 11.7Mt as Inferred.

Underground Mineable Coal Resource

Underground coal resources have been estimated for UHG by Norwest and presented in a report to ER dated January 12, 2010. There has been no mining of underground resources as of the effective date of this report, and neither has exploration adjusted the geologic understanding of the deposit. Therefore, estimates of resources amenable to extraction by underground methods remain unchanged from that report.

As 300m from surface is considered the maximum limit for practical surface mining, underground resources have been calculated using this depth as an upper, minimum depth limit. The criteria constraining the underground resource estimate include:

- Minimum depth from surface – 300m
- Maximum depth from surface – 800m
- Minimum apparent seam thickness – 1.5m
- Maximum mineable parting thickness – 0.5m
- Main seams included – 0A, 0B, 0C, 3A, 3B, 3C, 4A, 4C, and 8B.

Table 5 presents total resources amenable to extraction by underground mining methods using the criteria given above.

Table 5 Total Underground Coal Resources as of December 31, 2011

Category	Resource Volume (m ³) '000	Average Thickness (m)	In Place Tonnes (Mt*)	Density (ad) (g/cm ³)
Measured	-	-	-	-
Indicated	57,164	6.55	88.6	1.55
Inferred	45,517	6.46	69.3	1.52
Total	102,681	6.51	157.9	1.54

* Mt = Million metric tonnes (air dried).

**UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND
UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST**



Page 7
January 27, 2012
Letter to Dr. Gotov

The total in-place underground resources between 300m and 800m from surface are 157.9Mt, comprised of 88.6Mt Indicated and 69.3Mt Inferred tonnes. Estimated coal quality for the total underground resource is given by assurance category in Table 6.

Table 6 Underground Resource Quality - December 31, 2011

Category	Moisture Content % (ad)	Ash Content % (dry)	Sulphur Content % (dry)	Calorific Value kCal/kg (dry)	Volatile Matter Content % (dry)
Measured	-	-	-	-	-
Indicated	0.42	28.00	0.51	5,811	24.55
Inferred	0.42	25.32	0.61	6,029	25.03
Total	0.42	26.82	0.55	5,907	24.76

The coal quality values given in Table 6 are for raw (unwashed), in-place coal. The underground resource would presumably undergo coal processing (washing) in order to produce a marketable product. The underground resource is classified as a resource for future extraction and has not been evaluated for potential classification as reserves.

Table 7 shows the ratio of in-place potential coking versus thermal underground coal resources estimated for UHG as of December 31, 2011.

Table 7 In-Place Potential Coking Versus Thermal Underground Resources as of December 31, 2011

Category	Coking Coal (Mt)	Thermal Coal (Mt)	Total (Mt)
Measured	-	-	-
Indicated	50.7	37.9	88.6
Inferred	42.2	27.1	69.3
Total	92.9	65.0	157.9

*Includes Seams 0C, 3, 4, 8, and 9.

**Includes both proven thermal only seams and seams with unknown coking potential

An estimated 92.9Mt of potential coking coal and 65.0Mt of thermal in-place resource is calculated for UHG between 300m and 800m depth from ground surface. The coking coal is comprised of 50.7Mt Indicated and 42.2Mt of Inferred resource, while the thermal coal consists of 37.9Mt Indicated and 27.1Mt

UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST



Page 8
January 27, 2012
Letter to Dr. Gotov

Inferred. Underground mineable seams currently classified as thermal may be found to have suitable properties for a metallurgical product with further investigation of their characteristics, given that coal rank and coking properties tend to improve with increased depth of burial.

COAL RESERVE ESTIMATES

Coal reserves have been calculated for the UHG mining license by Norwest as of December 31, 2011, by reconciling agreed run-of-mine (ROM) coal production to depletion of the reserves indicated by a detailed end-of-year (2011) survey, then subtracting from the original reserve estimate (detailed methodology determining the economic viability of reserves and their calculation are given in the ITR of September 2010).

Table 8 presents total coal reserves as of December 31, 2011.

Table 8 Total Coal Reserves as of December 31, 2011

	Total Reserves*		Marketable Reserves**	
	Proved	Probable	Proved	Probable
Coking Coal (Mt, ad)	118	84	79	58
Thermal Coal (Mt, ad)	62	11	33	3
Sub-Total	180	95	113	61
Total***	275		174	

*Excludes 0.4Mt from mine plan within Inferred resource category

** Includes primary washed product and secondary product.

*** Rounded

The classification of coal as reserves is based on industry- standard analysis related to practical and economic mineability, such as: minimum acceptable coal thickness, wash recovery, coal quality, mining costs, market conditions and product price, minimum mineable area tonnage for economic extraction, etc. For the purpose of this estimate, the following assumptions have been made with respect to delineation of reserves at UHG:

- The basis of estimation of reserves as reported in the ITR remains fundamentally unchanged.

**UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND
UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST**



Page 9
January 27, 2012
Letter to Dr. Gotov

- The market price has not dropped significantly since the ITR estimate (assumption based on recent and direct experience in the region, along with communication with ER).
- There has been no material change in the coal quality (particularly coking coal quality, assumption based on communication with ER).
- There are no significant increases in the cost of mining as a result of physical variances in coal structure (based on understanding that there has been no material or significant changes in geological structure, coal quality, etc).
- There are no significant increases in the cost of mining as a result of logistical factors such as availability of labour, availability of equipment, unforeseen geotechnical or hydrological conditions, unexpected performance issues of the CHPP, issues with transportation of the coal, permitting and licensing issues, socio-economic issues, or any other factors which could adversely affect the operations (assumption based on communication with ER).

CONCLUSION

A total in-place coal resource of 570.8Mt is estimated for the UHG mining license as of December 31, 2011. The surface mineable resource is classified as a resource for immediate extraction while the underground is considered for future extraction. The surface mineable resource consists of 401.2Mt Measured and Indicated resource and 11.7Mt of Inferred, totaling 412.9Mt. Underground resources are estimated to be 157.9Mt, of which 88.6Mt are Indicated and 69.3Mt are Inferred.

The surface resource contains an estimated 290.3Mt of potential coking coal (70%) and 122.6Mt thermal coal (30%) while the underground resource is calculated to contain 92.9Mt potential coking seams (59%) and 65Mt thermal seams (41%). It is possible that seams currently categorized as thermal may become classified as coking in the future given rigorous evaluation of their potential metallurgical characteristics.

UHG reserves are estimated to contain a total of 275Mt, being comprised of 180Mt Proved and 95Mt Probable reserves. Marketable reserves are estimated to contain a total of 174Mt, of which 113Mt are Proved and 61Mt Probable reserves.

**UHG COAL PROJECT: INDEPENDENT TECHNICAL REPORT AND
UPDATE OF STATED RESOURCES AND RESERVES FOR THE UHG PROJECT BY NORWEST**



Page 10
January 27, 2012
Letter to Dr. Gotov

The resources and reserves presented herein are estimates, based on reasonable geologic assurance, for coal resources and reserves for the UHG property. The work has been performed by professional geologists and engineers with available data and using industry-accepted standards.

Sincerely,

NORWEST CORPORATION

A handwritten signature in blue ink, appearing to read "LD Henchel", written over a faint horizontal line.

Lawrence D. Henchel, PG
Vice President Geologic Services

[illegible]

STATEMENT OF COAL RESOURCES

BARUUN NARAN COAL PROJECT

UMNOGOVI PROVINCE,

MONGOLIA

Prepared for

Khangad Exploration LLC

By

McElroy Bryan Geological Services Pty Ltd

Report No. 247/3/1

February 2010

STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Statement of Coal Resources 2010 Baruun Naran Coal Deposit

TABLE OF CONTENTS

1. PURPOSE OF RESOURCE STATEMENT.....	1
2. COMPETENT PERSON STATEMENT	2
3. RESOURCE ASSESSMENT CRITERIA	3
4. RESOURCE DESCRIPTION	5
4.1 Location and Tenements	5
4.2 Topography and Climate	8
4.3 Geology	7
4.3.1 Stratigraphy.....	7
4.3.2 Coal Seams	8
4.3.3 Structure.....	9
5. GEOLOGICAL DATA, MODEL AND ESTIMATION PROCEDURES	14
5.1 Summary of Geological Data	14
5.2 Status of Geological Database and Model	21
5.3 Resource Estimation Procedure.....	30
6. COAL RESOURCE LIMITS AND CLASSIFICATION.....	32
7. COAL RESOURCES.....	34

FIGURES

Figure 4.1	Location of Baruun Naran Deposit in Southern Mongolia
Figure 4.2	Location of Mining License 14493A in Southern Mongolia
Figure 4.3	Regional Geology Map showing Khangad Exploration LLC license
Figure 4.4	West to East Stratigraphy
Figure 5.1	Gradient –Array Resistivity at Baruun Naran
Figure 5.2	Syncline Axis, Bounding Faults and Seam Floors at 1500m R.L.
Figure 5.3	ArcMap South to North Section 37050E
Figure 5.4	ArcMap South to North Section 35400E
Figure 5.5	ArcMap and Minex section overlay - east
Figure 5.6	ArcMap and Minex section overlay – west
Figure 5.7	Borehole Locations and types
Figure 7.1	Measured and Indicated Coal Resources V500 Seam
Figure 7.2	Measured and Indicated Coal Resources U500 Seam
Figure 7.3	Measured and Indicated Coal Resources T500 Seam
Figure 7.4	Measured and Indicated Coal Resources R500 Seam
Figure 7.5	Measured and Indicated Coal Resources R400 Seam
Figure 7.6	Measured and Indicated Coal Resources R300 Seam
Figure 7.7	Measured and Indicated Coal Resources R200 Seam
Figure 7.8	Measured and Indicated Coal Resources Q500 Seam
Figure 7.9	Measured and Indicated Coal Resources N500 Seam
Figure 7.10	Measured and Indicated Coal Resources N400 Seam
Figure 7.11	Measured and Indicated Coal Resources K500 Seam
Figure 7.12	Measured and Indicated Coal Resources K400 Seam

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Statement of Coal Resources 2010 Baruun Naran Coal Deposit

Figure 7.13 Measured and Indicated Coal Resources J600 Seam
Figure 7.14 Measured and Indicated Coal Resources J500 Seam
Figure 7.15 Measured and Indicated Coal Resources J400 Seam
Figure 7.16 Measured and Indicated Coal Resources I500 Seam
Figure 7.17 Measured and Indicated Coal Resources H500 Seam
Figure 7.18 Measured and Indicated Coal Resources G500 Seam
Figure 7.19 Measured and Indicated Coal Resources G450 Seam
Figure 7.20 Measured and Indicated Coal Resources G400 Seam
Figure 7.21 Measured and Indicated Coal Resources F500 Seam
Figure 7.22 Indicated and Inferred Coal Resources E500 Seam

TABLES

Table 5.1 Summary of Geological Data
Table 5.2 Status of Geological Database and Model
Table 5.3 Seam Floor Stacking Surfaces
Table 5.4 Summary of Reporting of the Exploration Results
Table 5.5 Estimation Procedures
Table 7.1 Summary of Indicated Coal Resource Estimates
Table 7.2 Summary of Measured Coal Resource Estimates
Table 7.3 Summary of Coal Resource Estimates

APPENDICES

Appendix A Resource Block Checklist
Appendix B ArcMap South to North Sections 37200E to 31200E
Appendix C Australasian Code for the Reporting of Mineral Resources and Ore Reserves (The JORC Code) September 2004

1. PURPOSE OF RESOURCE STATEMENT

McElroy Bryan Geological Services Pty Ltd (MBGS) have prepared a report for Khangad Exploration LLC on coal resources of the Baruun Naran Coal Deposit in southern Mongolia, which is located in the South Gobi Desert approximately 600km south of the Mongolian capital Ulaanbaatar.

The purpose of the report is to provide an objective assessment of coal resources that are compliant with the Australasian Code for Reporting of Mineral Resources, and Ore Reserves (The JORC Code). A copy of the 2004 JORC Code is included as Appendix C.



2. COMPETENT PERSON STATEMENT

The information in this report to which this statement is attached, that relates to Coal Resources, is based on information compiled and reviewed by Mr. Paul Harrison, who is a Member of the Australasian Institute of Mining and Metallurgy and is a Senior Geologist employed by McElroy Bryan Geological Services Pty Ltd (MBGS).

Paul Harrison has more than 25 years experience in the estimation of coal resources for coal projects and coal mines in Australia. This expertise has been acquired principally through exploration of coal deposits, coal resource deposit modelling assessments for the NSW State Government, evaluation assignments at operating coal mines in Australia and Indonesia, and for coal prospects in Australia's major coal basins. This experience is more than adequate to qualify him as a **Competent Person** for the purpose of Resource Reporting as defined in the 2004 edition of the JORC Code.

.....
Paul Harrison, B.Sc., M. Aus IMM

Senior Geologist

McElroy Bryan Geological Services Pty. Limited

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Willoughby NSW Australia 2068

The Coal Resource estimates for the Baruun Naran Coal Deposit in the Gobi Desert of southern Mongolia area presented in this report have been carried out in accordance with the "Australasian Code for Reporting of Mineral Resources and Ore Reserves" (December 2004) prepared by the Joint Ore Reserves Committee of the Australasian Institute of Mining and Metallurgy, Australian Institute of Geoscientists and Minerals Council of Australia.



3. RESOURCE ASSESSMENT CRITERIA

In order to summarise criteria relevant for a resource assessment, a checklist was developed by MBGS, using as a guide the 2004 Checklist of Assessment and Reporting Criteria which is included as Table 1 in the 2004 JORC Code. The sequence of criteria in the checklist reflects a systematic approach to exploring and evaluating resources, typical of best practice used in the coal industry in Australia.

The purpose of the checklist is to:

- establish a platform for the Competent Person to classify the status of the resource on the basis of the responses to criteria prompts,
- draw attention to relevant or material issues pertinent to the estimation of coal resources within the area and
- outline the estimation procedures used and the parameters adopted for the resource estimate.

The checklist for the resource area comprises three sections which address different aspects of the resource estimation process:

- A. Sampling Techniques and Geological Data** – type, reliability, relevance and density of geoscientific data/points of observation.
- B. Reporting of Exploration Results, Geological Database and Model** – tenement status, exploration, management of data in the geological database and computer model.
- C. Estimation and Reporting of Mineral Resources** – integrity of data and validation procedures, outline of the resource estimation process, resource tenement limits and any limitations (geological, geographic, mining title, etc) or exclusion zones relevant to that resource block.



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

The checklists for the status of geological data, database management, validation and modelling procedures for estimation and reporting resources are presented in Section 5, Tables 5.1, 5.2 and 5.3.

Checklists for resource limits and boundary criteria used to determine resources are presented in Appendix A. Note that for ease of comparison to resource maps, each of the resource tenement checklists in Appendix A has been colour-coded as follows to indicate the status of the resource in that block:

- green – Measured Resource
- yellow – Indicated Resource
- pink – Inferred Resources



4. RESOURCE DESCRIPTION

4.1 LOCATION AND TENEMENTS

The Baruun Naran property is located in southern Mongolia (Figure 4.1), approximately 600 km south of Ulaanbaatar, the capital of Mongolia. The town of Dalanzadgad (pop. 10,000), the provincial capital of the Umnogovi Province, is located approximately 60 km to the west of the property. Access is by unpaved road from Ulaanbaatar, Dalanzadgad and also from the Chinese border, although construction of a paved road from Ulaanbaatar to Dalanzadgad is planned in the coming years. A recently constructed airport with sealed tarmac is located 8 km west of Dalanzadgad and has replaced the original Russian unsealed landing strip. Reliability of flights to and from Dalanzadgad is dependent on wind direction at Ulaanbaatar, which has a single north-west orientated runway. The Baruun Naran property is in an entirely natural state with no paved roads and the exploration camp comprised a kitchen, accommodation and office gers with a sled mounted amenity block setup temporarily, during periods of exploratory field work.



Figure 4.1 Location of Baruun Naran coal project in Southern Mongolia.



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

The Baruun Naran mining license 14493A (Figure 4.2), in the Umnogovi Aimag (province), covers 4,485.64 ha and was converted to a mining license on December 1st 2008. Surrounding the Baruun Naran mining license is the Tsaikhar Khudag exploration concession 4326X (total area 90,782.36 ha). The Baruun Naran mining license is valid for 30 years and can be extended twice more for 20 years each, or a total of 70 years.



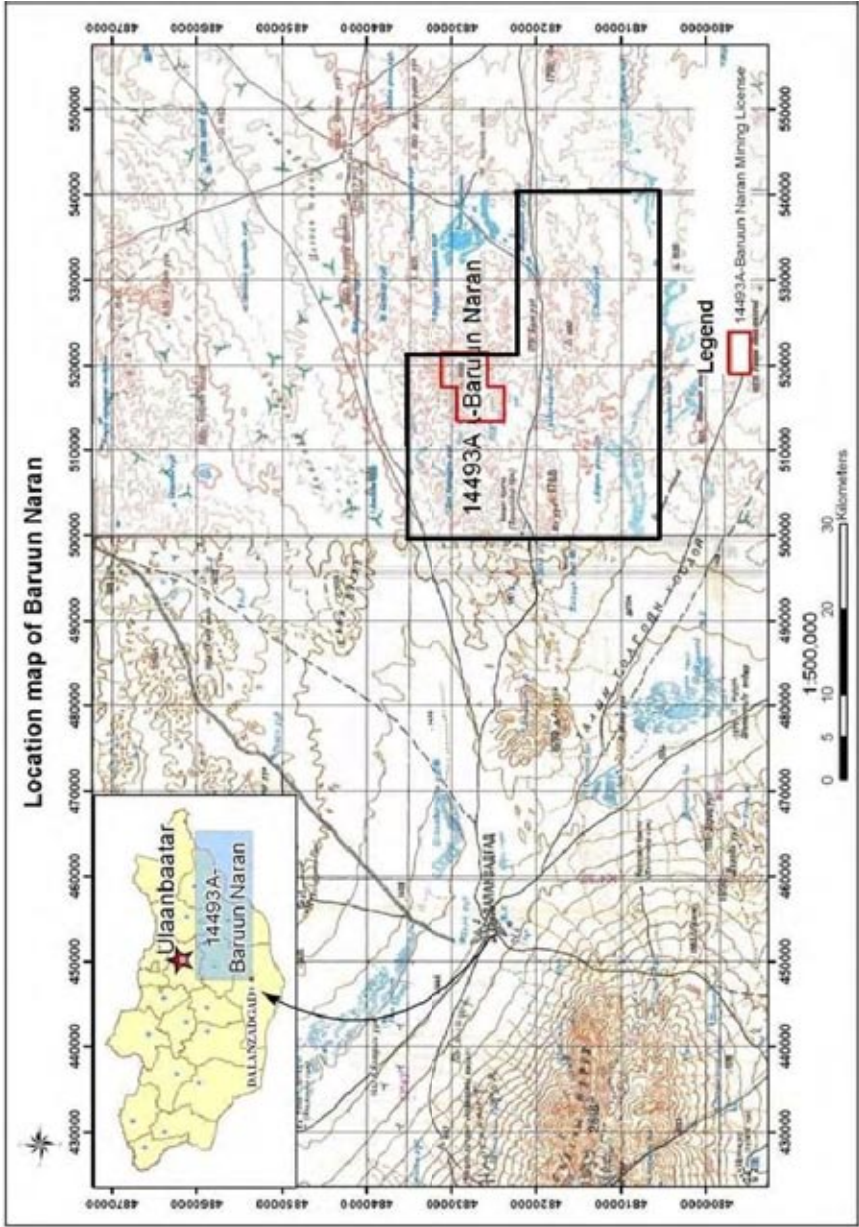


Figure 4.2: Location of Mining License 14493A in southern Mongolia.

4.2 TOPOGRAPHY AND CLIMATE

Surface topographic elevation in the ENE-trending Baruun Naran valley ranges from 1540m on the western end of the license to 1575m at the eastern end, and rises to 1600m above sea level against older Carboniferous rock units which form low hills in the north. The Baruun Naran valley is approximately 22 km long and 2 to 3 km wide.

Climate in the Gobi desert is generally hot and dry in summer and cold and dry in winter, with temperatures ranging from -36° C to +38° C. Strong winds often cause dust storms during spring and summer.

4.3 GEOLOGY

4.3.1 Stratigraphy

The Baruun Naran coal deposit occurs within an Upper Permian clastic sedimentary unit known as the Tavan Tolgoi Formation. This same formation also hosts the large Tavan Tolgoi coking and thermal coal deposit, located approximately 20 km northeast of Baruun Naran. An ENE-trending belt of Tavan Tolgoi Formation crops out in the Baruun Naran valley representing the western continuation of the Ulaan Nuur coal basin (Figure 4.3). The Ulaan Nuur basin is an asymmetric fault-bounded, ENE-trending syncline, with a very steep northern limb (overturned in part) and a more gently-dipping southern limb. In addition to this folding of coal-bearing strata, seams are truncated by faults in the north, west and south-west. Deformation of Permian sediments occurred during the early Mesozoic Era. Basement rocks are of Carboniferous age on the northern margin of the valley and Devonian on the southern limb. The earliest deposited coal seams are less extensive and onlap onto the older basement rocks.

Khangad Exploration LLC drilling at the northeast end of the Baruun Naran valley has shown that the coal-bearing sequence is unconformably overlain by a 10 to 30 meter sequence of tuffaceous siltstones and mudstones of unknown age that are interpreted by to be reworked volcanic rocks. The basal contact of this unit appears to be an angular unconformity and the unit clearly post-dates folding of the Tavan Tolgoi Formation. Bedrock within the Baruun Naran valley is covered by up to 5m of unconsolidated Quaternary deposits. Weathering of the underlying Permian strata is variable and in early modelling was set at 30m



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

below natural surface levels. In November 2008 an oxidation drilling program targeted T500 and H500 seams along subcrop to determine the limit of oxidation (LOX) for thermal and coking coals. Visual estimates of weathering were made, and samples of coal collected every metre were sent to the laboratory to test both calorific value and coking properties. This work indicated that H500 and T500 seams have a calorific value of 32 MJ/kg (daf) at 1-3m below visual base of weathering recorded in drill chip logging, while fresh coal with full coking properties was found 1-3m below this thermal oxidation depth for the H500 seam, and 1-5m deeper for T500 seam.

For T500 seam the thermal LOX depth averaged 19.5m (range 16m-26m) while the LOX for coking properties averaged 23m depth (ranging 18m-29m). In the east H500 had an average thermal LOX of 31m depth (range 24m-38m) and average depth for coking properties of 33m (range 25m-41m) following the trend of deeper weathering towards the east of the deposit. In the Minex geological model the base of weathering grid used for resource estimation was set at the depth where 32 MJ/kg (daf) was achieved in the oxidation boreholes, and elsewhere recorded visual oxidation plus 2m. No igneous intrusions have been identified within coal bearing strata.





4.3.2 Coal Seams

The coal-bearing Tavan Tolgoi Formation within the Baruun Naran valley has a stratigraphic thickness of approximately 1000m. Drilling to date has defined twenty two major coal seams ranging from 0.6m to 16.9m in average true thickness. Determining true thickness of coal seams in this deposit is difficult due to the steeply dipping strata and the mix of vertical and inclined boreholes, all of which deviated to some degree, during drilling. Intersected seam thickness was converted to true thickness by applying a thickness correction factor determined from the angle of the borehole, and the estimated seam dip at the point of drill penetration.

In addition to major seam groups, a number of thin laterally discontinuous coal beds occur in the area as well as fault repetitions of major known seams. Many of these thin seams are highly banded and may be localised discontinuous coal lenses, as often correlation between more than a few holes is difficult.

Coal seams at Baruun Naran have been labelled alpha numerically from oldest to youngest. The major seam in any alphabetic group is designated the "500" seam (e.g., "T500"); Subordinate seams (riders or splits) are numerically greater than "500" if stratigraphically higher in the sequence (e.g., "T510"), or less than "500" if stratigraphically lower in the sequence (e.g., "G400"). The current model includes 132 coal plies, from V seam (top ply V506) to the basal E seam (ply E504). **Figure 4.4** shows seam/ply configuration throughout the deposit based on four boreholes from the west to the east from V to F seams.

4.3.3 Structure

Coal seams at Baruun Naran are folded into an asymmetrical syncline which plunges west at approximately 24°. Coal seams subcrop from east to west and can be traced from the southern to the northern limb, around the syncline nose. The north limb is very steep and borehole data indicates it progressively overturns toward the west **Figure 5.4**, before the coal seams are no longer present. The south limb has a gentler dip of about 40° near the syncline nose (east) but progressively steepens to 75° dip towards the west. The coal sequence is terminated on the north limb by a fault and by a fault or unconformity against Devonian sediments on the southern limb. The western end

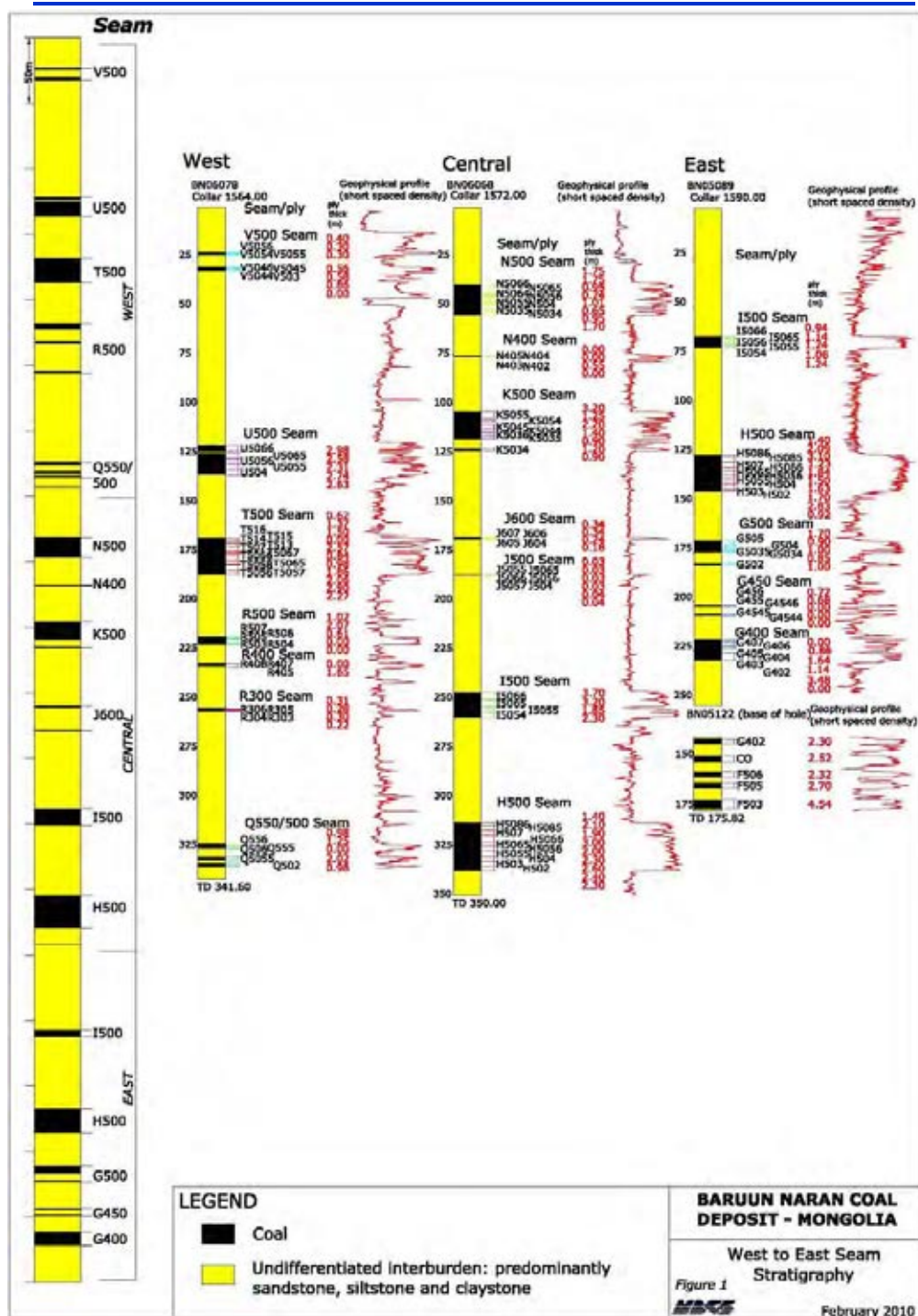


STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

appears faulted against another sedimentary unit with no economic coal seams. Slickensided surfaces commonly occur within drill core and, as well as major bounding faults, numerous minor faults would be expected within the highly deformed sedimentary sequence at Baruun Naran.



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS



5. GEOLOGICAL DATA, MODEL AND ESTIMATION PROCEDURES

5.1 SUMMARY OF GEOLOGICAL DATA

The Baruun Naran coal deposit was first explored in 1983 through a program of aerial photo interpretation, geological mapping, trenching and three shallow boreholes. A regional aeromag survey was flown in the 1980's at a 400m height and 2km line spacing. Two additional phases of drilling were completed on the property by Soviet-Mongolian teams in 1990 and 1993 bringing the number of boreholes completed to 24 comprising 3,700m of drilling. The property was later abandoned and QGX was granted an exploration license in 2002, now held by the Kuok Group, through Khangad Exploration LLC.

In April 2005, QGX commenced a systematic drilling program and engaged Norwest Corporation to provide geological consulting services including supervision of drilling and trenching programs. Trenching was carried out with a back hoe to depths of 4m to 7m. The major work programs completed during 2005-6 were geological mapping, 19,000m of trenching, a gradient array resistivity survey, and completion of 350 drill holes totalling over 95,700m.

During 2006 QGX sought MBGS's assistance in seam and ply correlating across the deposit and to provide guidance on geological logging and sampling. A Minex geological model of the deposit was developed by MBGS's Senior Geologist Andrew Paul, during 2005 and 2006. The model required advanced modelling techniques due to the steeply dipping nature of the deposit and the risk of resource over-estimation due to large apparent thicknesses being recorded in borehole intersections.

In 2007 a drilling program was carried out to assess water availability in the region to support a mining/coal processing operation. As part of this program three holes (total 1213 m) were drilled close to the southern boundary of the mining concession. An oxidation drilling program of 38 holes totalling 1533m was completed during 2008. This program included laboratory analyses to investigate the relationship of thermal LOX and coking LOX to the visual base of oxidation, as detailed above. Considerable exploration during 2009 included 71



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

holes drilled in the main deposit. This amounted to 13,200m of drilling to define deposit geometry, identify where seams are faulted at depth and improve understanding of coal quality variation. Seven previously drilled boreholes were reopened and extended to deeper seams. Large diameter drilling of 11 holes (~1000m of drilling) recovered 6" and 12" diameter coal cores for washability testing coking properties of H500 and T500 seams. Also in 2009, dewatering of the proposed pit area was investigated with a small number of new boreholes and the reaming out of existing holes. Geotechnical studies were also carried out during 2009 with samples taken in 4 specific boreholes dedicated for geotechnical purposes (rock strength testing etc).



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Table 5.1
Summary of Geological Data

CRITERIA	CONSIDERATIONS
ACCURACY OF SURVEY DATA	QGX drillhole collars were surveyed to WGS84 and UTM zone 48N and a local grid established with origin 30,000mE and 30,000mN at 513450E, 4825080N, or 43° 34' 42" N Latitude and 105° 9' 59" Longitude. The surface topographical survey was carried out by Monmap Engineering Services Co. Ltd. in October 2007. The survey covered 56.6 sq. km. with 65,022 surveyed points spaced at 50-120m. The digital terrain model has been checked against drill hole collar heights with the surveyed topographic model error generally less than 2m but a few locations with differences of 2-4m.
DRILLHOLE TYPES	Only QGX drillholes were used in the model and included both partially cored and non-core structure holes.
DATA DENSITY AND DISTRIBUTION	QGX, being Canadian, designed its exploration drilling pattern for a "complex" deposit under the 43-101 classification system. Boreholes were drilled on section lines spaced either 150m, or 300m apart on the local grid which is orientated perpendicular to the syncline axis. Section lines 150m apart were drilled for 1.1 km west of the H500 subcrop and 1.2km west of the T500 subcrop (at the synclinal nose). Borehole collars on each section line are spaced at 75-100m with seam intersection spacing dependant on borehole dip and seam dip. Once the deposit structure was broadly recognized borehole orientation was designed to intersect seams orthogonally, to reduce apparent thickness intersections as much as possible. Boreholes were drilled at 90° (160 boreholes), 75-85° (16 boreholes), 70° (31 boreholes), 65° (23 boreholes), 60° (37 boreholes), 55° (59 boreholes), 50° (13 boreholes) and 45° (27 boreholes). Coal quality holes are drilled at either 300m or 600m spacing.
GEOLOGICAL LOGGING	Lithological logs are available for all QGX exploration drillholes.
GEOPHYSICAL LOGGING	Geophysical logs were acquired for all 2005-2009 boreholes.
SAMPLING STRATEGY AND SAMPLE RECOVERY	Sampling of 2005 coal quality drillholes (sent to SGS Denver) was not undertaken on a consistent basis as no seam ply system had been established at the time of sampling. Once the ply by ply logging and sampling program commenced in Feb 2006 a more systematic, reliable coal quality database was developed by MBGS with samples dispatched to ACIRL Rockhampton, Australia. The 2009 slim core and large diameter core samples were analysed at SGS-CSTC Minerals Lab (Coal and Coke) Tianjin Port, China. The ply system applied at BN has indicated lateral



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

CRITERIA	CONSIDERATIONS
	variability in quality across the deposit. There are no core holes with valid analyses of the V500, R500, R400, R300 and R200 Seams and default raw ash and ISD values have been assigned to these seams. For other seams where cored recoveries were unsatisfactory, the coal analytical results were excluded from the database for the estimation of coal resources.
LABORATORY COAL ANALYSIS	Raw coal quality testing was undertaken at three separate laboratories. Testing of 2005 boreholes was conducted at SGS's Denver Laboratory in the USA. This testing was carried out using a now outdated method of crushing to pass 19mm prior to analysis. This procedure is now recognized as giving misleading results, particularly in metallurgical coal products, in situations where product coal is sold after beneficiation. Crushing of 2005 coal samples prior to washability analysis may have degraded the metallurgical characteristics of the coal. From Feb 2006 a drop-shatter and wet-tumble pre treatment process replaced the crushing of coal samples. This method reproduced the natural breakage of coal which occurs during mining and handling. Apparent relative density is calculated using a full-immersion technique which is then used to estimate raw ash. Where density/ash indicate potential for metallurgical use, composites are selected for drop-shatter. Higher ash samples were crushed to 12mm prior to analysis. Sub sampling is done to create samples for reserving, raw coal analysis and wet tumbling and sizing at 16, 8, 4, 2, 1, 0.25, 0.125mm. Washability tests at F1.30, F1.35, F1.40, F1.45, F1.50, F1.60, and F1.80 are carried out on the wet-tumbled size fractions followed by analysis of each density increment to F1.60 for ash and CSN. From 2009 dry sizing was increased from 32mm to 50mm with wet size samples of 32, 16, 8, 4, 2, 1 and 0.25mm. Raw coal plies were tested for Relative Density (RD), Apparent Relative Density (ARD), free moisture, air dried moisture, Ash, Volatiles, FC, Total Sulphur (TS), Specific Energy (SE) (gad and daf) and Chlorine.
OTHER DATA	A gradient array Resistivity survey was carried out in 2005. QGX employed Geomaster (based in Ulaanbaatar, Mongolia) to conduct a gradient-array resistivity survey. The survey was conducted using dipole-dipole resistivity on 1 km sq. blocks along north-south (local grid) trending parallel lines spaced 50 m apart with a 20 m dipole spacing with 100m overlap between lines of 100 m. Monmap Ulaanbaatarsurveyed the grid lines. The gradient-array survey covered a length of 13 km down the Baruun Naran valley. Figure 5.1 shows the location of gradient-array surveyed across



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

CRITERIA	CONSIDERATIONS
	the coal resource area.
COMMENT	The resource estimate in the deposit rely largely on the QGX drillholes which have downhole geophysical logs. The structural interpretation and modelling of the deposit used both drillhole information and gradient array results to assist in subcrop definition. Trench data was of limited use due to the deep weathering at BN. The combination of steep dips, faulting at different levels along both the north and south limbs, as well as, greater than 20m of weathering to the thermal LOX depth, all contribute to the complexity of the coal deposit.



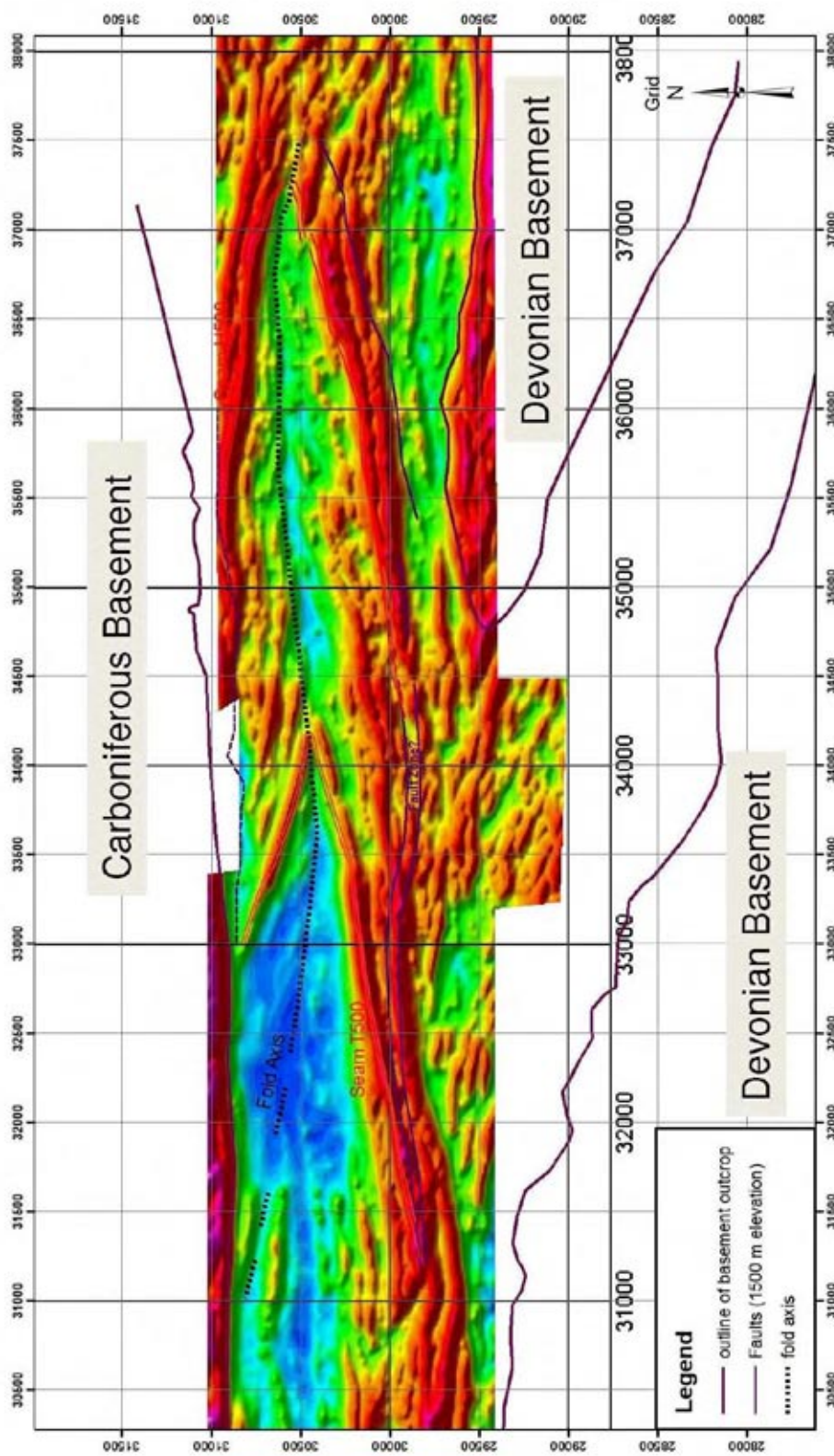


Figure 5.1: Gradient-Array Resistivity at Baruun Naran.

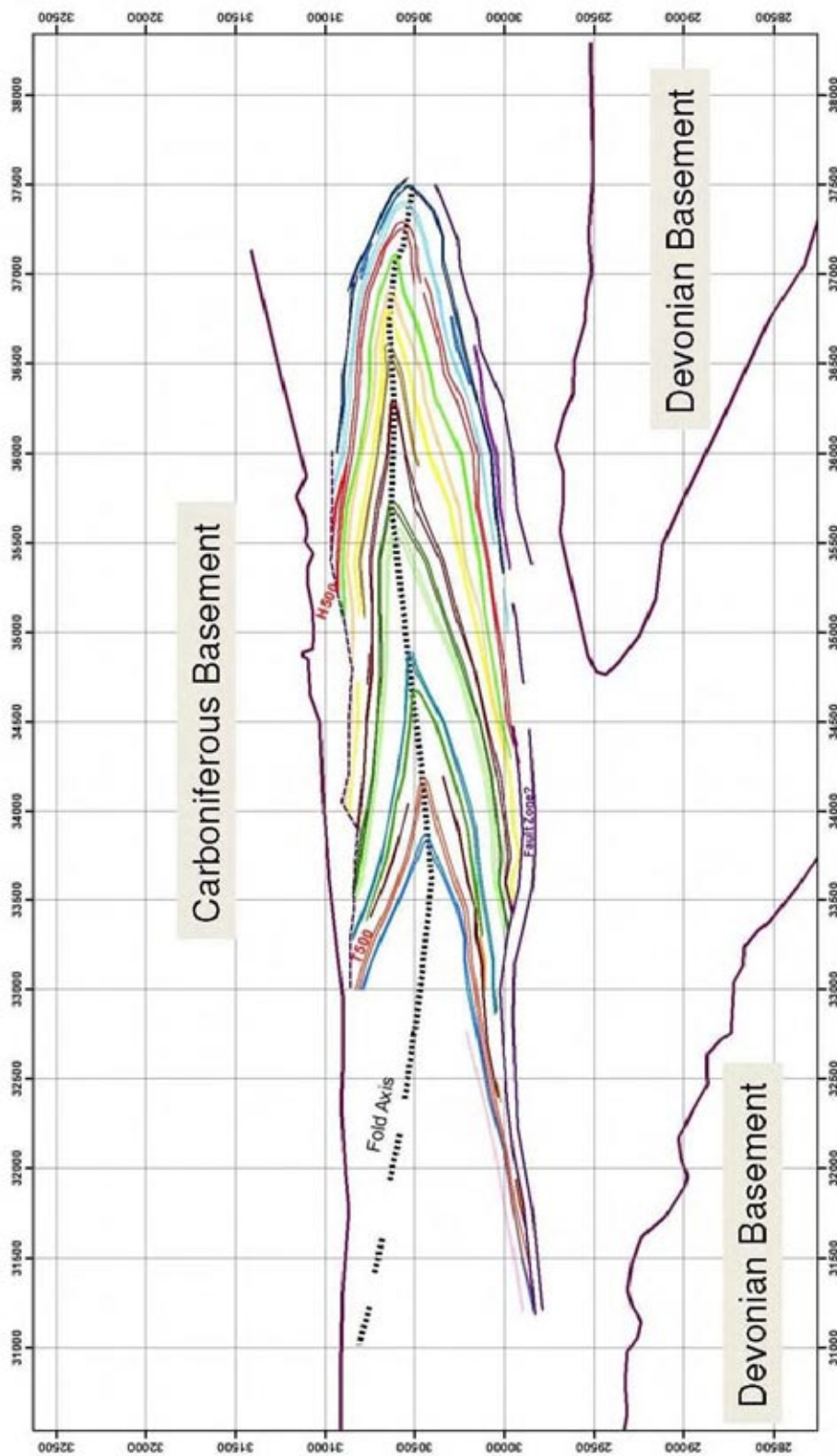


Figure 5.2: Syncline Axis, Bounding Faults and Seam Floors at 1500m R.L.

5.2) STATUS OF GEOLOGICAL DATABASE AND MODEL

The geological database comprises data from 446 drillholes, which total 110,083m of drilling. Initial Minex modelling in 2005 and 2006 has been refined with results of the 2008 and 2009 drill programs. Considerable interpretation of the structure of the deposit was carried out on site by QGX's Senior Geologist, Margaret E. Venable who produced a series of cross sections at 150m or 300m spacing which were imported into the Minex Model as xyz data. These section lines were used as the basis of digitising 2382 strings which were snapped in 3D to seam floor positions along the deviated borehole stem. Interpolation of seam floor R.L. between boreholes was controlled by snapping strings (geometry data) to the imported 2D ArcMap section floors. Strings were connected between sections by joining floor geometry by rib strings. As a result of this, fifteen floor grids were produced in multi-seam multi-variable gridding and used as stacking surfaces in strata building the geological model. Due to the extensive use of the stacking surfaces, no attempt at 3D fault modelling was made as strings were digitised along x,y,z position of faulted and unfaulted seam floors.

Table 5.3
Seam Floor Stacking Surfaces

Stacking Floor	Upper Seam	Lower Seam
V5044SF	V506	V503
U5035SF	U5066	U5035
T5045SF	T516	T5045
R406SF	R507	R406
Q502SF	R405	Q502
N403SF	N5066	N402
K5035SF	K5056	K5035
K405SF	K5034	K405
J604SF	J607	J604
J400SF	J5066	J400
I5054SF	I5066	I5054
H5055SF	H5086	H502
G5015SF	G505	G5015
G403SF	G407	G402
F503SF	F506	E504



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Table 5.4
Summary of Reporting of the Exploration Results

CRITERIA	CONSIDERATIONS
TENEMENT AND LAND TENURE STATUS	Baruun Naran comprises mining license 14493A covering 4,485.64 ha (see Figure 4.2). Surrounding areas are held in exploration concession 4326x which covered 90,782.36 ha but will be reduced in size following regional exploration work.
GEOLOGICAL DATABASE	The full geological descriptions of cuttings and drillcore recorded in QGX's hardcopy borehole database were not loaded into Minex, rather the top and base of depths seams and plies. The Minex geological database includes drillhole survey including collar, azimuth, dip, as well as the base of thermal weathering horizon and coal seam/ply roof and floor intersections. In addition a borehole deviation tool was run down each drillhole and recorded azimuth, inclination and depth every 50m. Where unsplit seams were recorded the seams were split in accordance with averages across the deposit using the splits.par file. The structural interpretations from cross sectional studies and gradient array surveys are interpreted and stored in a Minex design database. Geophysical LAS data is available, however only selected geophysical logs have been loaded into the Minex model. Downhole surveys, done every 50m down the drillhole, were loaded into the Minex borehole database and used to deviate the drill strings with depth. Two geological databases were required in order to model the steeply dipping coal seams at BN. The first contains the "as drilled" borehole intersections loaded into the deviated drill strings. On this database borehole SQLs were run to convert the drilled seam thickness into "true" seam thickness for nineteen seam groups. This was done by applying 50m depth spaced correction factors to boreholes to convert apparent seam and interburden thicknesses to true thicknesses. This database was used for thickness and interburden gridding. The true thickness intersections were subsequently converted to apparent thickness via the application of grid SQL's which convert true to apparent thickness depending on the interpreted dip of the seam for any given x,y,z location within the deposit. The seam and interburden apparent thickness grids were then stacked using the fifteen stacking surfaces to ensure seam floor z values honoured the drilled borehole intersections.
LITHOLOGICAL DATA AND	Rig geologists entered the lithological data from the original



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

CRITERIA	CONSIDERATIONS
SEAM CORRELATION	geological log into Excel spreadsheets at the QGX office on site (see Plate 1); these spreadsheets were forwarded to MBGS for inclusion in the Minex model. MBGS became involved in 2005 and devised a coal seam and ply nomenclature system, which has had some subsequent revisions. Geophysical logs were used to pick seams and divide them into correlatable plies, and lithological logs were used to assess weathering depth. Seam intersections were re-interpreted into correlatable plies and then picked from the geophysical logs and the weathering extracted from the lithological logs. These intervals were entered into a spreadsheet and then uploaded to Minex to form the base modelling information in conjunction with a drillhole collar file. Following the 2008 LOX program thermal weathering depth was recognized as being on average 2m below the visual base of weathering observed in chip logging and this surface has been gridded as a cutting surface to exclude weathered coal from JORC resource estimates. There is a reasonably high level of confidence in the correlation of the seams within the main synclinal structure where the seams occur at shallow depths. Boreholes sited within the syncline between existing ones conformed to the overall structure. Reinterpretation based on 2009 drilling determined that the seams previously thought to roll over into a southern anticline did not actually do so. Thick apparent thickness intersections of seam H which had previously been considered to roll-over, was re-interpreted as the underling F seam, conformable with H seam.
GEOPHYSICAL DATA	Downhole geophysical logs were obtained for QGX drillholes programs and were used to correlate plies, confirm the recovered seam thicknesses and depths and interpret lithologies and structure. The short spaced density, gamma and resistivity tools were used extensively to correlate seams across the deposit.
GEOLOGICAL FEATURES	The QGX Senior Geologist conducted seam correlation work by entering downhole seam intersections and geophysical logs into ArcMap software from which seam cross sections were produced (see Figures 5.3 and 5.4 and Appendix B). These sections were imported into Minex and stored as 2D seismic in a sub program within the Minex modeling package (see Figures 5.5 and 5.6). When the basal seams of the deposit dip to the west they are truncated at depth by a system of east to west orientated faults. In the north the syncline becomes overturned and eventually sheared off by a complex fault system. It was not possible to



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

CRITERIA	CONSIDERATIONS
	model the overturned seams on the north limb, due to software limitations in such a geologically complex environment. Grid based software systems do not allow unfaulted seam floors to occur at two different z positions for the same x,y location. An alternative structural interpretation for the north-limb overturn could be a series of overthrusts splaying from the major thrust which ultimately shears off the coal seam sequence further to the west. Where the north limb is truncated against a north-dipping fault plane on the west end, the interpreted fault plane was merged with the thermal weathering grid to limit the extent of the coal seam.
COAL QUALITY DATA	The coal quality database was prepared by Bob Leach (A & B Mylec Pty. Ltd.) from coal quality analyses carried on cores drilled since 2006. Based on the rank and coal quality the estimated in situ moisture is 6%. ID (insitu density) was calculated from air dried RD and air dried moisture% from laboratory analysis converted to 6% moisture using Preston Sanders (see section 5.3). Coal qualities loaded into Minex include ISD (@6% MOI), Raw Ash% (a.d.), Inherent Moisture% (a.d.), SE MJ/Kg (gaf), Volatile Matter% (daf) and ARD. Where a seam had no coal quality testing a set of average default raw coal qualities for were estimated for Rash, ISD and ARD based on comparison of the geophysical logs of seams with actual analysed coal qualities.
GEOLOGICAL MODEL	The initial Baruun Naran deposit geological model was constructed in 2005 and revised in 2006 using Minex software. These models were superseded by the current model (BN09B) generated using all QGX boreholes drilled since 2005 (boreholes BN05001-BN09070). The BN09B Minex borehole database includes 446 QGX boreholes, including barren boreholes. The topography model was generated by gridding the 65,022 survey points. A Base of Weathering (BOW) grid was generated from descriptions of weathering in the drill holes and merged with the north limb fault plane (BOWFN09.grid). Drill holes were deviated using verticality data. Seams were modeled on a ply basis. A procedure of setting missing seams to zero was employed to take into account seams not present in boreholes due to washouts, facies variation, basement onlap and faulting. The model was developed in Minex 5.3.2 faulting software to allow importing of 2D sections. Trend lines (strings) were used in the modelling process to control the subcrop of the coal seams where drill hole or trench data was absent. The model grids were generated on a 10m mesh size.



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Statement of Coal Resources 2010, Baruun Naran Coal Deposit

Page 25

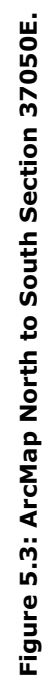
CRITERIA	CONSIDERATIONS
	Structural grids were generated using Minex growth techniques modeling methodology and limited to confidence masks. No seam "working sections" have been developed/ modeled.
MINING FACTORS OR ASSUMPTIONS	No minimum seam thicknesses were applied to the computer model, however, a minimum seam thickness of 0.1m was used to limit the resources.



Plate 1: QGX Baruun Naran office – South Gobi desert Mongolia.



Statement of Coal Resources 2010, Barun Naran Coal Deposit



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

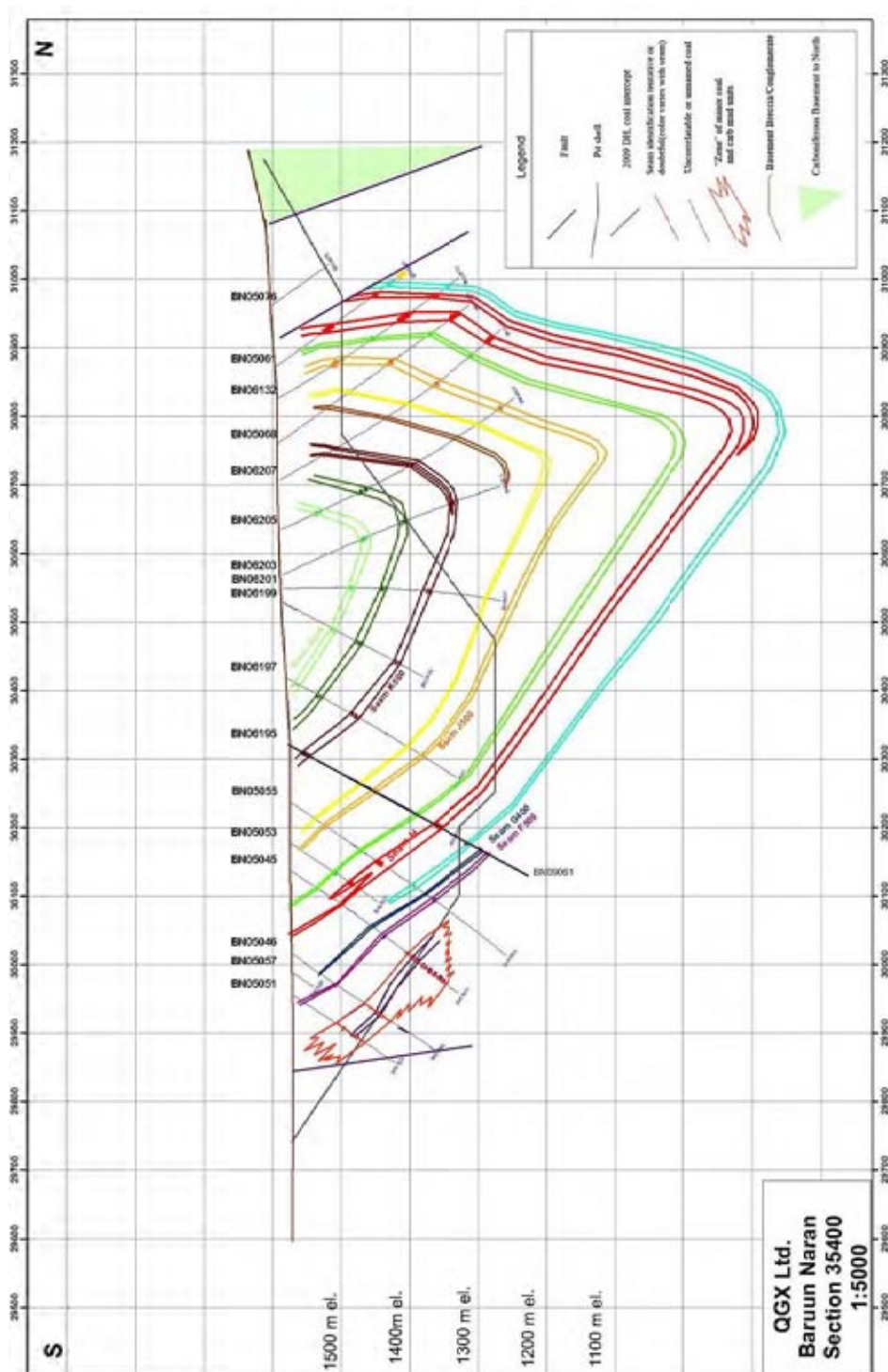


Figure 5.4: ArcMap North to South Section 35400E.

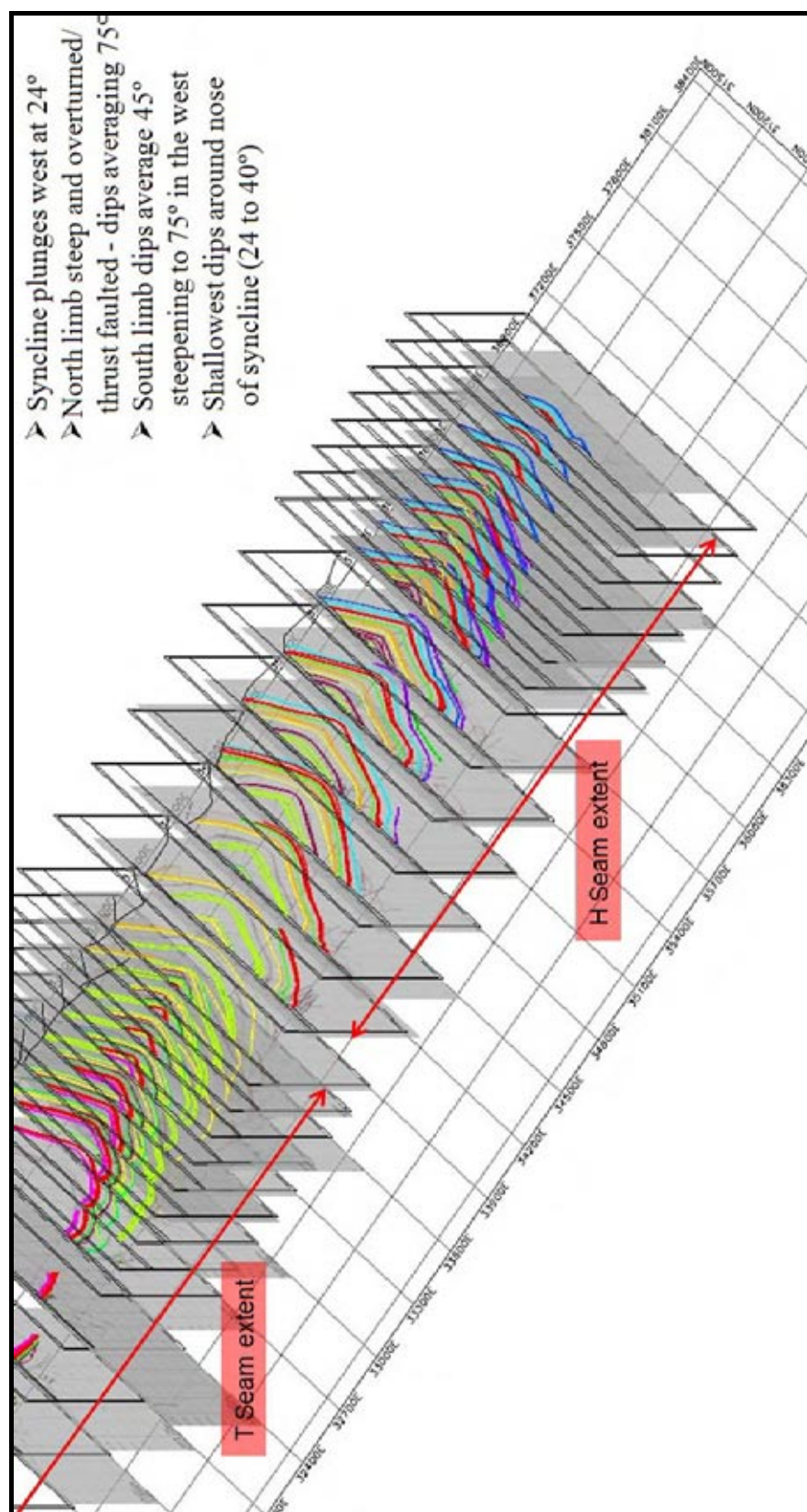


Figure 5.5: ArcMap and Minex section overlay - east.

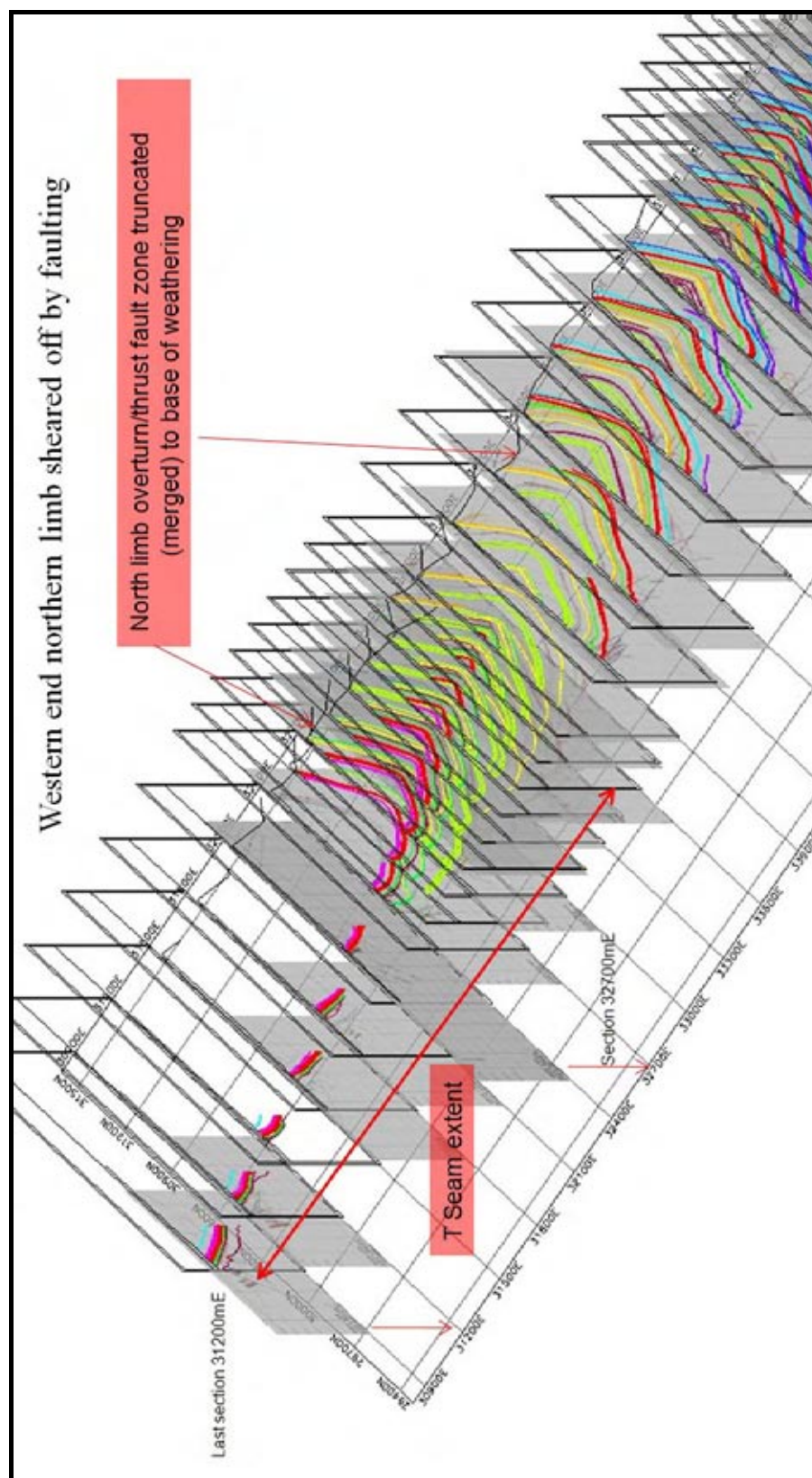


Figure 5.6: ArcMap and Minex section overlay - west.

STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

5.3) RESOURCE ESTIMATION PROCEDURE

Resources were estimated by MBGS using the current computer model. Table 5.4 outlines the resource estimation process undertaken in this assessment.

Table 5.5
Estimation Procedures

CRITERIA	CONSIDERATIONS
PARTY RESPONSIBLE FOR RESOURCE ESTIMATION	P. Harrison (McElroy Bryan Geological Services Pty Ltd) undertook the computer modelling.
COMPETENT PERSON	Mr. P. Harrison (McElroy Bryan Geological Services Pty Ltd).
DATE(S)	The topographic model was generated from surface survey pickups acquired in October 2007 using the WGS84 and UTM48 surface datum. Computer modeling was finalized in December 2009 and resource estimation completed in January 2010.
RELATIVE DENSITY	In situ density at 6.0% moisture (estimated in situ moisture content) was determined from the relative density data. The in situ density was derived using the Preston Sanders method which uses RD as a base and adjusts it to account for the in situ moisture. The Preston Sanders formula is as follows: $\text{Relative Density (in situ)} = \frac{\text{RD}_{\text{ad}} * (100 - \text{M}_{\text{ad}})}{100 + \text{RD}_{\text{ad}} (\text{ISM} - \text{M}_{\text{ad}}) - \text{ISM}}$ where: RD_{ad} = Relative Density, air dried basis M_{ad} = Inherent Moisture, air dried basis ISM = In situ Moisture (estimated at 6%) Although Relative Density (RD) measurements were determined on coal cores the large number of seams and plies in the deposit resulted in plies of the V500, R500, R400, R300, R200 and G450 seams required having insufficient coal quality analyses to model RD. For these plies default ISD was estimated by reference to other seams at BN with similar seam/ply ISD values.
METHODOLOGY	The resource estimation was completed using the thickness grids from the uncut computer model (BN09B) with the upper surface of the model limited by the base of weathering / north limb fault plane merged grid. Vertical sided polygon areas were used for the resource estimation. Thickness grids for each of the plies (V506 to E504) were multiplied by both the average in situ density value (ID) and the area of the polygon in Minex. The extent of the drill holes, on a seam basis, was used to limit the polygon areas.



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Statement of Coal Resources 2010, Baruun Naran Coal Deposit

Page 31

VALIDATION	The February 2010 estimate of 274 Mt has been made to a depth of 400m. The estimate to 300m depth of 212 Mt is less than the last resource estimate of 253Mt (July 2007) as both QGX and MBGS Geologists have reinterpreted seam correlations and the deposit structure as a result of the 2009 drilling program.



6. COAL RESOURCE LIMITS AND CLASSIFICATION

Coal resources from the V500 to E500 seams within Baruun Naran mining license 14493A have been estimated to a depth of 400m below natural topographic surface. North limb resources are limited on the west at about 32850E by truncation against a fault plane, and extend almost 5km to the east to where G400 subcrops at approximately 37700E. On the south limb coal seams extend westward to about 31050E, where they are apparently lost against a bounding fault. Coal intercepts are found west of these limits, but they do not appear to have any lateral continuity (see Figures 5.2 - 5.4).

Baruun Naran has been drilled to a density of cored and geophysically logged non-core holes (see Figure 5.5), sufficient to classify resources in either Measured or Indicated JORC categories. Resource estimates have been categorised as Measured Resources where analysed coal quality cored boreholes are no greater than 300m apart. In areas where more widely spaced coal quality bores are interspersed with geophysically logged non-core holes, resources have been categorised as Indicated Resources.

Where an analysed seam occurs as the last down dip intersection on the south limb and this intersection is correlated to a coal quality core on the north limb, Measured Resources are extrapolated 300m beyond the borehole down dip on both the north and south limbs. Due to steep dips this Measured Resource extrapolation generally extends to 400m depth of cover, the maximum depth to which resources have been estimated.



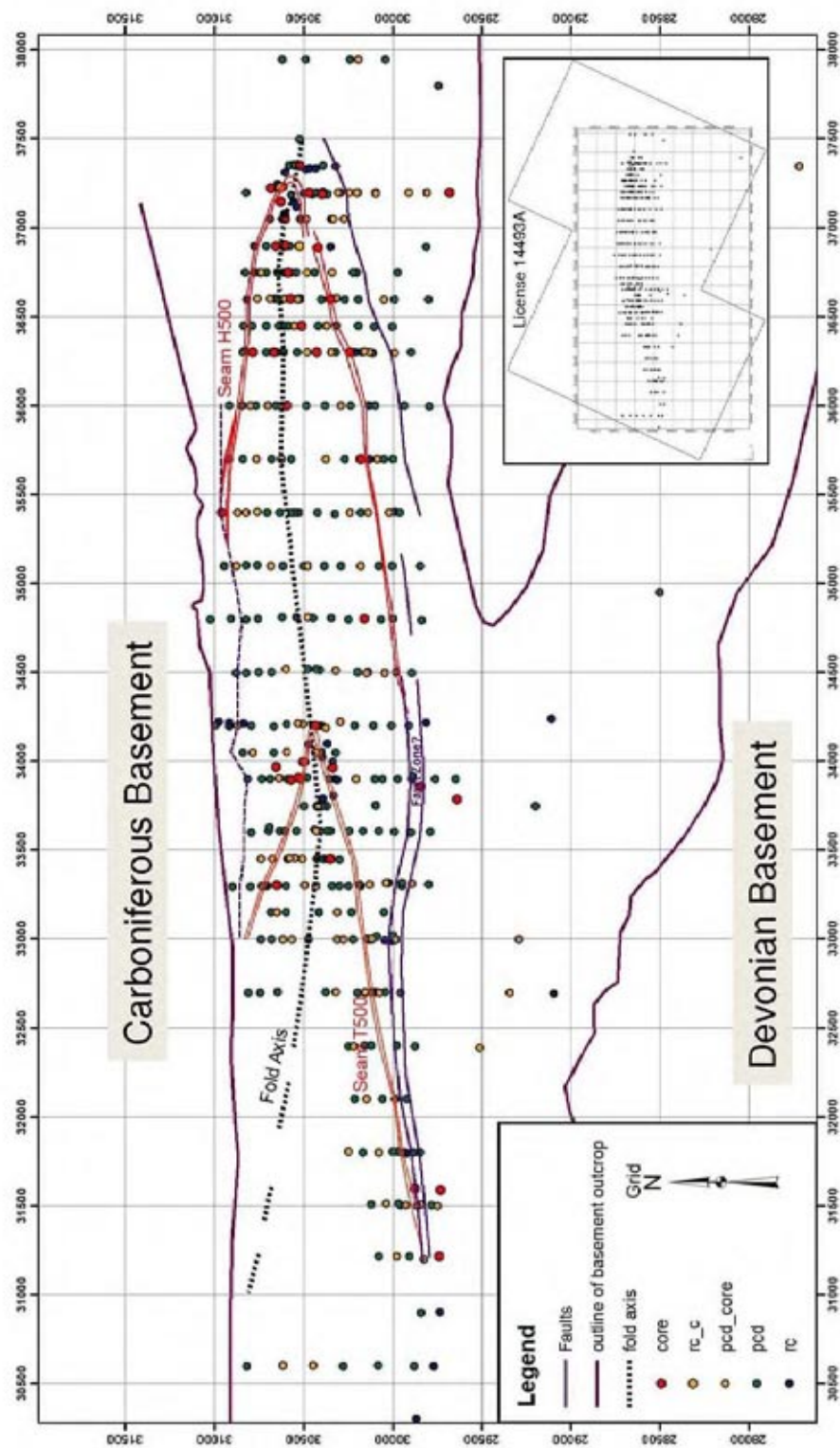


Figure 5.7: Borehole locations and types.

7. COAL RESOURCES

The Baruun Naran coal deposit is estimated to contain approximately **212 million tonnes (Mt)** of Measured and Indicated resources to a depth of 300m.

Approximately **70 million tonnes (Mt)** of Measured and Indicated resources are estimated to occur from 300m to 400m depth giving a total to 400m depth of approximately **282 million tonnes (Mt)** as detailed on Tables 7.1 - 7.3 and Figures 7.1 - 7.22.



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Table 7.1 Summary of Indicated Coal Resource Estimates, Baruun Naran Deposit
As at 1st March 2010

Seam	Coal area (sq.km)	Average seam thickness (m) (1)	In situ density (g/cc) (6% moisture) (3)	Average ash (%) (ad) (3) (4)	Indicated Resources (Million tonnes)						Inferred Resources (Mt) 300m to 400m (4)
					Subcrop to 100m (4)	100m to 200m (4)	200m to 300m (4)	300m to 400m (4)	Total subcrop to 300m (4)	Total 300 to 400m (4)	
V500	0.45	4.61	1.48(2)	20(2)	1.09	1.48	1.38	1.27	3.95	1.27	
U500	0.15	7.90	1.55	33	0.59	0.92	1.02	1.10	2.53	1.10	
T500	0.06	16.20	1.42	15.8	-	-	0.10	2.52	0.10	2.52	
R500	0.36	4.22	1.54	28.2	1.00	1.44	1.38	1.16	3.82	1.16	
R400	0.52	3.12	1.55	33.5	1.18	1.76	1.77	1.66	4.71	1.66	
R300	0.34	1.03	1.55(2)	40.0(2)	0.26	0.58	0.57	0.56	1.41	0.56	
R200	0.39	3.03	1.54	30.3	0.79	1.19	0.99	0.65	2.97	0.65	
Q500	0.24	4.39	1.53	28.2	0.53	0.73	0.78	1.12	2.04	1.12	
N500	0.15	8.17	1.48	27.2	0.10	0.34	0.74	1.79	1.18	1.79	
N400	0.14	7.07	1.54	30.0	0.35	0.60	0.80	1.45	1.75	1.45	
K500	0.21	6.12	1.53	29.6	0.99	1.53	2.21	2.90	4.73	2.90	
K400	0.10	2.17	1.64	36.2	0.13	0.19	0.25	0.07	0.57	0.07	
J600	0.36	2.68	1.46	22.3	0.42	0.75	1.02	1.39	2.19	1.39	
J500	0.56	4.40	1.41	18.3	0.59	1.31	1.72	2.95	3.62	2.95	
J400	0.54	0.57	1.55	30.8	0.18	0.33	0.50	0.42	1.01	0.42	
I500	0.16	4.83	1.40	18.8	0.16	0.58	0.74	1.54	1.48	1.54	
H500	0.14	16.92	1.40	19.9	-	-	0.99	3.11	0.99	3.11	
G500	0.06	6.82	1.57	34.9	0.09	0.28	0.36	0.69	0.73	0.69	
G450	0.10	5.76	1.59	38.0	0.02	0.04	0.05	0.44	0.11	0.44	
G400	0.13	7.79	1.60	36.9	0.32	0.61	0.58	0.70	1.51	0.70	
F500	0.04	8.84	1.51	26.2	0.24	0.21	0.18	0.18	0.63	0.18	
E500	0.14	5.54	1.56	37.1	-	0.20	0.83	1.86	1.03	1.86	0.5
Depth Totals				27.4	9.03	15.07	18.96	29.53	43.06	29.53	0.5
Total	5.34								72.59	29.53	0.5

Notes:

This table, together with the associated statement, should only be quoted in its entirety

(1) Minimum seam thickness 0.10m - average thickness from true thickness borehole database

(2) Insufficient quality data available for gridding, default estimate.

(3) Borehole database average

(4) No max raw ash criteria used to constrain coal resource estimates.

TOTAL INDICATED (ROUNDED)	73 Million Tonnes

STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Table 7.2 Summary of Measured Coal Resource Estimates, Baruun Naran Deposit

As at 1st March 2010

Seam	Coal area (sq.km)	Average seam thickness (m) (1)	In situ density (g/cc) (6% moisture) (3)	Average ash (%) (ad) (3)(4)	Measured Resources (Million tonnes)				Total subcrop to 300m (4)	Total 300m to 400m (4)	Total subcrop to 300m (4)	Total 300 to 400m (4)
					Subcrop to 100m (4)	100m to 200m (4)	200m to 300m (4)	300m to 400m (4)				
V500	0.45	4.61	1.48(2)	20(3)	-	-	-	-	-	-	-	-
U500	0.15	7.90	1.55	33	2.94	3.80	2.89	2.51	9.36	2.51	9.36	2.51
T500	0.06	16.20	1.42	15.8	8.47	10.92	10.54	7.02	29.93	7.02	29.93	7.02
R500	0.36	4.22	1.54	28.2	0.69	0.90	0.98	0.97	2.57	0.97	2.57	0.97
R400	0.52	3.12	1.55	33.5	0.24	0.34	0.42	0.40	1.00	0.40	1.00	0.40
R300	0.34	1.03	1.55(2)	40.0(2)	-	-	-	-	-	-	-	-
R200	0.39	3.03	1.54	30.3	-	-	-	-	-	-	-	-
Q500	0.24	4.39	1.53	28.2	1.16	1.55	1.28	0.63	3.99	0.63	3.99	0.63
N500	0.15	8.17	1.48	27.2	3.64	5.65	4.79	3.20	14.08	3.20	14.08	3.20
N400	0.14	7.07	1.54	30.0	2.85	3.49	2.74	1.60	9.08	1.60	9.08	1.60
K500	0.21	6.12	1.53	29.6	3.67	4.81	3.72	2.59	12.2	2.59	12.2	2.59
K400	0.10	2.17	1.64	36.2	0.53	0.61	0.10	-	1.24	-	1.24	-
J600	0.36	2.68	1.46	22.3	1.29	1.78	1.36	0.48	4.43	0.48	4.43	0.48
J500	0.56	4.40	1.41	18.3	1.58	2.59	2.03	0.52	6.20	0.52	6.20	0.52
J400	0.54	0.57	1.55	30.8	-	-	-	-	-	-	-	-
I500	0.16	4.83	1.40	18.8	2.6	4.14	3.51	2.00	10.25	2.00	10.25	2.00
H500	0.14	16.92	1.40	19.9	8.06	12.88	11.88	8.38	32.82	8.38	32.82	8.38
G500	0.06	6.82	1.57	34.9	2.46	4.42	4.44	3.55	11.32	3.55	11.32	3.55
G450	0.10	5.76	1.59	38.0	0.60	0.86	0.92	0.37	2.38	0.37	2.38	0.37
G400	0.13	7.79	1.60	36.9	2.88	4.06	3.35	2.70	10.29	2.70	10.29	2.70
F500	0.04	8.84	1.51	26.2	1.75	2.75	3.00	3.23	7.50	3.23	7.50	3.23
E500	-	-	-	-	-	-	-	-	-	-	-	-
Depth Totals				27.4	45.41	65.55	57.95	40.15	168.91	40.15	168.91	40.15
Total	5.34										209.06	

Notes:
 This table, together with the associated statement, should only be quoted in its entirety
 (5) Minimum seam thickness 0.10m – average thickness from true thickness borehole database
 (6) Insufficient quality data available for gridding, default estimate.
 (7) Borehole database average
 (8) No max raw ash criteria applied to resources

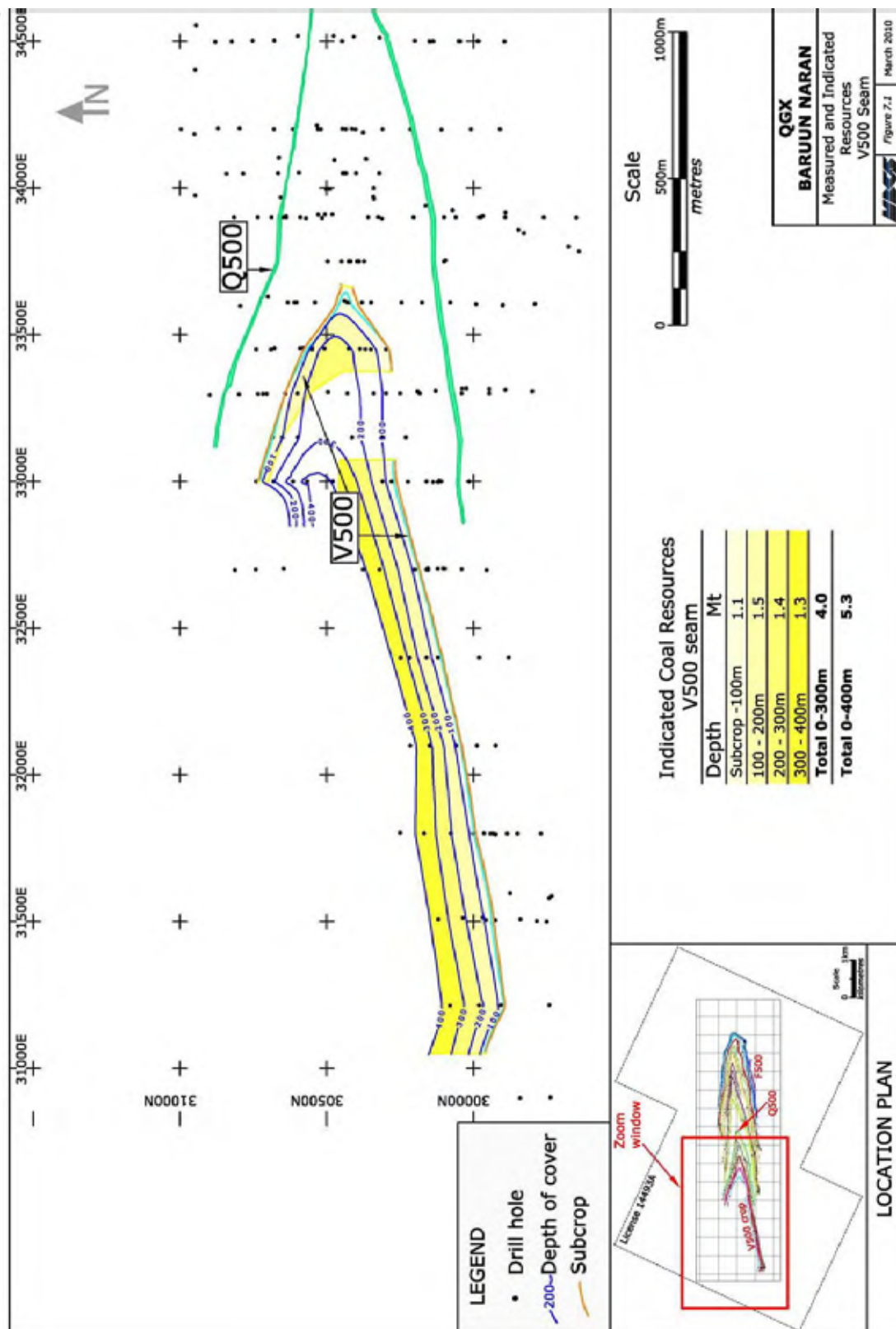
TOTAL MEASURED (ROUNDED)	209 Million Tonnes

Table 7.3 Summary of Coal Resource Estimates, Baruun Naran Deposit
As at 1st March 2010

DEPTH INTERVAL	Average ash (%) (ad)	Measured + Indicated (Rounded) (Mt)	Inferred (Rounded) (Mt)
Subcrop to 100m	25.6	54	0
100m to 200m	26.3	81	0
200m to 300m	26.4	77	0
300m to 400m	26.1	70	0.5
TOTAL 0-300m	26.2	212	0
TOTAL 0-400m	26.1	282	0.5

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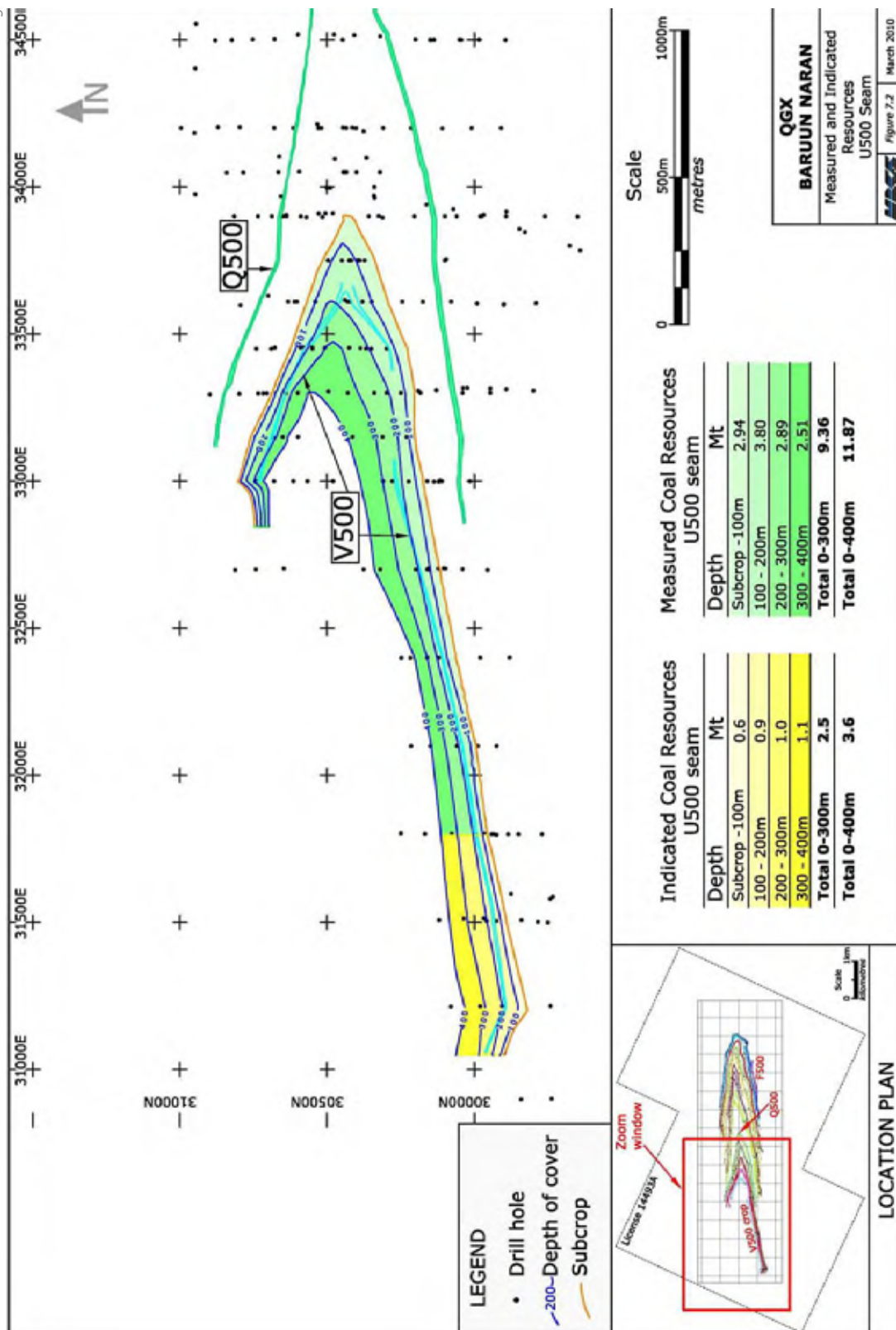
Page 38



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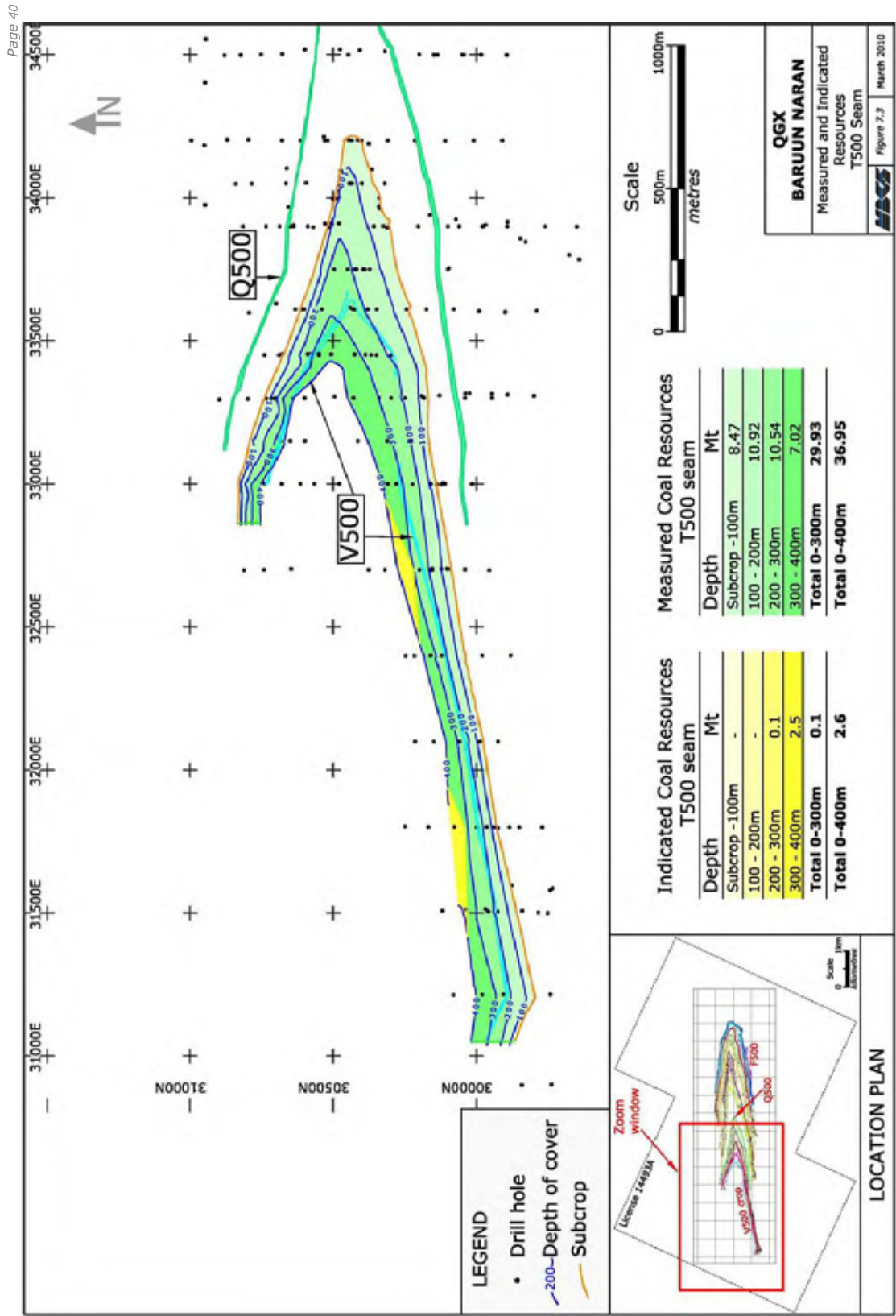
STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Page 39



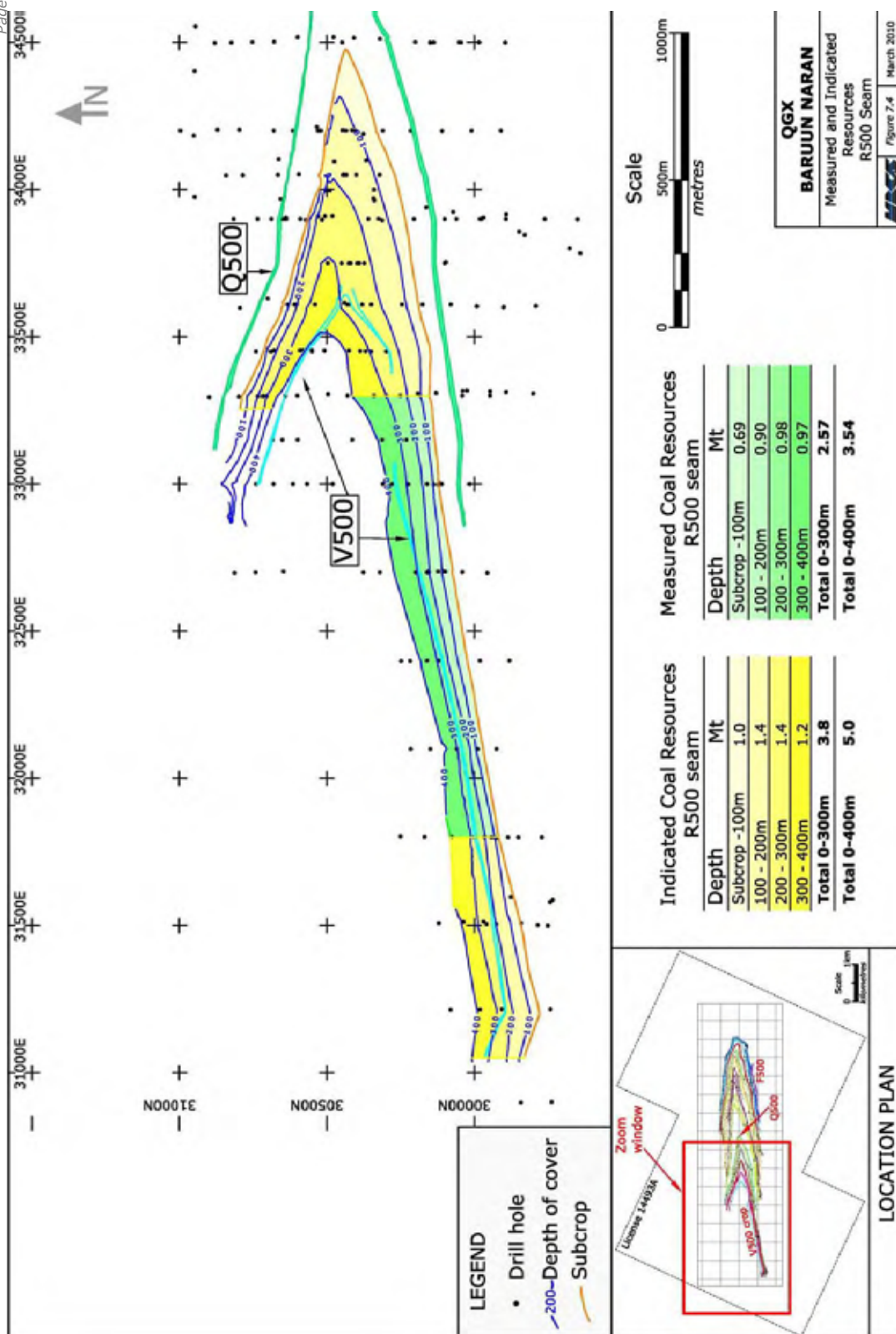
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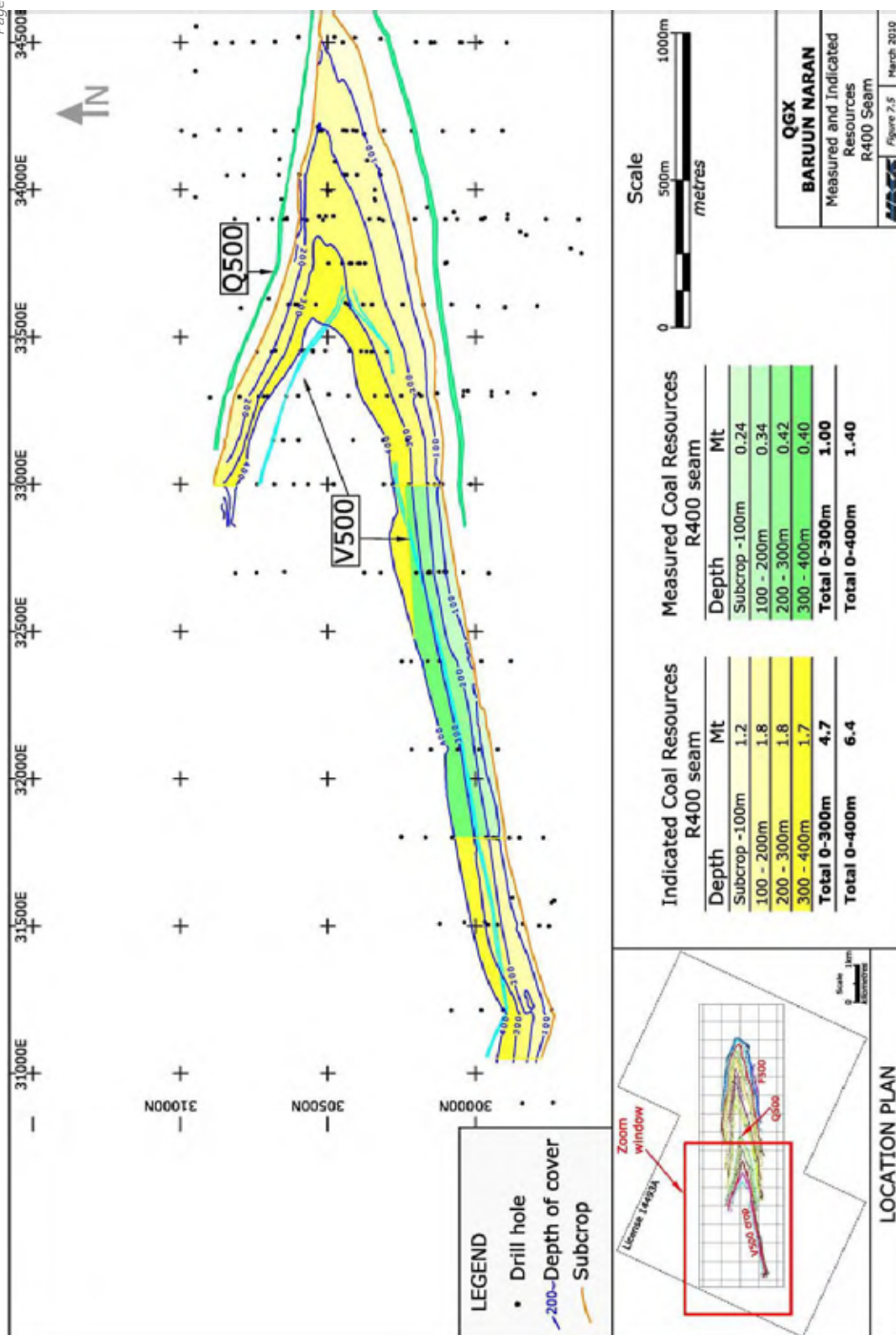
Page 41



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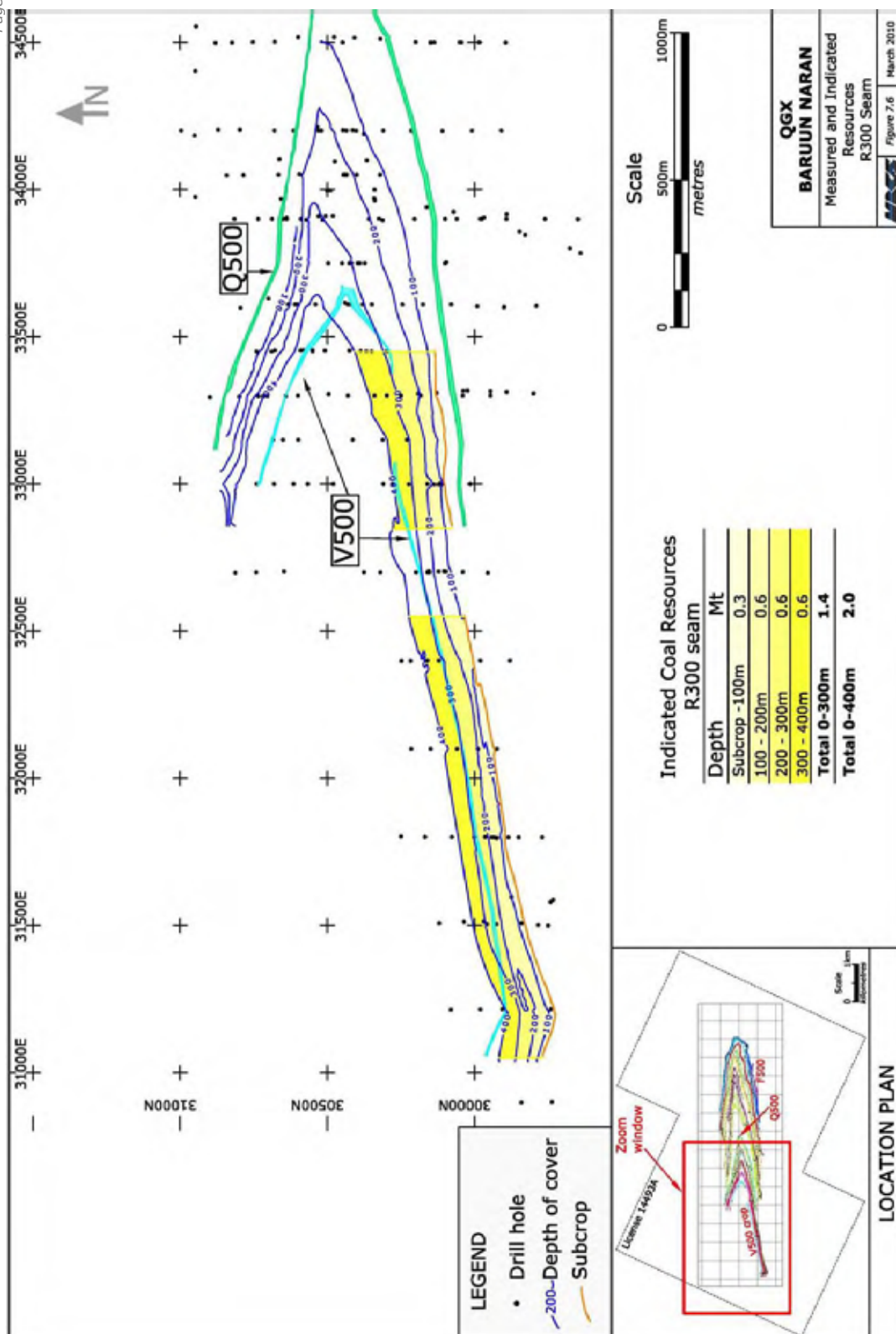
STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Page 42



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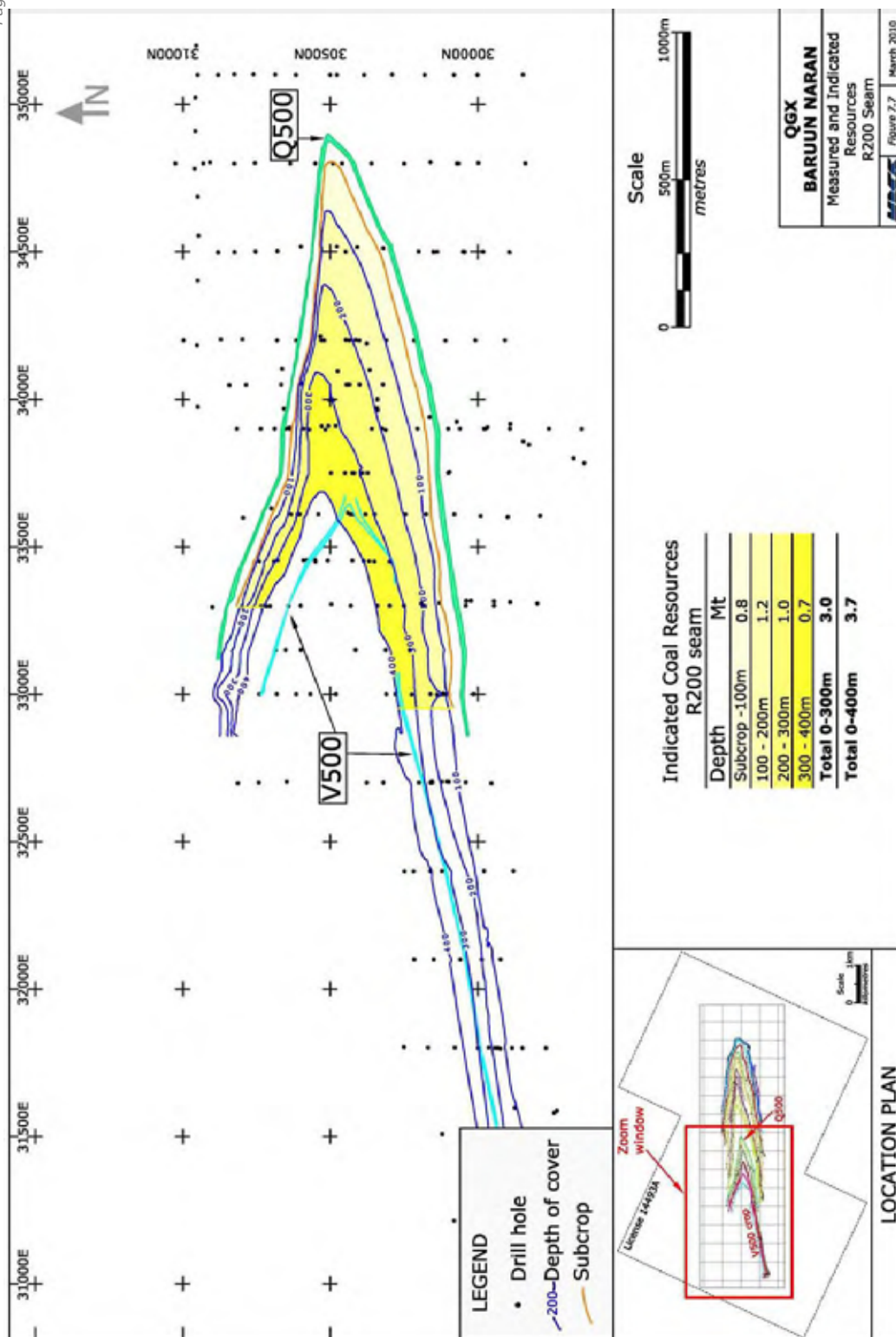
Page 43



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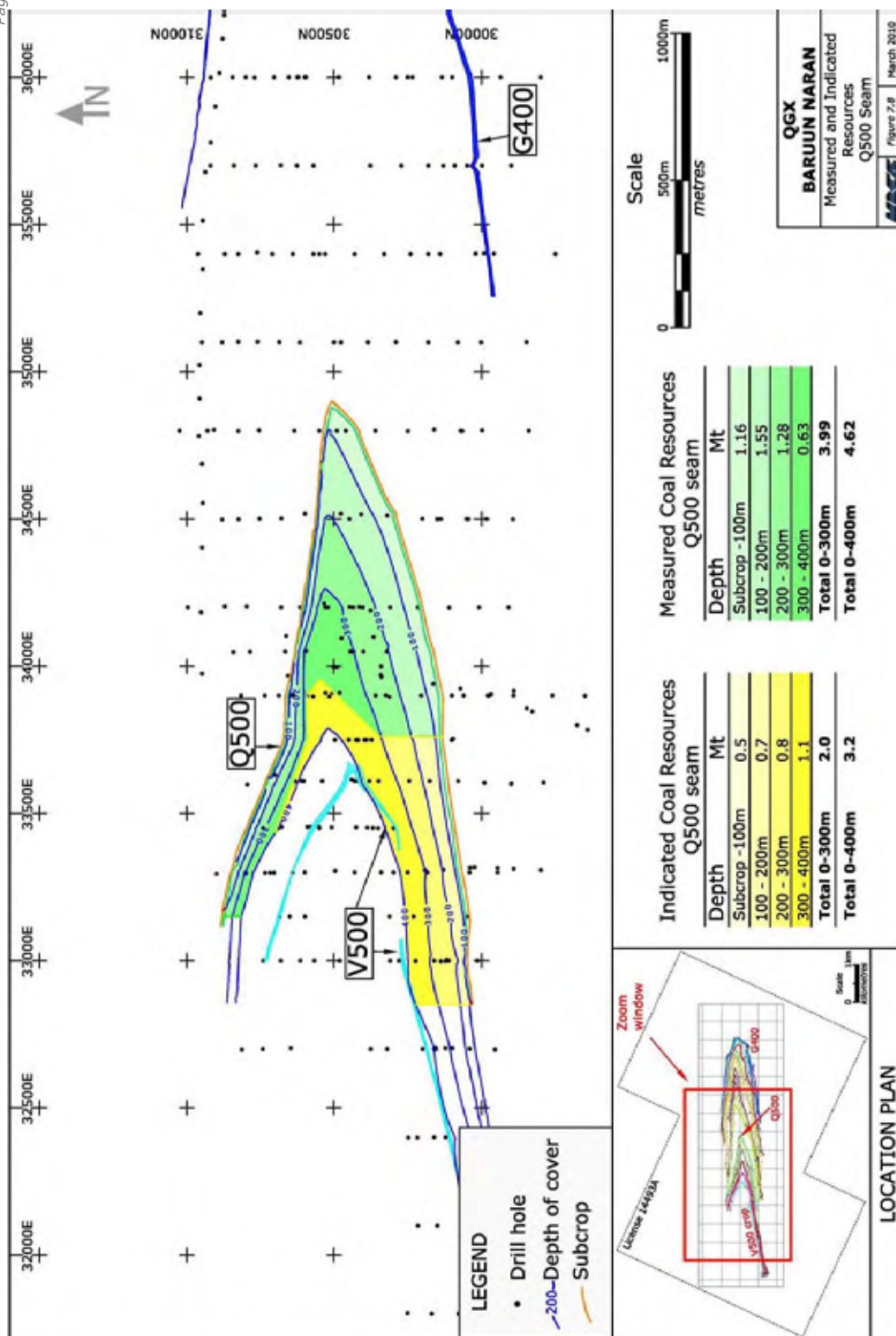
Page 44



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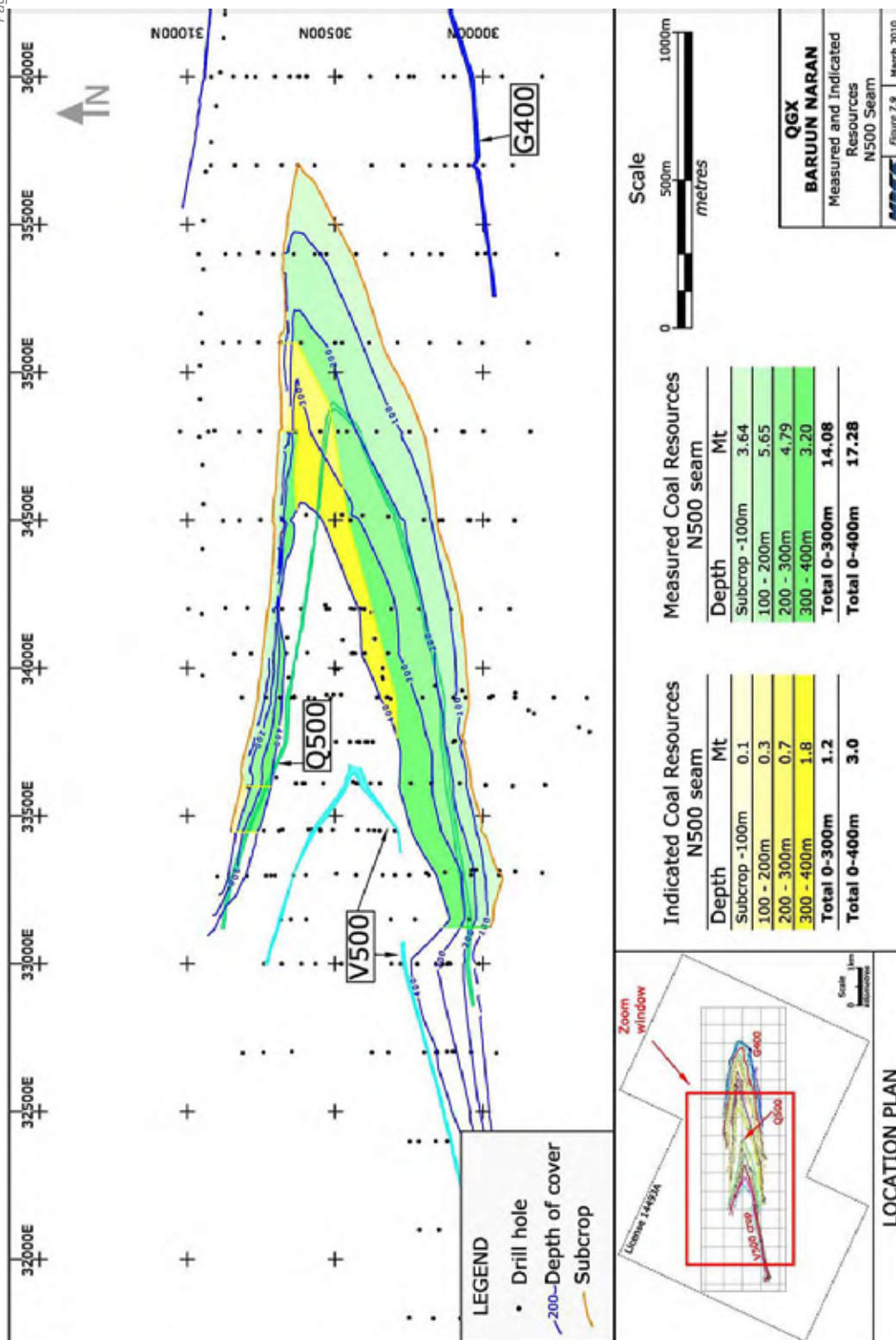
Page 45



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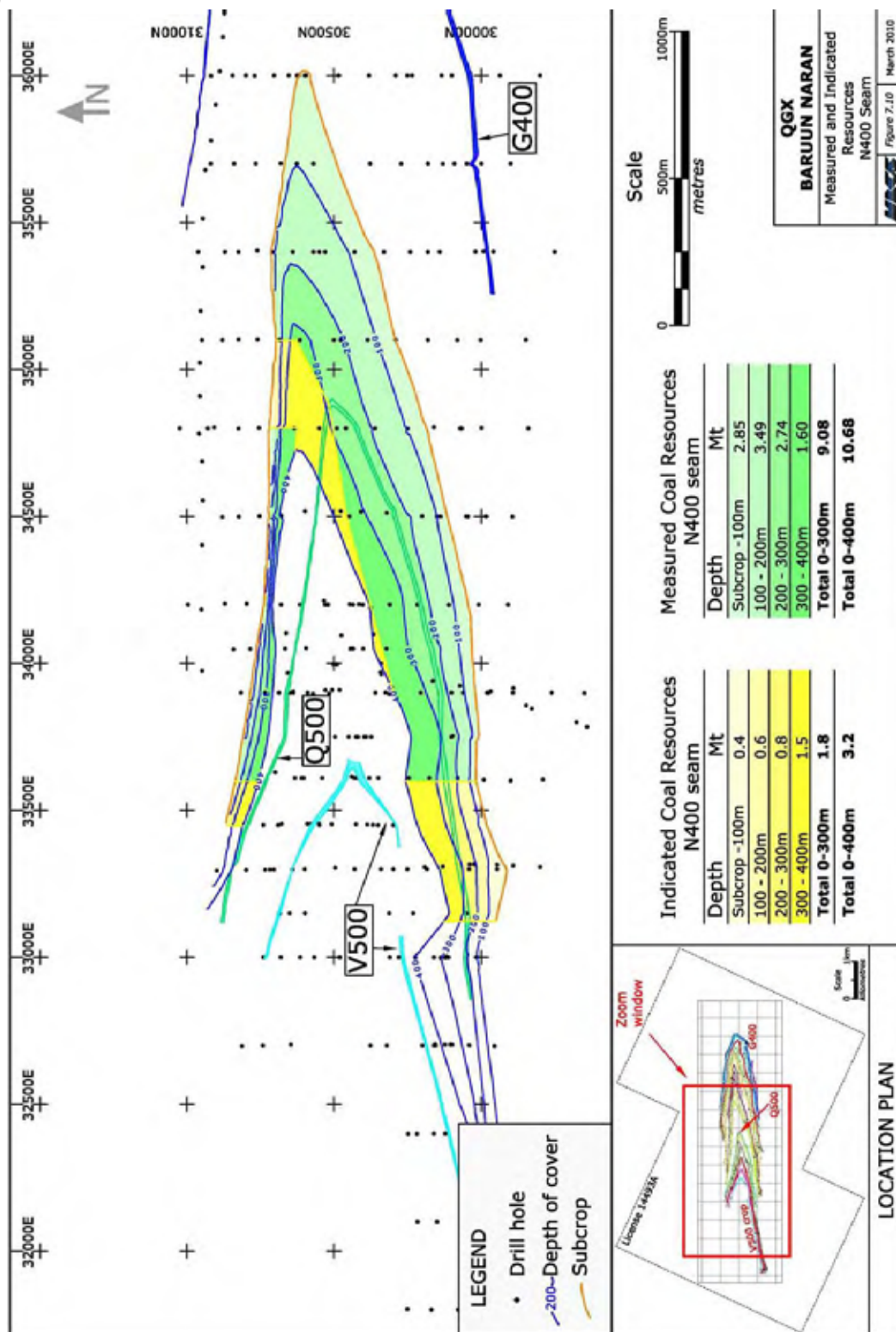
Page 46



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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

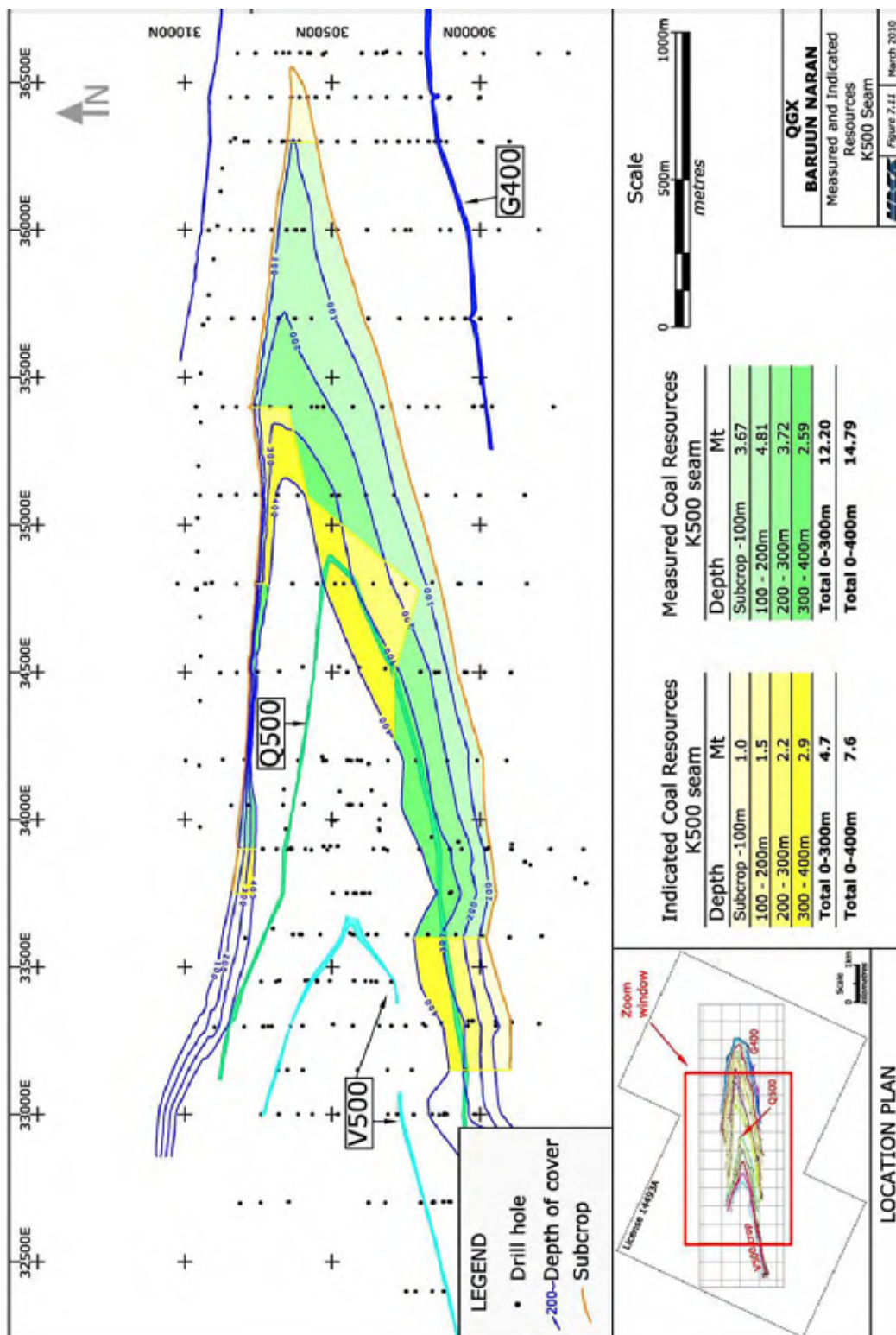
Page 47



MBGS Resource Statement Baruun Naran Coal Deposit 2010.doc

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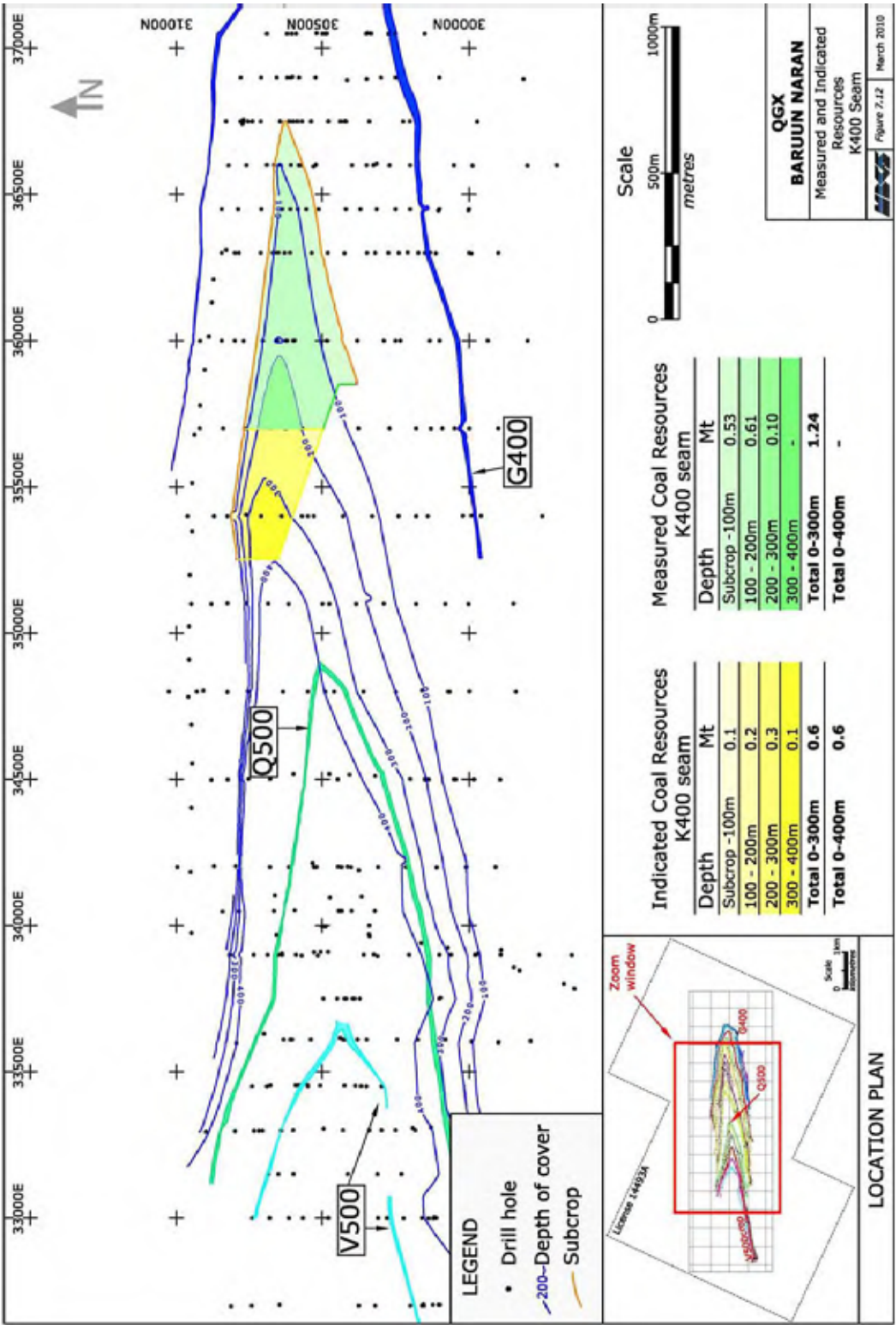
Page 48



MBGS Resource Statement Baruum Naran Coal Deposit 2010.doc

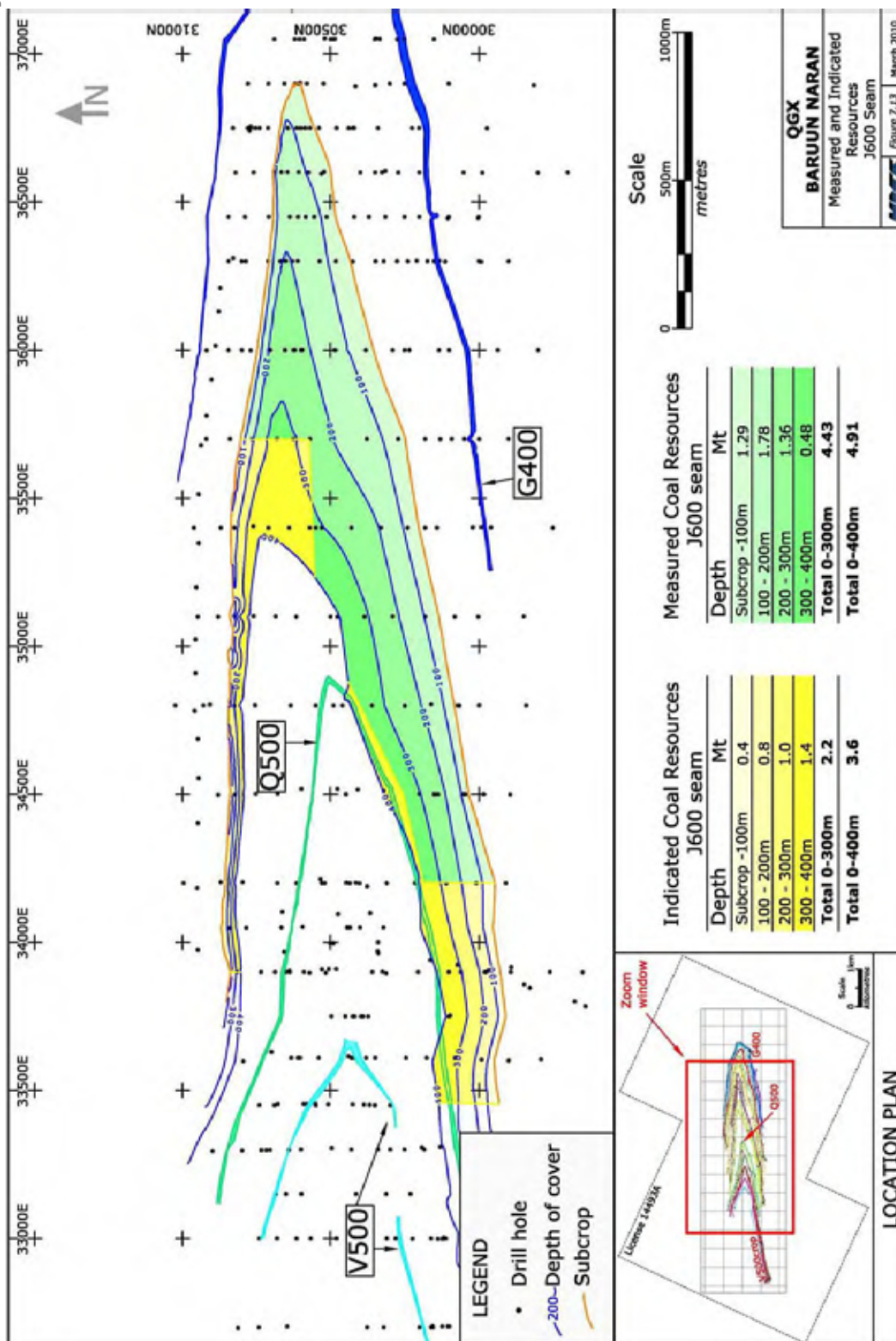
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Page 49



STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

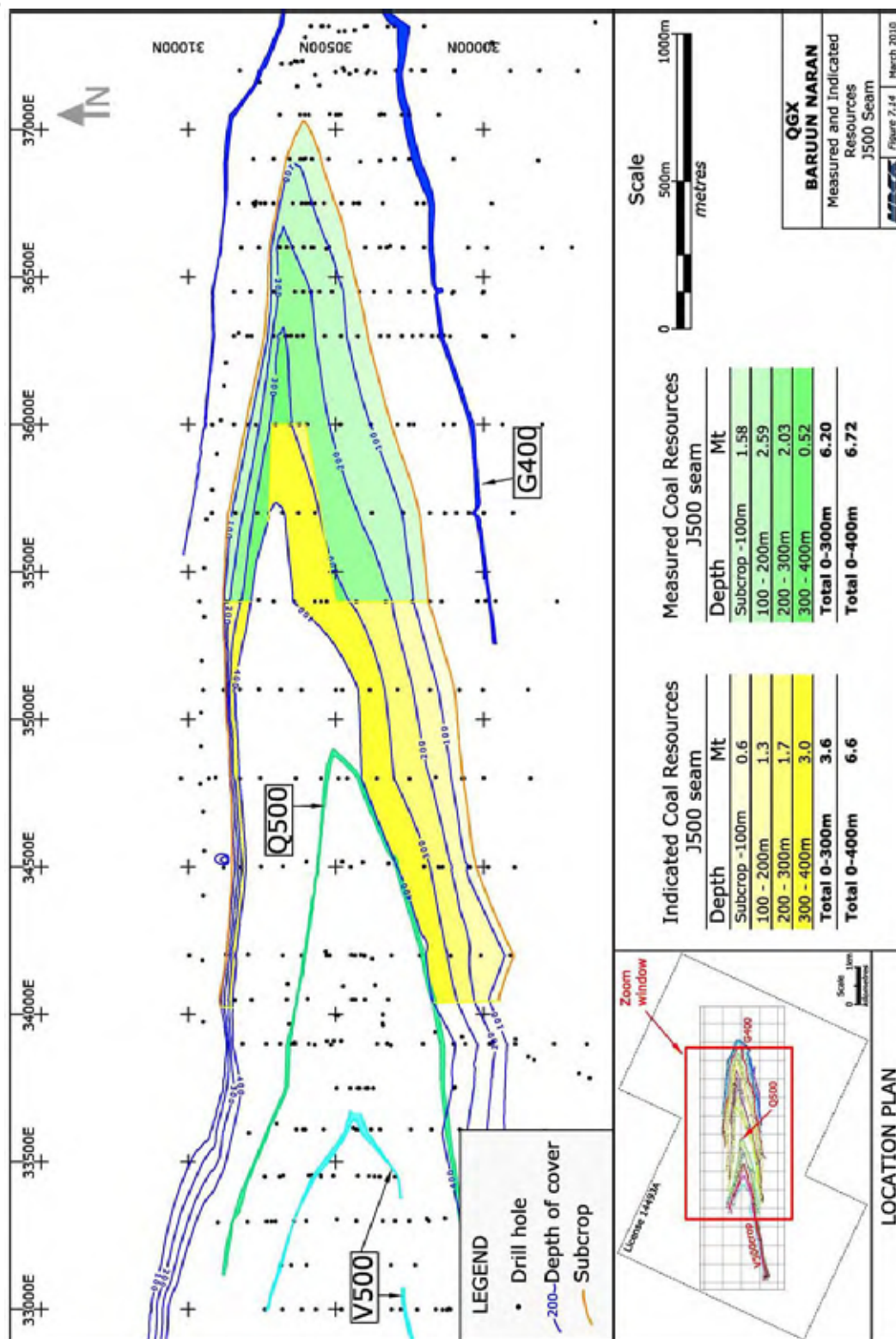
Page 50



MBGS Resource Statement Baruum Naran Coal Deposit 2010.doc

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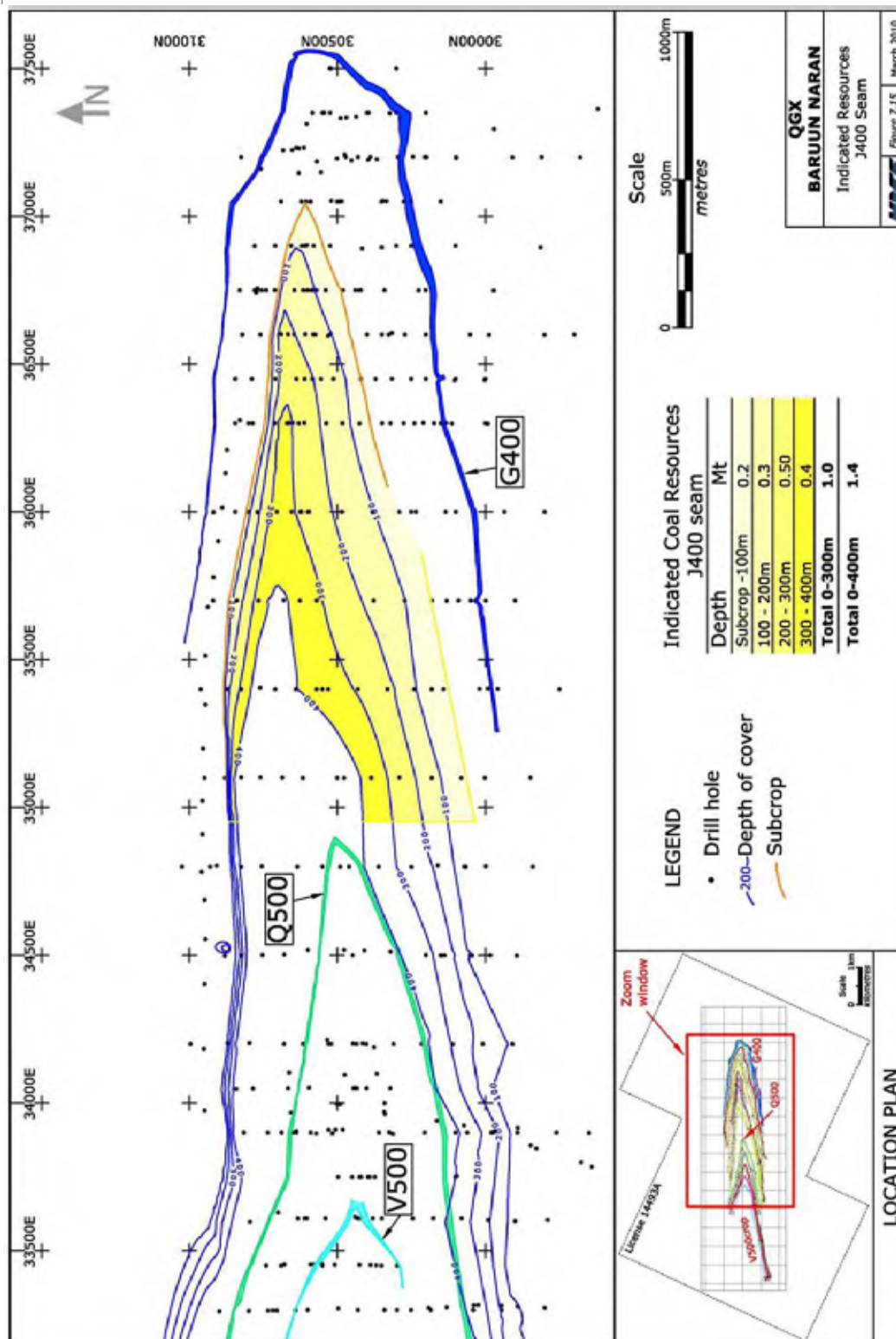
Page 51



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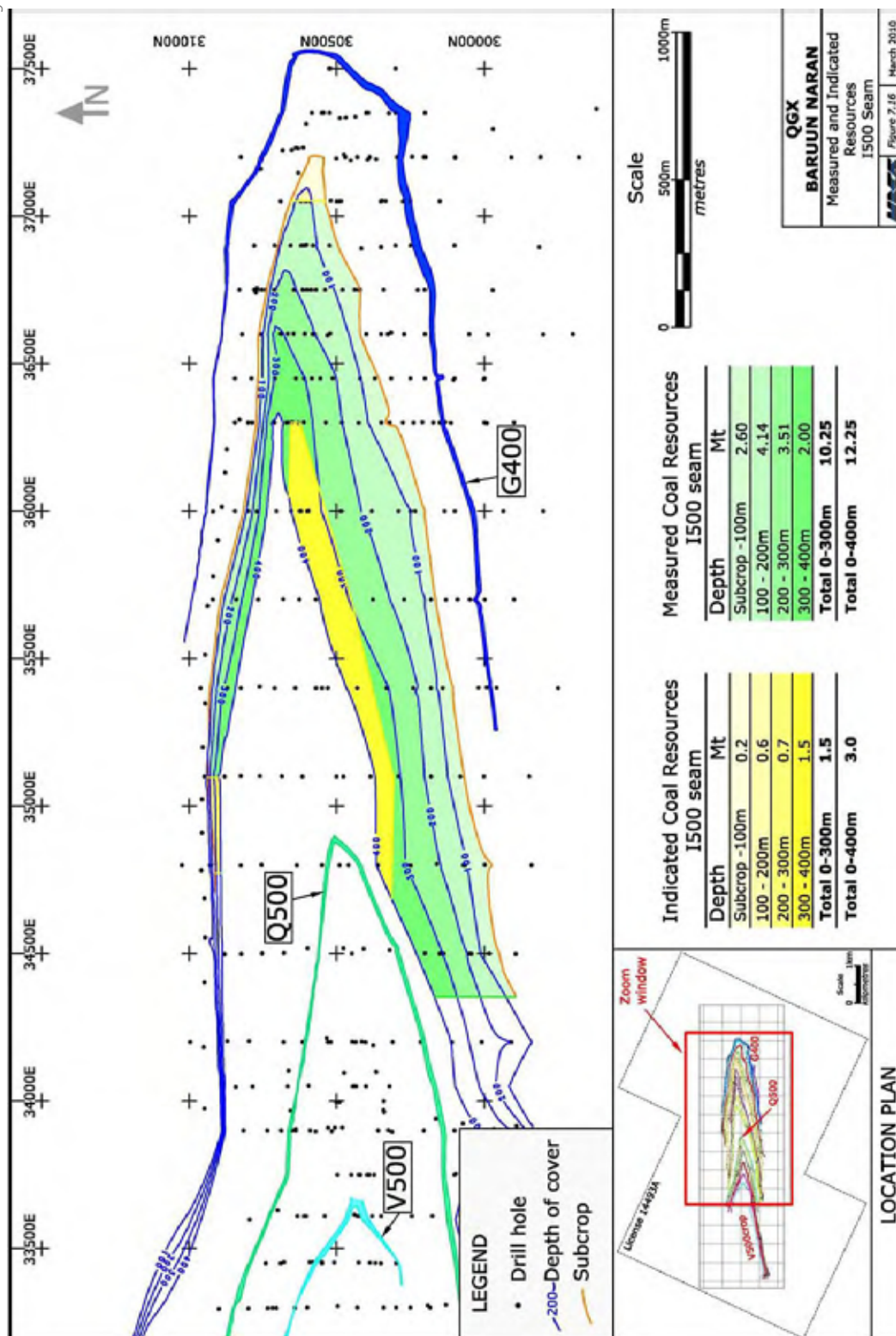
Page 52



MBGS Resource Statement Baruun Naran Coal Deposit 2010.doc

STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

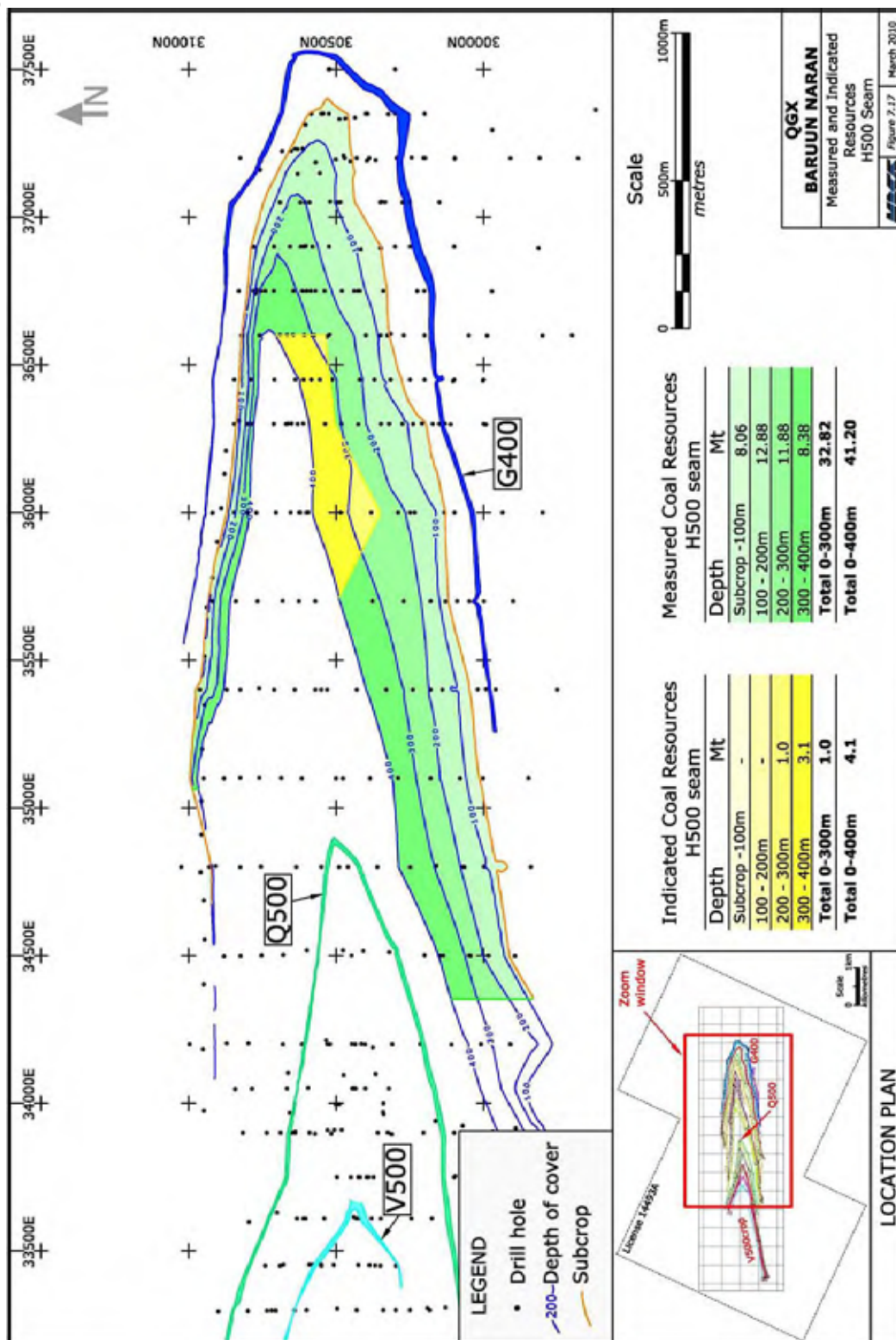
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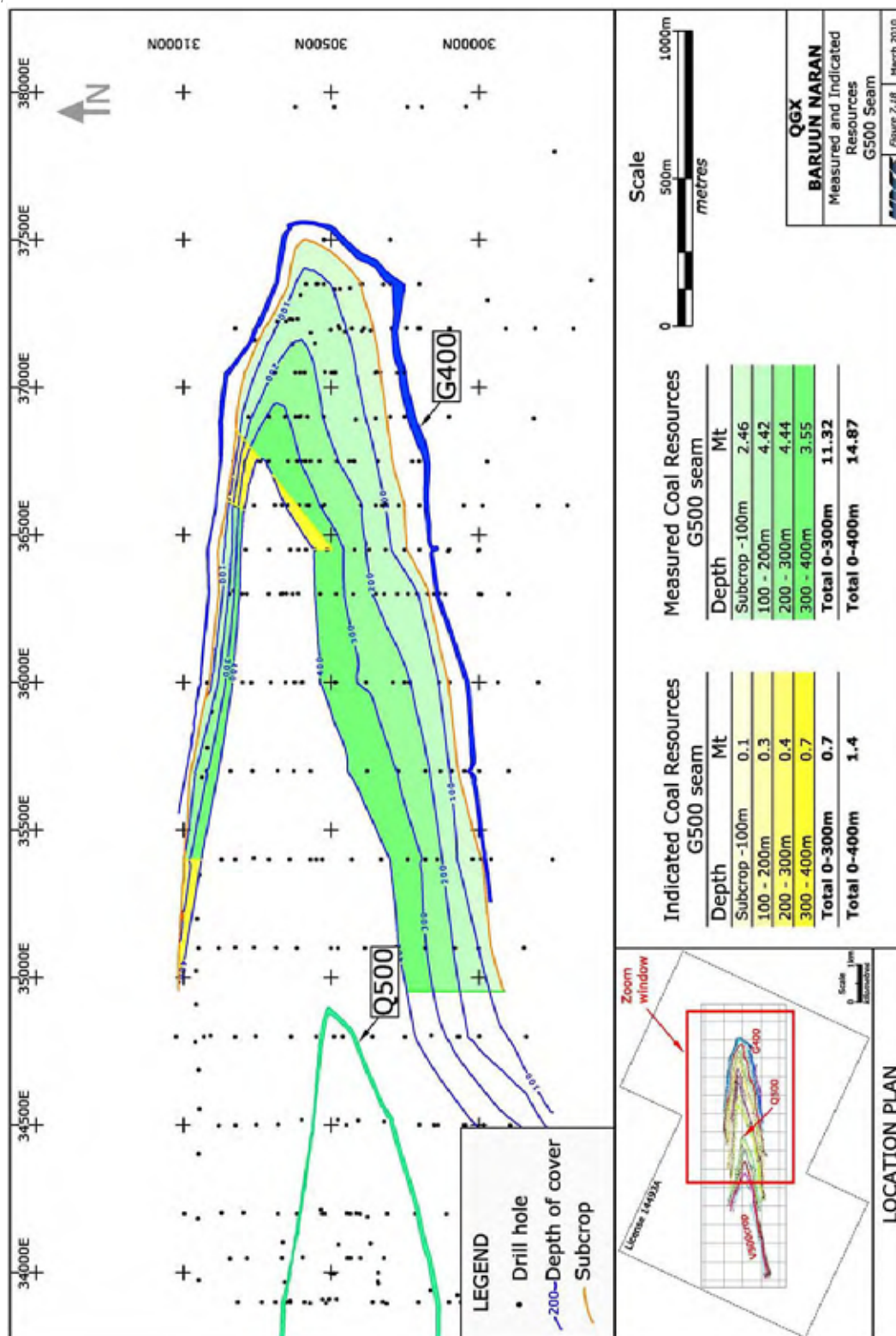
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MBGS Resource Statement Baruun Naran Coal Deposit 2010.doc

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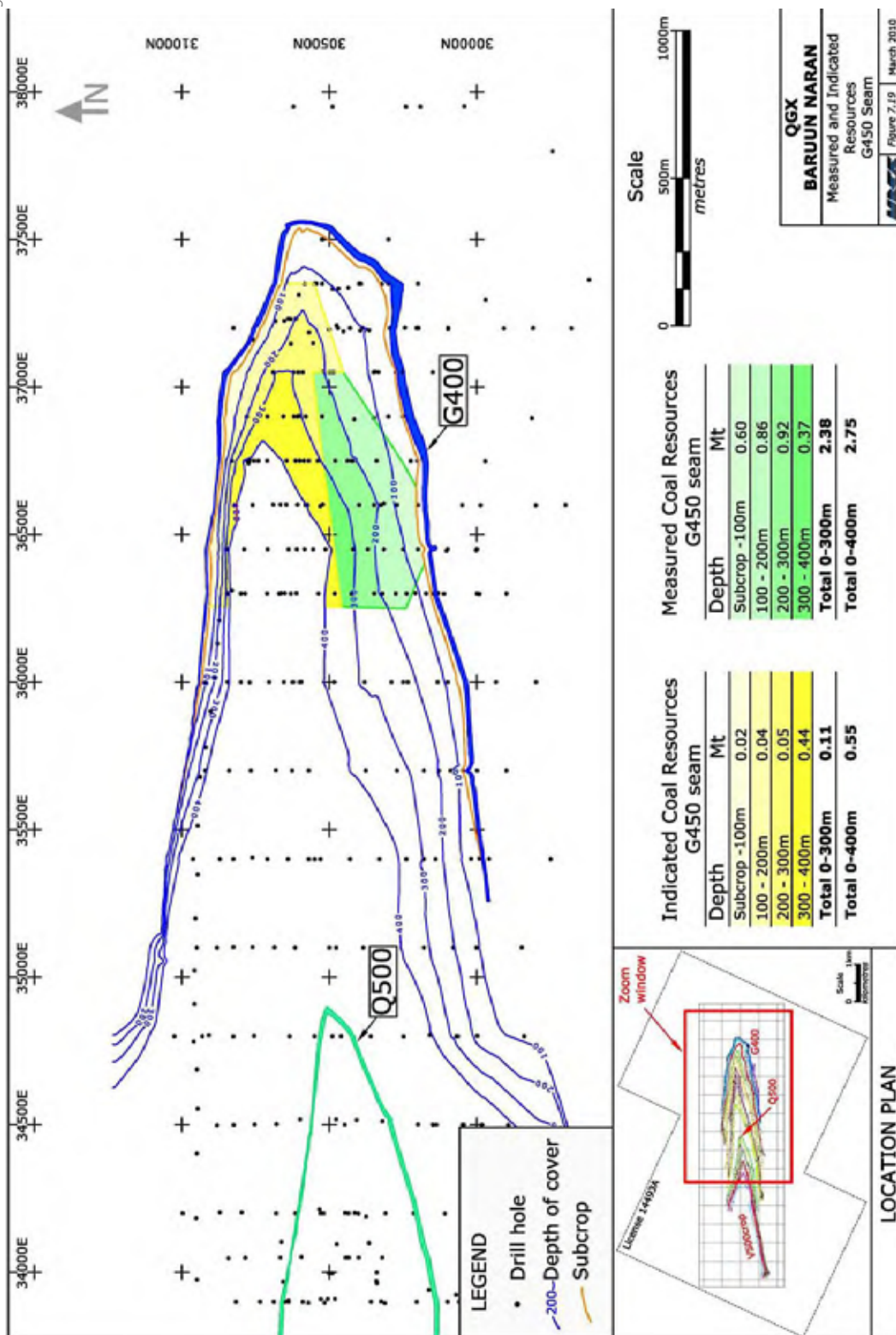
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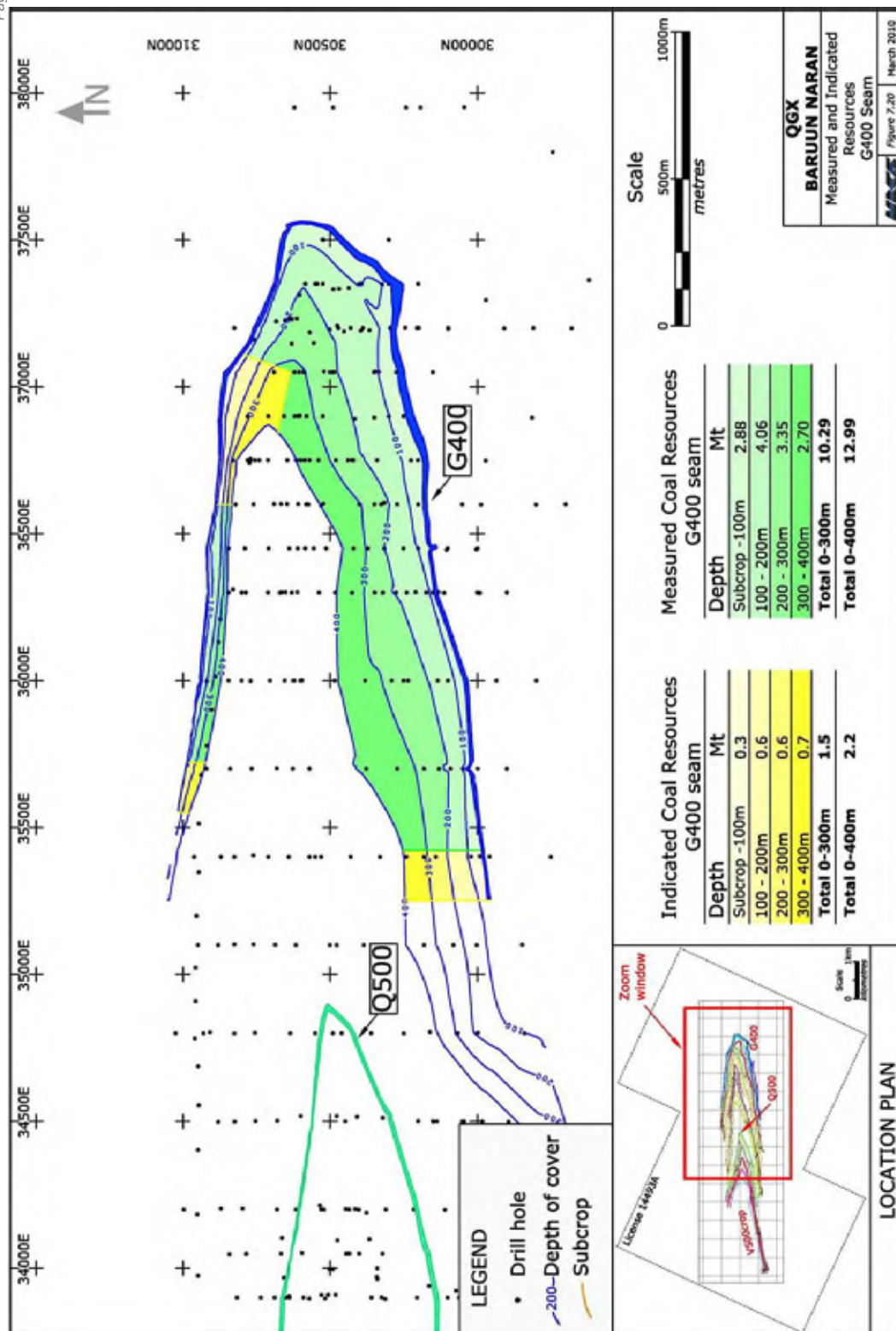
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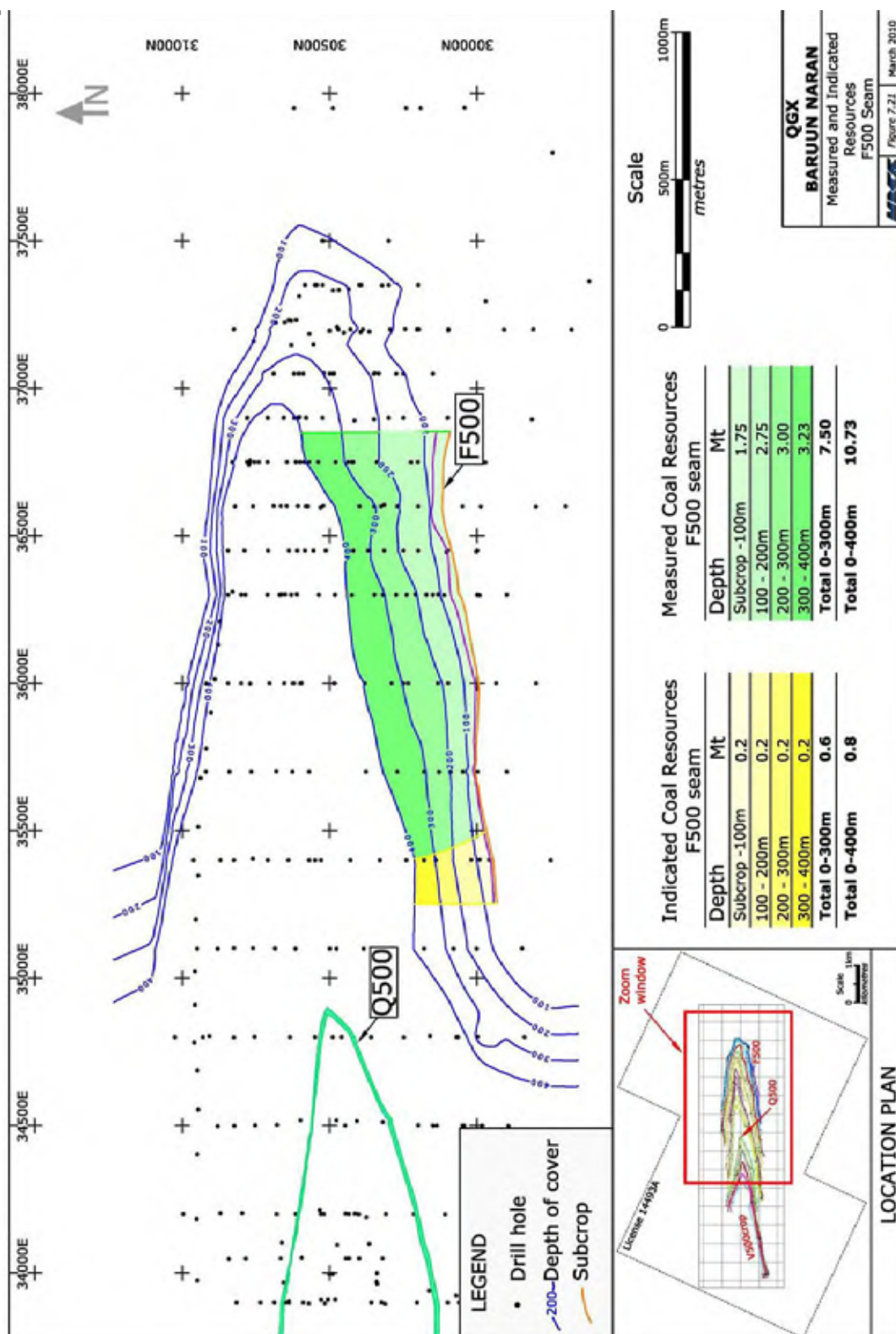
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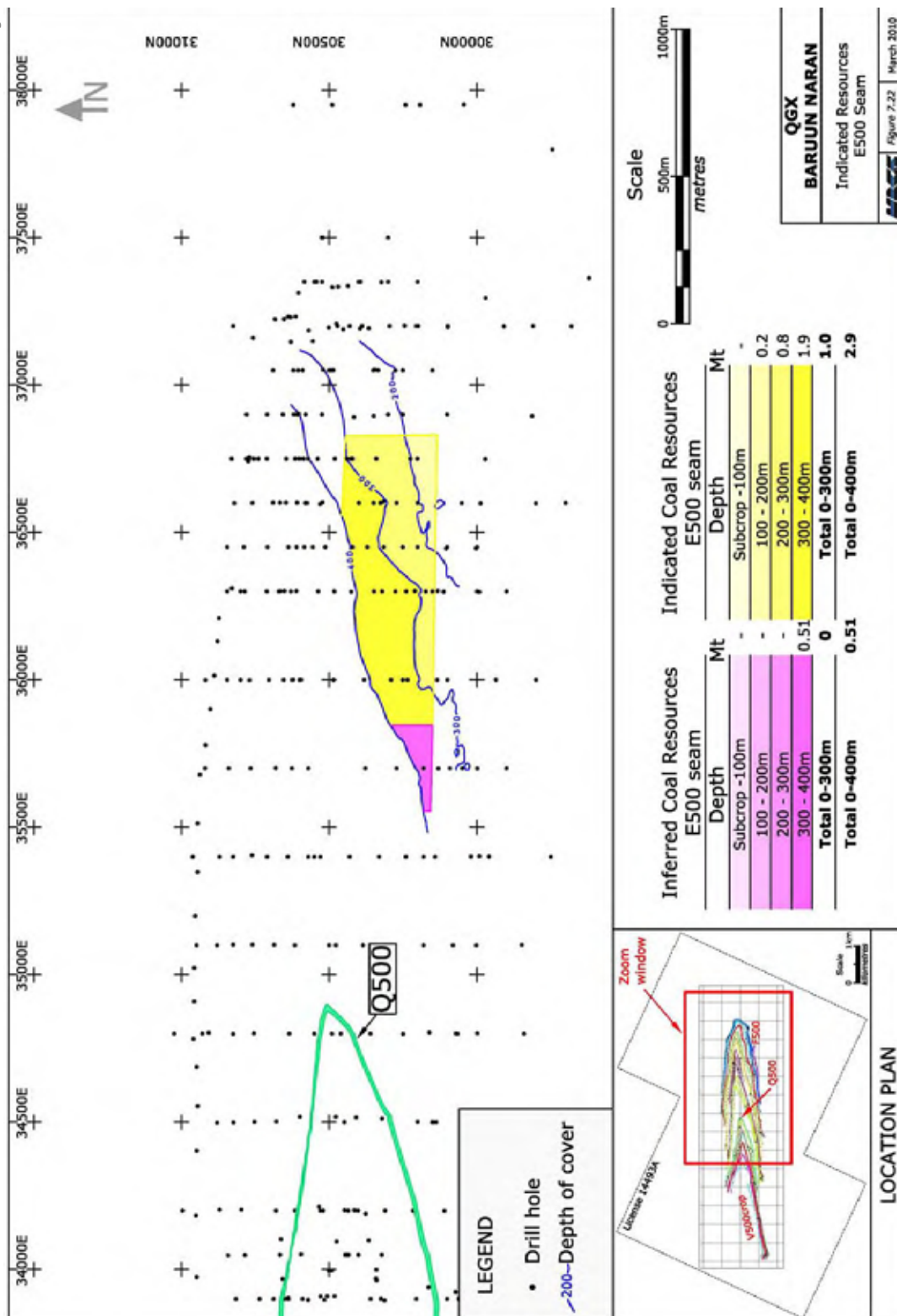
Page 58



MBGS Resource Statement Baruum Naran Coal Deposit 2010.doc

STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Page 59



MBGS Resource Statement Baruun Naran Coal Deposit 2010.doc

STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Statement of Coal Resources 2010 Baruun Naran Coal Deposit

Appendix A

APPENDIX A

RESOURCE BLOCK CHECKLIST

PROJECT/MINE NAME	Baruun Naran		
MINING/EXPLORATION TITLE	Mining License 14493A granted 1 st December 2008 can be renewed for up to 70yrs. Surrounding exploration license Tsaikhar Khudag exploration concession 4326X (total area 90,782.36 Ha).		
RESOURCE BLOCK(S) ID	Baruun Naran		
RESOURCE CLASSIFICATION	Measured Resource	Indicated Resource	Inferred Resource
COAL SEAM(S)	V500, U500,T510, T500, R500, R400, R300, R200, Q550, Q500, N500, N400, K500, K400,J600, I500, H500, G500, G450, G400, F500 and E500.		
POTENTIAL EXTRACTION METHODS	Open Cut		
GEOLOGY	All seam subcrop within License 14493A. The east to west orientated syncline plunges to the west at 24°. The north limb is steep 75° to overturned towards the west. South limb less steep – 45° steepening to 75° in the west. Shallowest dips close to subcrop around the synclinal nose – 40°.		

RESOURCE LIMITS/LIMITATIONS (Resource Block Limits)		
CRITERIA		Considerations
AREAL LIMITS		
C1	Lease Boundaries	The coal resources are located within the current mining license.
C2	Infrastructure	No permanent structures exist.
C3	Environmental/ Historical Features	Extremes of climate occur with seasonal changes.
C4	Native Title interests	N/A
C5	Mine workings	Nil to date.
C6	Data limits	Resource limits defined from drilling.
GEOLOGICAL LIMITS		
C7	Seam thickness limitations	N/A
C8	Interburden thickness	N/A
C9	Subcrop	Subcrops clearly defined in the east. Towards the west and north-west resources are truncated at depth by faulting
C10	Overburden	Depth slices of 100m to each seam.
C11	Strip Ratio	N/A
C12	Quality parameters	Due to the large number of seams and plies, quality will require

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Appendix A

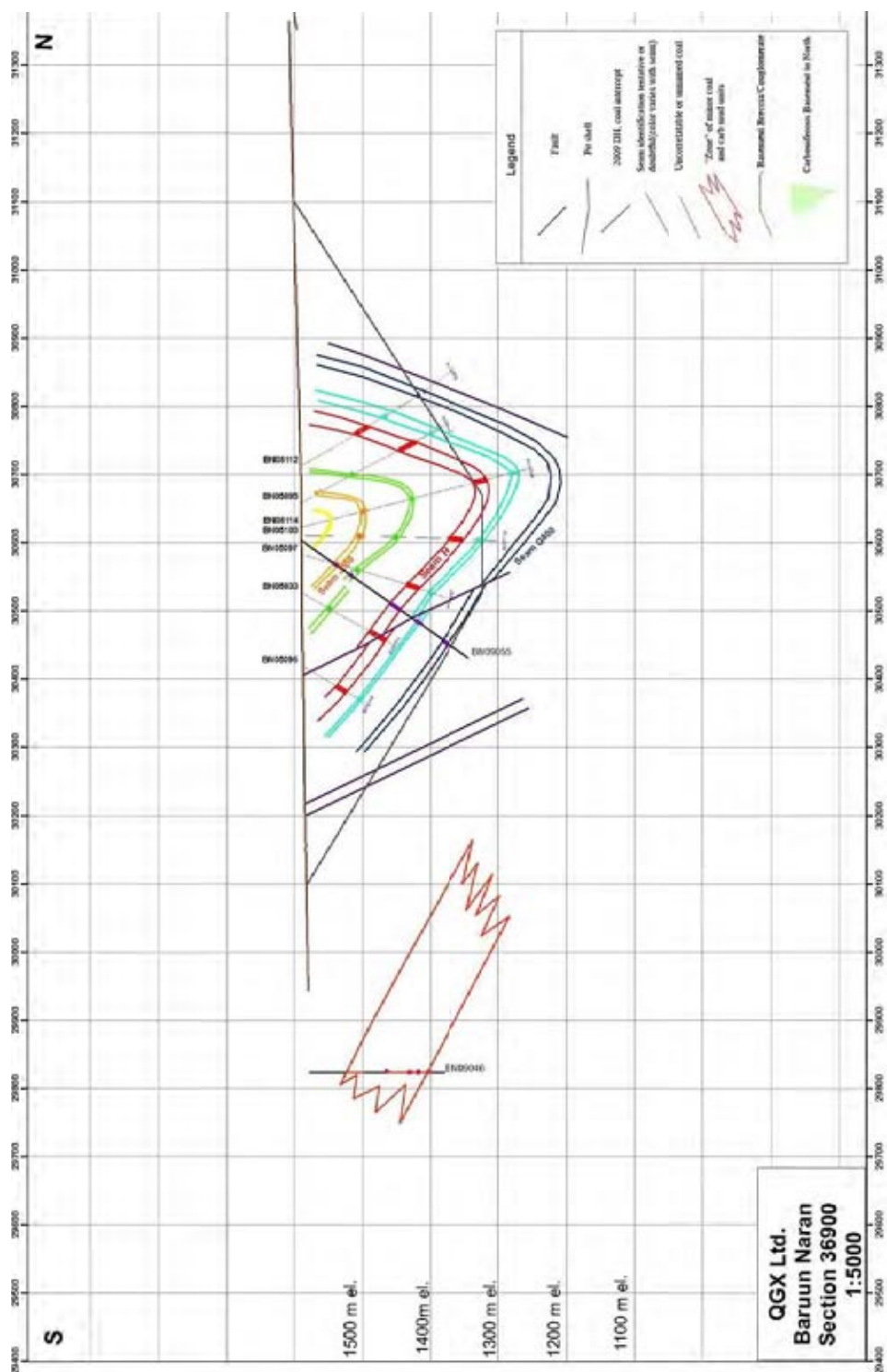
		further analysis at the coal face, during mining.
C13	Structure - faults, seam dip	Large and small scale faulting is expected across the deposit. Large bounding faults occur and smaller scale faulting is expected throughout the coal seam sequence.
C14	Igneous bodies	None identified from exploration.
C15	Other	
	COMMENT	



Appendix B



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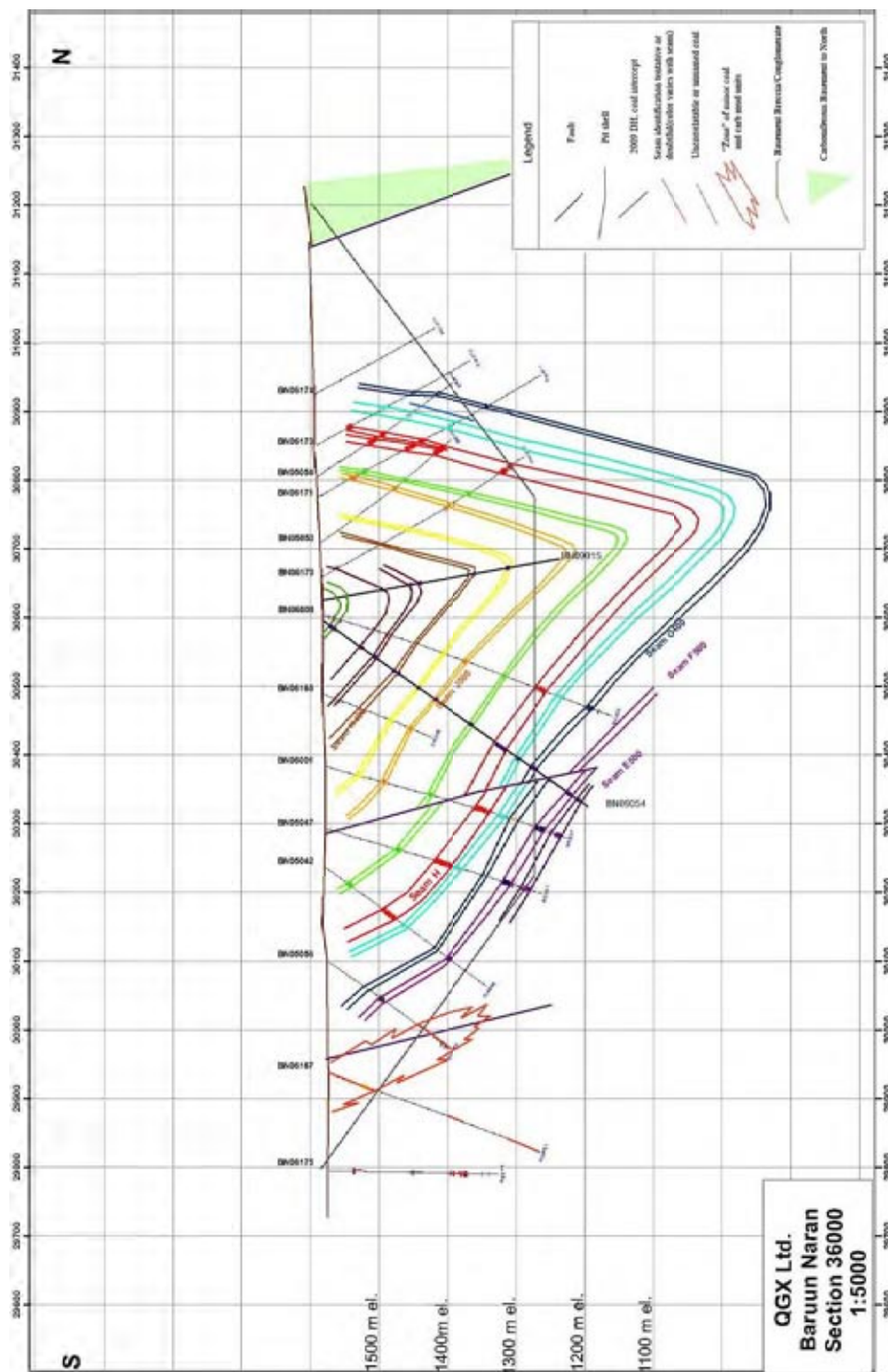
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Statement of Coal Resources 2010 Baruu Naran Coal Deposit

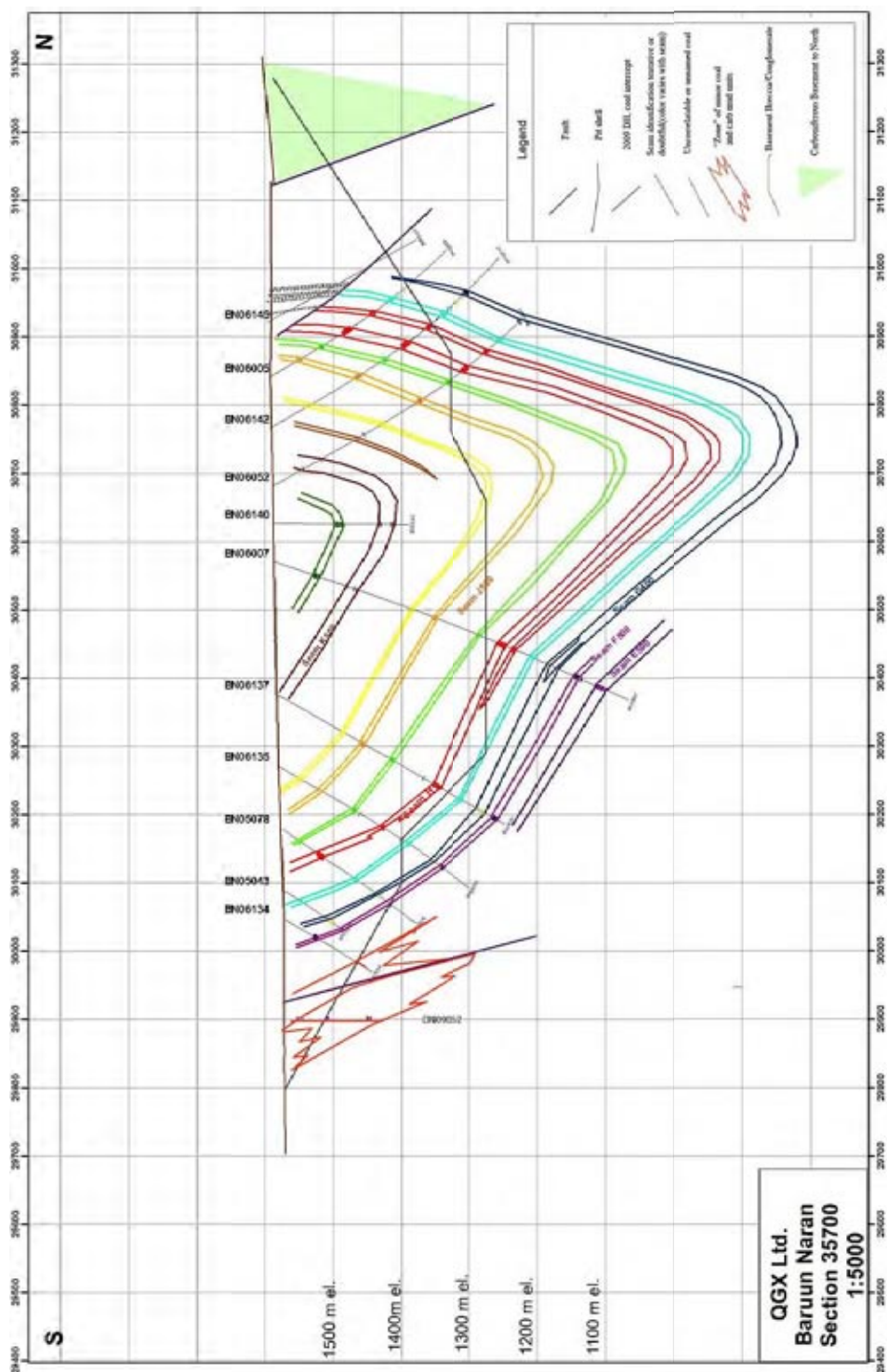


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Appendix B



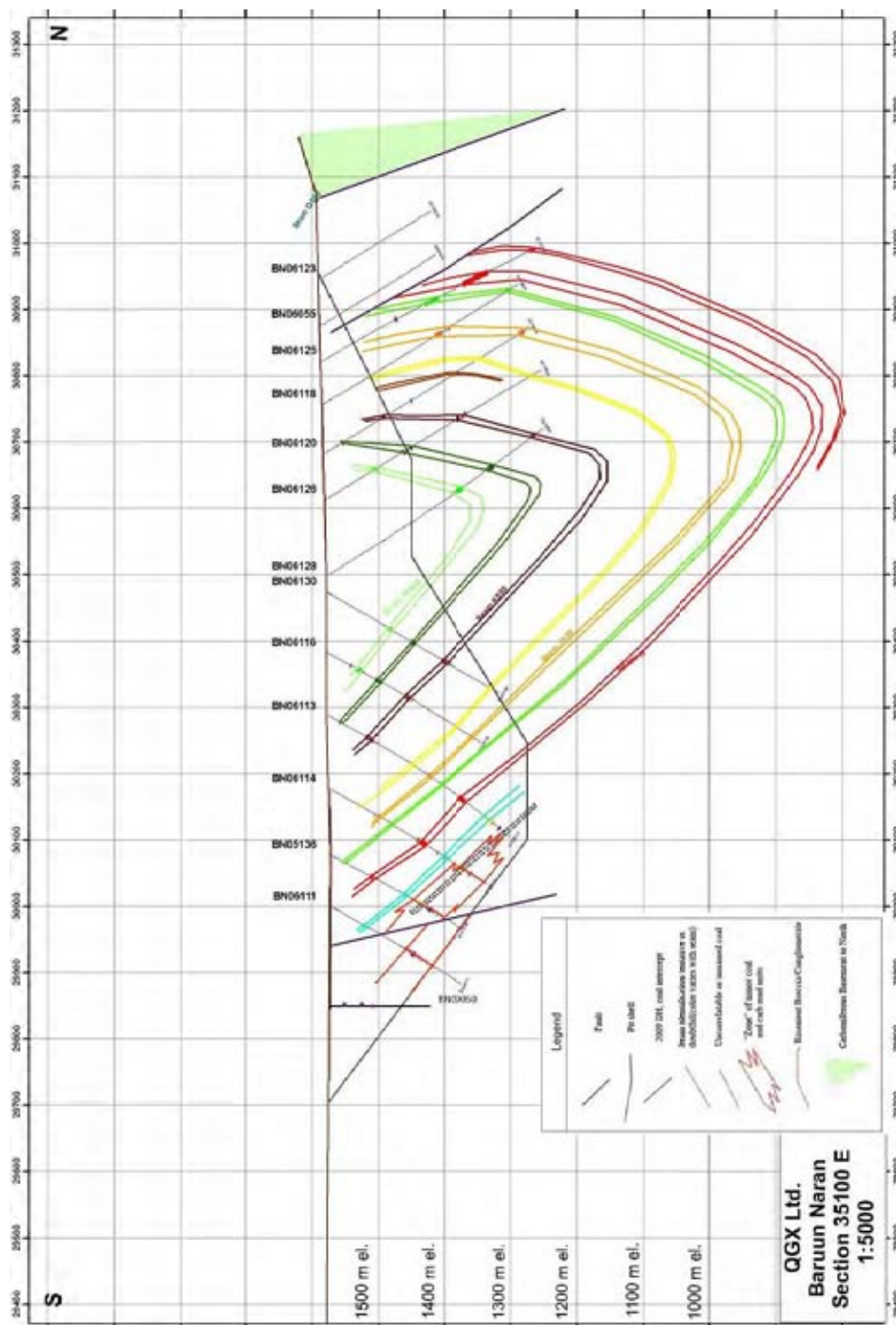
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Appendix B

Statement of Coal Resources 2010 Baruun Naran Coal Deposit



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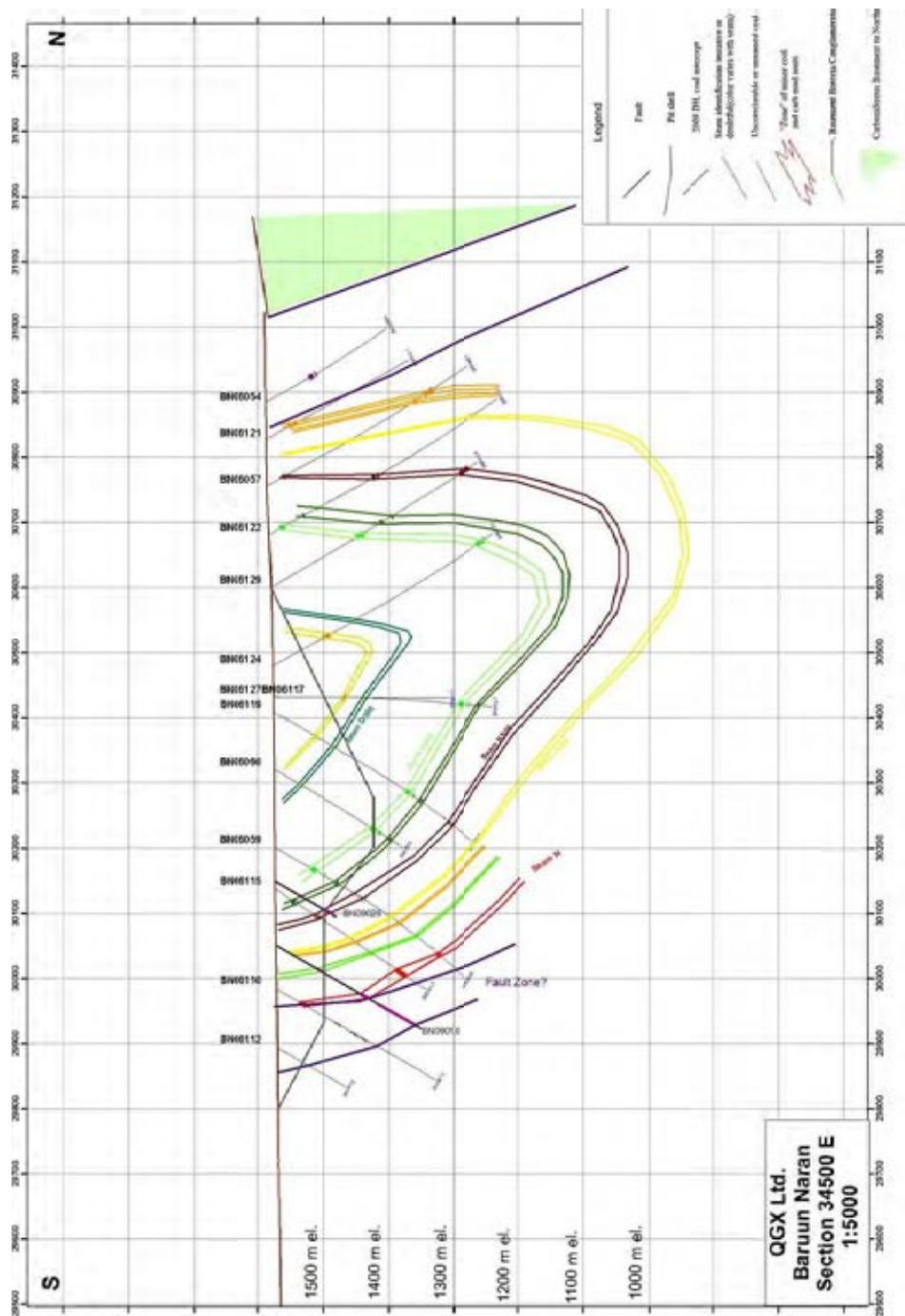
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Appendix B

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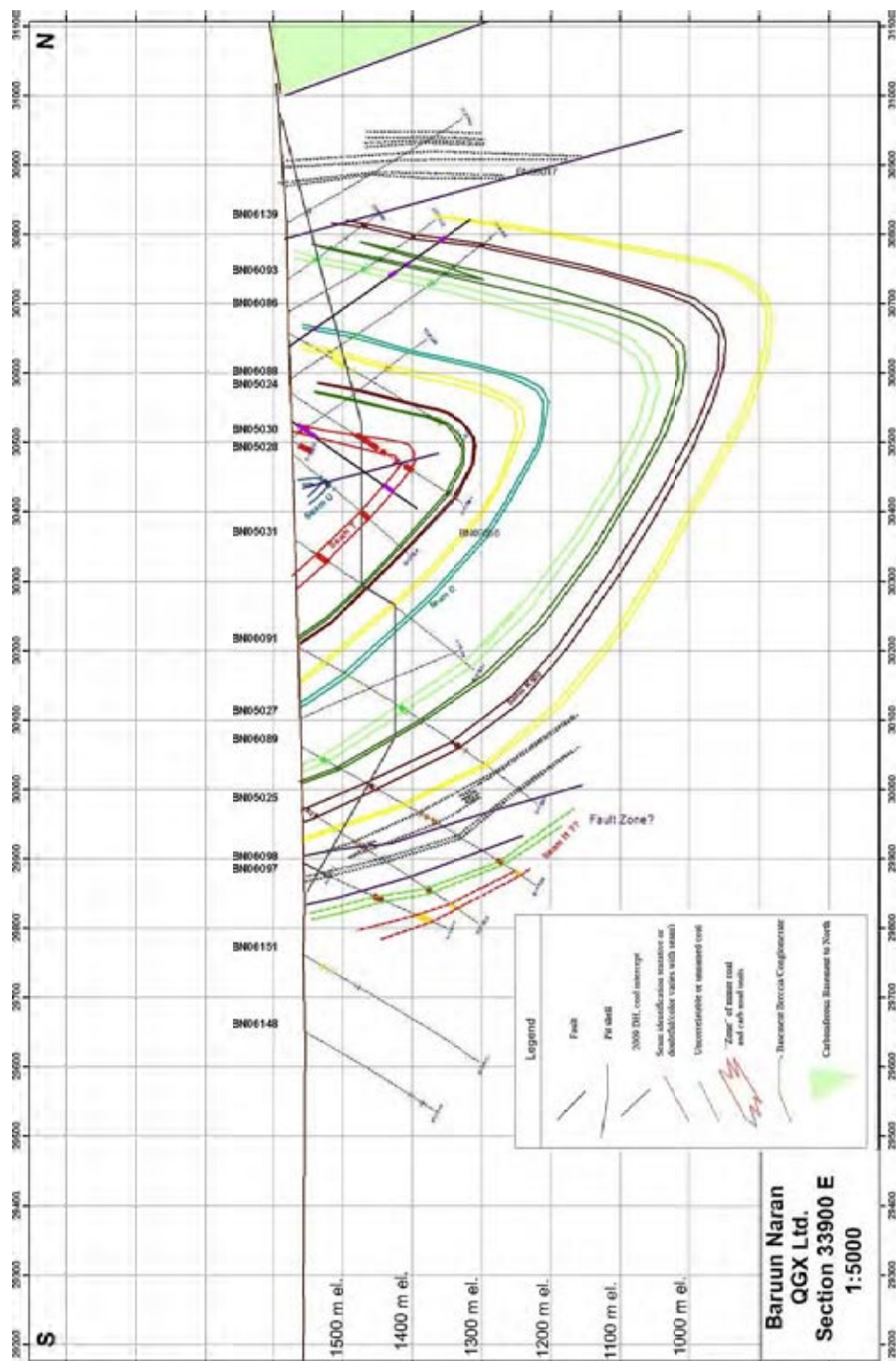
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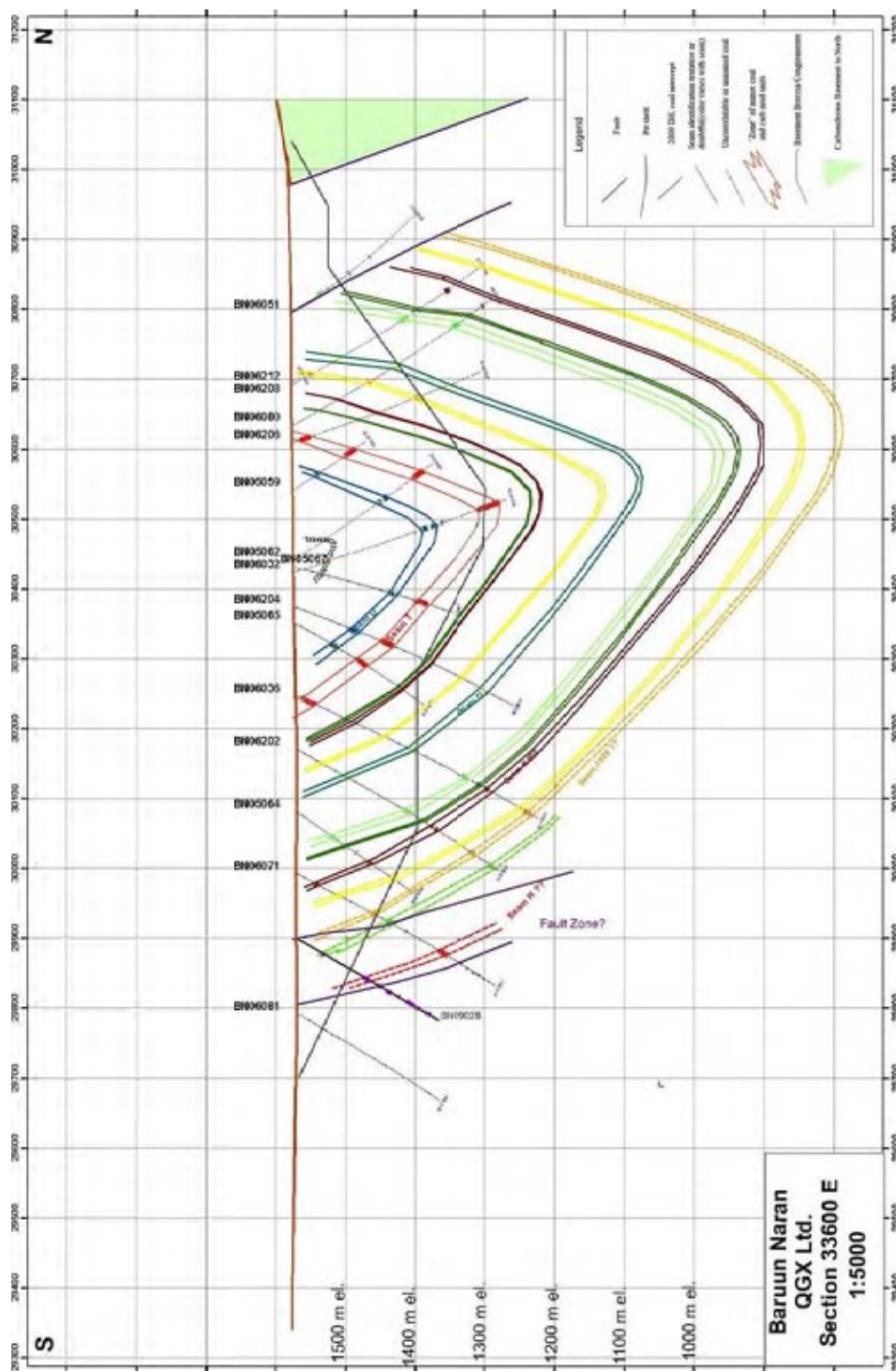
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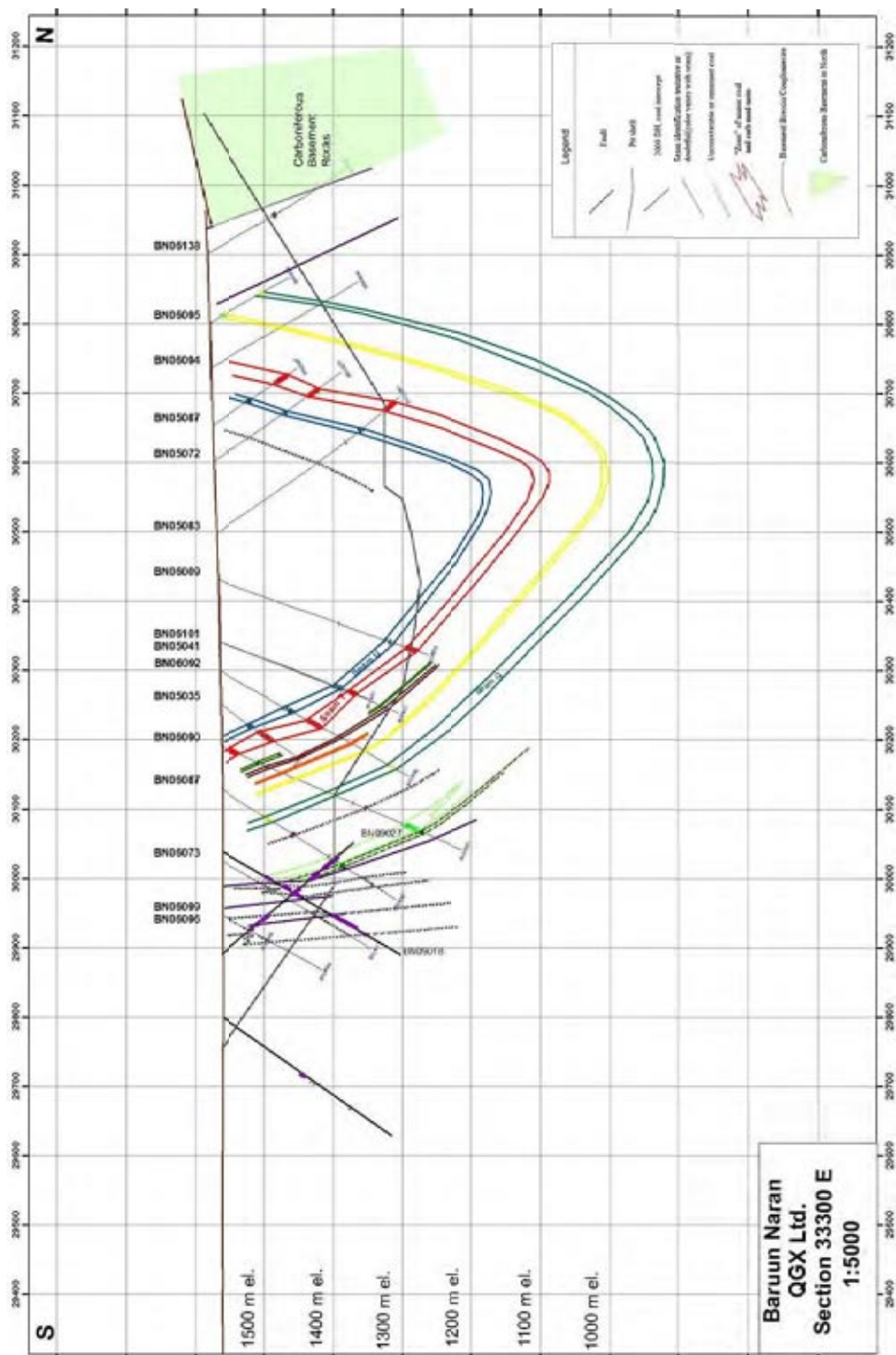
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Appendix B

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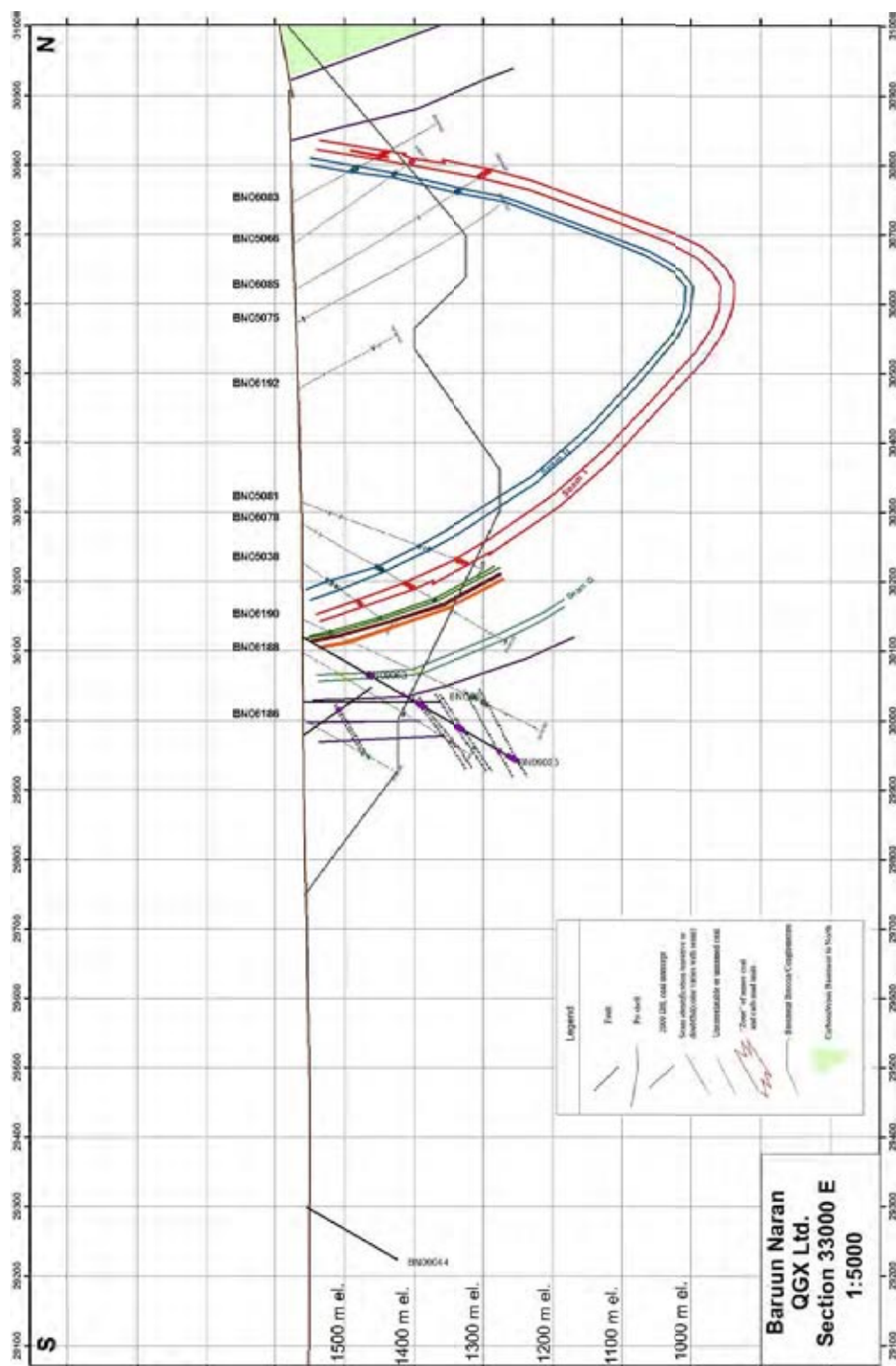


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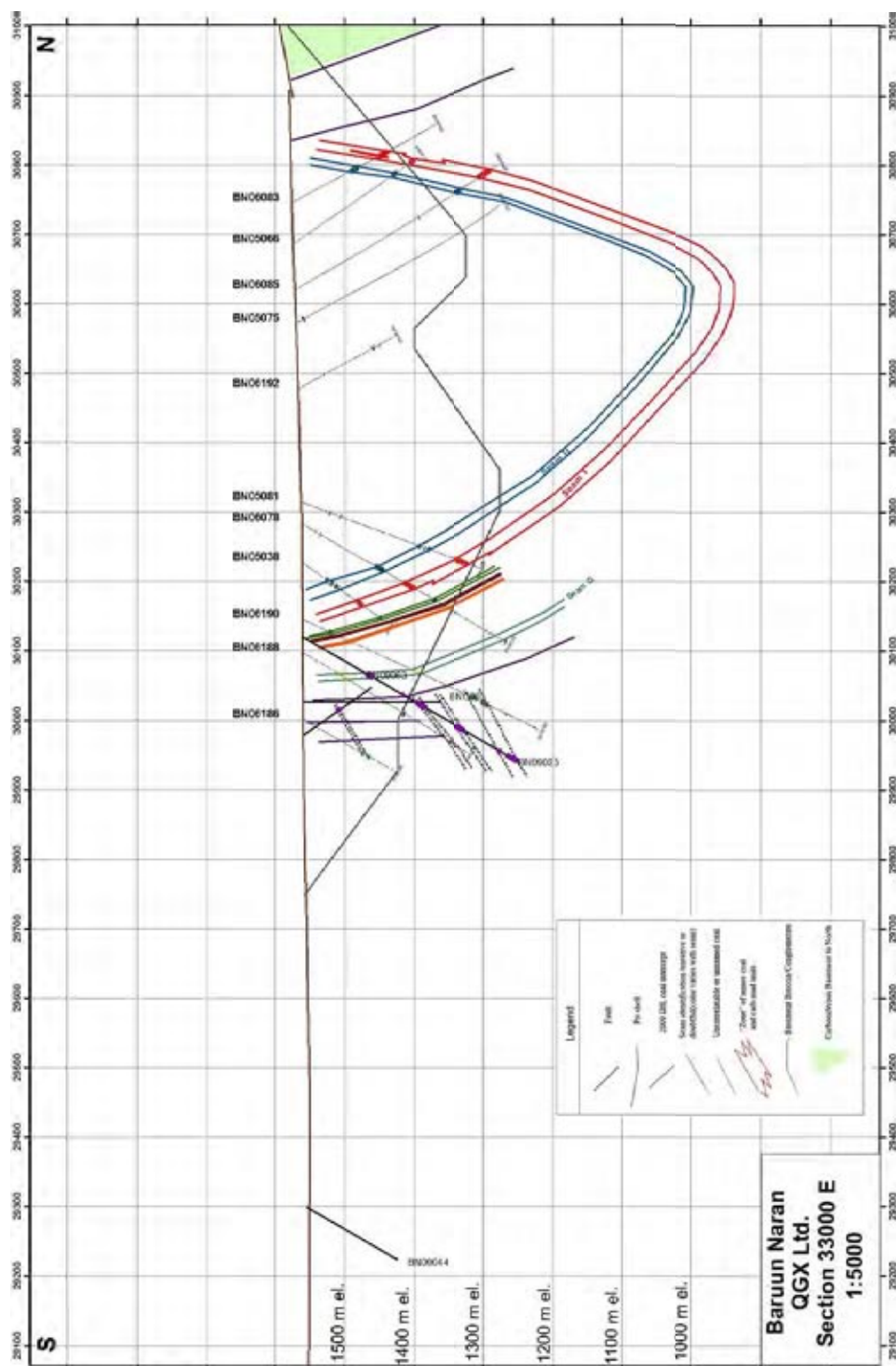
Appendix B

Statement of Coal Resources 2010 Baruun Naran Coal Deposit



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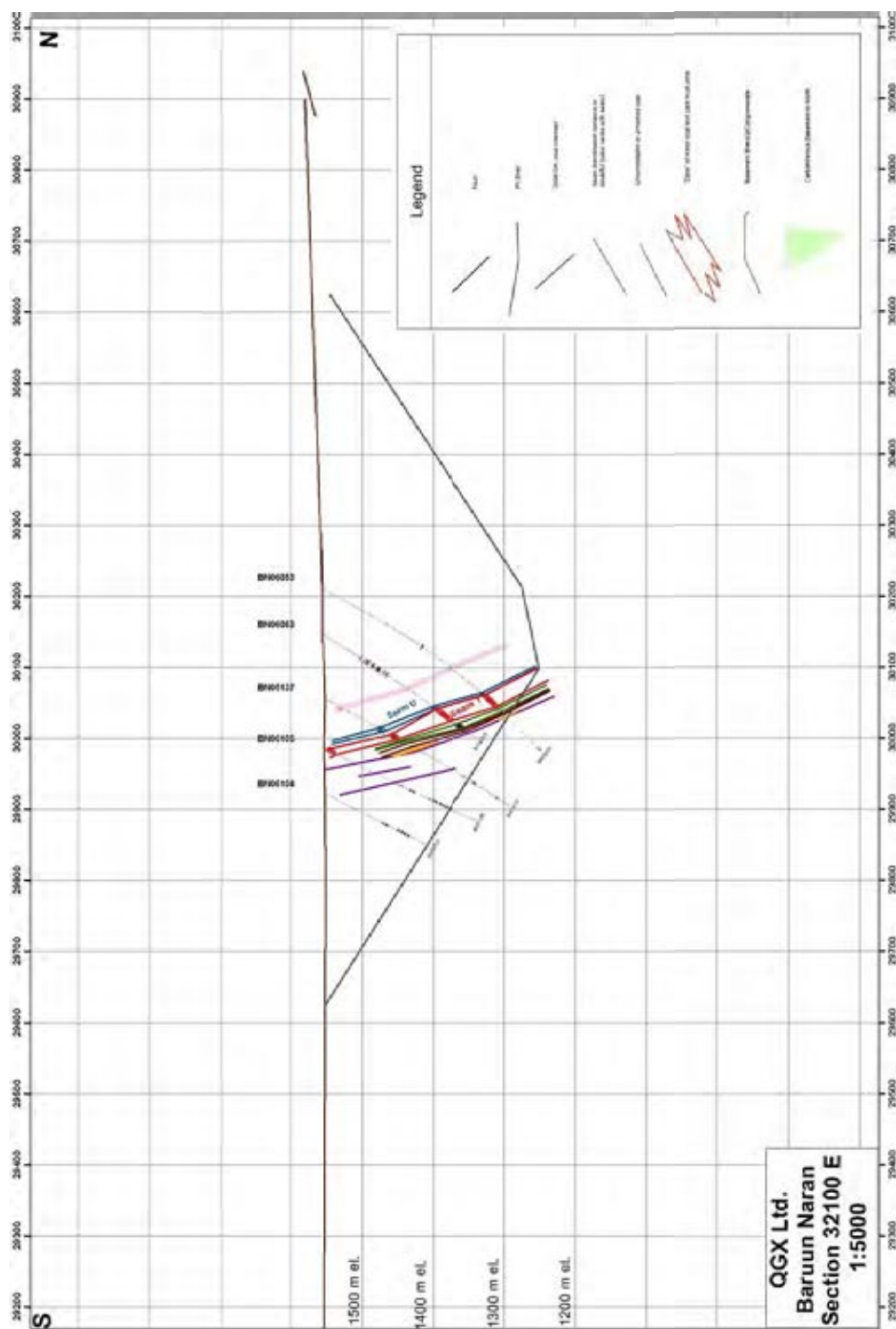
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Appendix B

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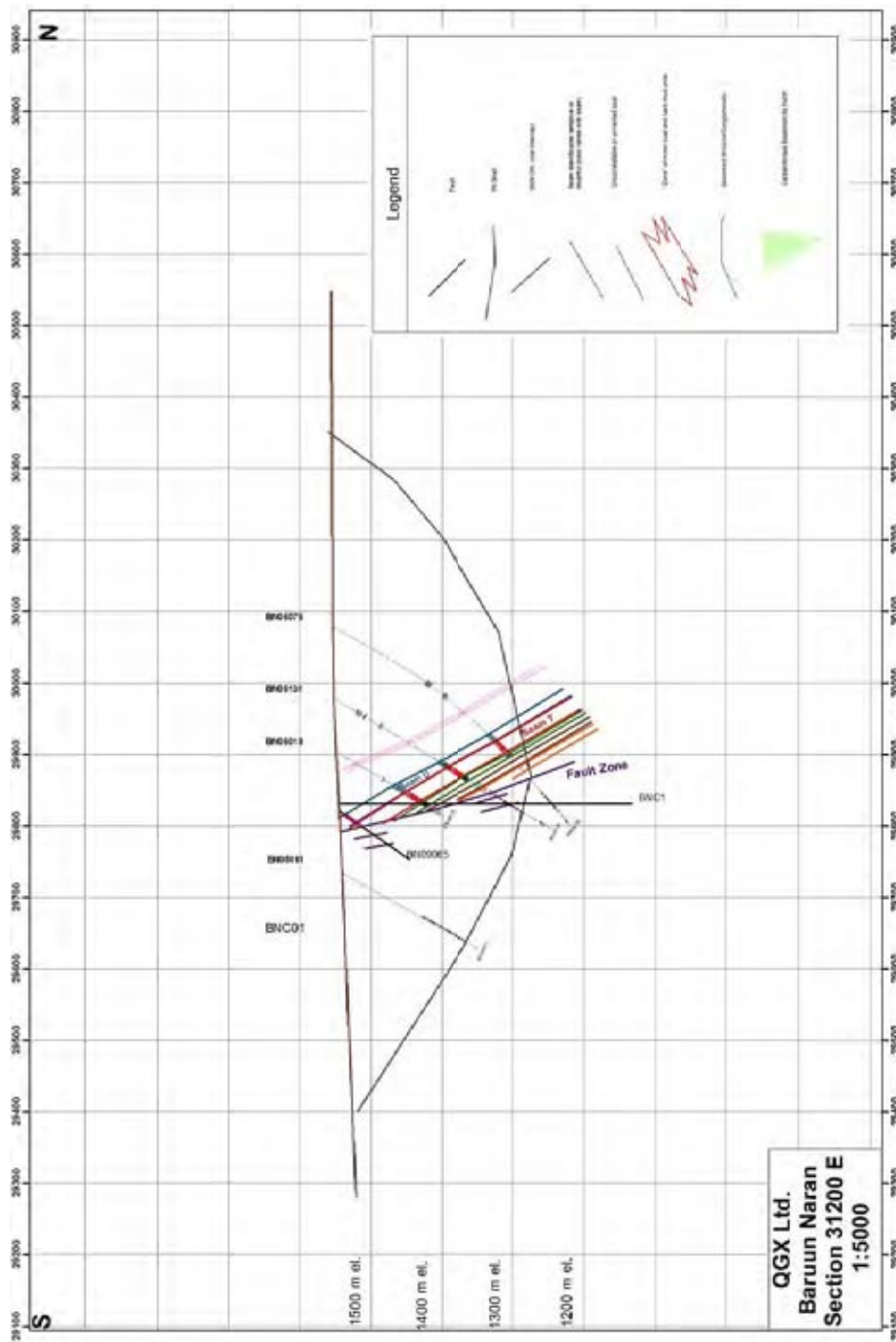
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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

Appendix B

Statement of Coal Resources 2010 Barun Naran Coal Deposit



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APPENDIX C

AUSTRALASIAN CODE FOR THE REPORTING OF

MINERAL RESOURCES AND ORE RESERVES

(THE JORC CODE)

December 2004

Australasian Code for
**Reporting of Exploration Results,
Mineral Resources and Ore Reserves**

~ **The JORC Code** ~
2004 Edition



Effective December 2004

Prepared by:
The Joint Ore Reserves Committee of The Australasian Institute of
Mining and Metallurgy, Australian Institute of Geoscientists and
Minerals Council of Australia (JORC)

STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

FOREWORD

1. The *Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves* (the 'JORC Code' or 'the Code') sets out minimum standards, recommendations and guidelines for Public Reporting in Australasia of Exploration Results, Mineral Resources and Ore Reserves. The Joint Ore Reserves Committee ('JORC') was established in 1971 and published several reports containing recommendations on the classification and Public Reporting of Ore Reserves prior to the release of the first edition of the JORC Code in 1989.

Revised and updated editions of the Code were issued in 1992, 1996 and 1999. This 2004 edition supersedes all previous editions.

Concurrently with the evolution of the JORC Code, the Combined Reserves International Reporting Standards Committee ('CRIRSCO'), initially a committee of the Council of Mining and Metallurgical Institutions ('CMMI'), has, since 1994, been working to create a set of standard international definitions for reporting Mineral

Resources and Mineral (Ore) Reserves, modelled on those of the JORC Code.

Representatives of bodies from participating countries (Australia, Canada, South Africa, USA and UK) reached provisional agreement on standard definitions for reporting in 1997. This was followed in 1998 by an agreement to incorporate the CMMI definitions into the International Framework Classification for Reserves and Resources – Solid Fuels and Mineral Commodities, developed by the United Nations Economic Commission for Europe ('UN-ECE').

As a result of the CRIRSCO/CMMI initiative, considerable progress has been made towards widespread adoption of consistent reporting standards throughout the world. These are embodied in the similar codes, guidelines and standards published and adopted by the relevant professional bodies in Australia, Canada, South Africa, USA, UK, Ireland and many countries in Europe. The definitions in this edition of the JORC Code are either identical to, or not materially different from, those international definitions.

INTRODUCTION

2. In this edition of the JORC Code, important terms and their definitions are highlighted in **bold** text. The guidelines are placed after the respective Code clauses using *indented italics*. They are intended to provide assistance and guidance to readers. They do not form part of the Code, but should be considered persuasive when interpreting the Code. Indented italics are also used for Appendix 1 – '*Generic Terms and Equivalents*', and Table 1 – '*Check List of Assessment and Reporting Criteria*' to make it clear that they are also part of the guidelines, and that the latter is not mandatory for reporting purposes.
3. The Code has been adopted by The Australasian Institute of Mining and Metallurgy ('The AusIMM') and the Australian Institute of Geoscientists ('AIG') and is therefore binding on members of those organisations. It is endorsed by the Minerals Council of Australia, and the Securities Institute of Australia as a contribution to good practice. The Code has also been adopted by and included in the listing rules of the Australian ('ASX') and New Zealand ('NZX') Stock Exchanges.

The ASX and NZX have, since 1989 and 1992 respectively, incorporated the Code into their listing rules. Under these listing rules, a Public Report must

be prepared in accordance with the Code if it includes a statement on Exploration Results, Mineral Resources or Ore Reserves. The incorporation of the Code imposes certain specific requirements on mining or exploration companies reporting to the ASX and NZX. The 2004 edition of the Code has included much of the relevant material previously found only in the listing rules concerning the reporting of Exploration Results and the naming of the Competent Person. Despite the inclusion of this material in the Code it is strongly recommended that users of the Code familiarise themselves with those listing rules which relate to Public Reporting of Exploration Results, Mineral Resources and Ore Reserves.

The JORC Code requires the Competent Person(s), on whose work the Public Report of Exploration Results, Mineral Resources or Ore Reserves is based, to be named in the report. The report or attached statement must say that the person consents to the inclusion in the report of the matters based on their information in the form and context in which it appears, and must include the name of the person's firm or employer. Refer to Clause 8 of the Code.

SCOPE

4. The main principles governing the operation and application of the JORC Code are transparency, materiality and competence.
- **Transparency** requires that the reader of a Public Report is provided with sufficient information, the presentation of which is clear and unambiguous, to understand the report and is not misled.
 - **Materiality** requires that a Public Report contains all the relevant information which investors and their professional advisers would reasonably require, and reasonably expect to find in the report, for the purpose of making a reasoned and balanced judgement regarding the Exploration Results, Mineral Resources or Ore Reserves being reported.

Note: Code is in normal typeface, guidelines are in indented italics, definitions are in bold.

STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

- **Competence** requires that the Public Report be based on work that is the responsibility of suitably qualified and experienced persons who are subject to an enforceable professional code of ethics.
5. **Reference in the Code to a Public Report or Public Reporting is to a report or reporting on Exploration Results, Mineral Resources or Ore Reserves, prepared for the purpose of informing investors or potential investors and their advisers. This includes a report or reporting to satisfy regulatory requirements.**

The Code is a required minimum standard for Public Reporting. JORC also recommends its adoption as a minimum standard for other reporting. Companies are encouraged to provide information in their Public Reports which is as comprehensive as possible.

Public Reports include but are not limited to: company annual reports, quarterly reports and other reports to Australian and New Zealand Stock Exchanges, or as required by law. The Code applies to other publicly released company information in the form of postings on company web sites and briefings for shareholders, stockbrokers and investment analysts. The Code also applies to the following reports if they have been prepared for the purposes described in Clause 5: environmental statements; Information Memoranda; Expert Reports, and technical papers referring to Exploration Results, Mineral Resources or Ore Reserves.

For companies issuing concise annual reports, or other summary reports, inclusion of all material information relating to Exploration Results, Mineral Resources and Ore Reserves is recommended. In cases where summary information is presented it should be clearly stated that it is a summary, and a reference attached giving the location of the Code-compliant Public Reports or Public Reporting on which the summary is based.

It is recognised that companies can be required to issue reports into more than one regulatory jurisdiction, with compliance standards that may differ from this Code. It is recommended that such reports include a statement alerting the reader to this situation. Where members of The AusIMM and the AIG are required to report in other jurisdictions, they are obliged to comply with the requirements of those jurisdictions.

The term 'regulatory requirements' as used in Clause 5 is not intended to cover reports provided to State and Federal Government agencies for statutory purposes, where providing information to the investing public is not the primary intent. If such reports become available to the public, they would not

normally be regarded as Public Reports under the JORC Code (see also guidelines to Clauses 19 and 37).

Reference in the Code to 'documentation' is to internal company documents prepared as a basis for, or to support, a Public Report.

It is recognised that situations may arise where documentation prepared by Competent Persons for internal company or similar non-public purposes does not comply with the JORC Code. In such situations, it is recommended that the documentation includes a prominent statement to this effect. This will make it less likely that non-complying documentation will be used to compile Public Reports, since Clause 8 requires Public Reports to fairly reflect Exploration Results, Mineral Resource and/or Ore Reserve estimates, and supporting documentation, prepared by a Competent Person.

While every effort has been made within the Code and Guidelines to cover most situations likely to be encountered in Public Reporting, there may be occasions when doubt exists as to the appropriate form of disclosure. On such occasions, users of the Code and those compiling reports to comply with the Code should be guided by its intent, which is to provide a minimum standard for Public Reporting, and to ensure that such reporting contains all information which investors and their professional advisers would reasonably require, and reasonably expect to find in the report, for the purpose of making of a reasoned and balanced judgement regarding the Exploration Results, Mineral Resources or Ore Reserves being reported.

6. The Code is applicable to all solid minerals, including diamonds, other gemstones, industrial minerals and coal, for which Public Reporting of Exploration Results, Mineral Resources and Ore Reserves is required by the Australian and New Zealand Stock Exchanges.

The JORC Code is cited by the 'Code and Guidelines for Technical Assessment and/or Valuation of Mineral and Petroleum Assets and Mineral and Petroleum Securities for Independent Expert Reports' (the 'VALMIN Code') as the applicable standard for the public reporting of Exploration Results, Mineral Resources and Ore Reserves. References to 'technical and economic studies' and 'feasibility studies' in the JORC Code are not intended as references to Technical Assessments or Valuations as defined in the VALMIN Code.

7. JORC recognises that further review of the Code and Guidelines will be required from time to time.

Note: Code is in normal typeface, guidelines are in indented italics, definitions are in bold.

STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

COMPETENCE AND RESPONSIBILITY

8. A Public Report concerning a company's Exploration Results, Mineral Resources or Ore Reserves is the responsibility of the company acting through its Board of Directors. Any such report must be based on, and fairly reflect the information and supporting documentation prepared by a Competent Person or Persons. A company issuing a Public Report shall disclose the name(s) of the Competent Person or Persons, state whether the Competent Person is a full-time employee of the company, and, if not, name the Competent Person's employer. The report shall be issued with the written consent of the Competent Person or Persons as to the form and context in which it appears.

Appropriate forms of compliance statements may be as follows (delete bullet points which do not apply):

- *If the required information is in the report:*

"The information in this report that relates to Exploration Results, Mineral Resources or Ore Reserves is based on information compiled by (insert name of Competent Person), who is a Member or Fellow of The Australasian Institute of Mining and Metallurgy or the Australian Institute of Geoscientists or a 'Recognised Overseas Professional Organisation' ('ROPO') included in a list promulgated by the ASX from time to time (select as appropriate and if a ROPO insert name of ROPO)": or

- *If the required information is included in an attached statement:*

"The information in the report to which this statement is attached that relates to Exploration Results, Mineral Resources or Ore Reserves is based on information compiled by (insert name of Competent Person), who is a Member or Fellow of The Australasian Institute of Mining and Metallurgy or the Australian Institute of Geoscientists or a 'Recognised Overseas Professional Organisation' ('ROPO') included in a list promulgated by the ASX from time to time (select as appropriate and if a ROPO insert name of ROPO)".

- *If the Competent Person is a full-time employee of the company:*

"(Insert name of Competent Person) is a full-time employee of the company".

- *If the Competent Person is not a full-time employee of the company:*

"(Insert name of Competent Person) is employed by (insert name of Competent Person's employer)".

- *For all reports:*

"(Insert name of Competent Person) has sufficient experience which is relevant to the style of mineralisation and type of deposit under consideration

and to the activity which he (or she) is undertaking to qualify as a Competent Person as defined in the 2004 Edition of the 'Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves'. (Insert name of Competent Person) consents to the inclusion in the report of the matters based on his (or her) information in the form and context in which it appears".

9. Documentation detailing Exploration Results, Mineral Resource and Ore Reserve estimates, on which a Public Report on Exploration Results, Mineral Resources and Ore Reserves is based, must be prepared by, or under the direction of, and signed by, a Competent Person or Persons. The documentation must provide a fair representation of the Exploration Results, Mineral Resources or Ore Reserves being reported.

10. A 'Competent Person' is a person who is a Member or Fellow of The Australasian Institute of Mining and Metallurgy, or of the Australian Institute of Geoscientists, or of a 'Recognised Overseas Professional Organisation' ('ROPO') included in a list promulgated from time to time.

A 'Competent Person' must have a minimum of five years experience which is relevant to the style of mineralisation and type of deposit under consideration and to the activity which that person is undertaking.

If the Competent Person is preparing a report on Exploration Results, the relevant experience must be in exploration. If the Competent Person is estimating, or supervising the estimation of Mineral Resources, the relevant experience must be in the estimation, assessment and evaluation of Mineral Resources. If the Competent Person is estimating, or supervising the estimation of Ore Reserves, the relevant experience must be in the estimation, assessment, evaluation and economic extraction of Ore Reserves.

The key qualifier in the definition of a Competent Person is the word 'relevant'. Determination of what constitutes relevant experience can be a difficult area and common sense has to be exercised. For example, in estimating Mineral Resources for vein gold mineralisation, experience in a high-nugget, vein-type mineralisation such as tin, uranium etc. will probably be relevant whereas experience in (say) massive base metal deposits may not be. As a second example, to qualify as a Competent Person in the estimation of Ore Reserves for alluvial gold deposits, considerable (probably at least five years) experience in the evaluation and economic extraction of this type of mineralisation would be needed. This is due to the characteristics of gold in alluvial systems, the particle sizing of the host sediment, and the low grades involved. Experience with placer deposits containing minerals other than gold may not necessarily provide appropriate relevant experience.

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

The key word 'relevant' also means that it is not always necessary for a person to have five years experience in each and every type of deposit in order to act as a Competent Person if that person has relevant experience in other deposit types. For example, a person with (say) 20 years experience in estimating Mineral Resources for a variety of metalliferous hard-rock deposit types may not require five years specific experience in (say) porphyry copper deposits in order to act as a Competent Person. Relevant experience in the other deposit types could count towards the required experience in relation to porphyry copper deposits.

In addition to experience in the style of mineralisation, a Competent Person taking responsibility for the compilation of Exploration Results or Mineral Resource estimates should have sufficient experience in the sampling and analytical techniques relevant to the deposit under consideration to be aware of problems which could affect the reliability of data. Some appreciation of extraction and processing techniques applicable to that deposit type may also be important.

As a general guide, persons being called upon to act as Competent Persons should be clearly satisfied in their own minds that they could face their peers and demonstrate competence in the commodity, type of deposit and situation under consideration. If doubt exists, the person should either seek opinions from appropriately experienced colleagues or should decline to act as a Competent Person.

Estimation of Mineral Resources may be a team effort (for example, involving one person or team collecting

the data and another person or team preparing the estimate). Estimation of Ore Reserves is very commonly a team effort involving several technical disciplines. It is recommended that, where there is clear division of responsibility within a team, each Competent Person and his or her contribution should be identified, and responsibility accepted for that particular contribution. If only one Competent Person signs the Mineral Resource or Ore Reserve documentation, that person is responsible and accountable for the whole of the documentation under the Code. It is important in this situation that the Competent Person accepting overall responsibility for a Mineral Resource or Ore Reserve estimate and supporting documentation prepared in whole or in part by others, is satisfied that the work of the other contributors is acceptable.

Complaints made in respect of the professional work of a Competent Person will be dealt with under the disciplinary procedures of the professional organisation to which the Competent Person belongs.

When an Australian or New Zealand Stock Exchange listed company with overseas interests wishes to report overseas Exploration Results, Mineral Resource or Ore Reserve estimates prepared by a person who is not a member of The AusIMM, the AIG or a ROPO, it is necessary for the company to nominate a Competent Person or Persons to take responsibility for the Exploration Results, Mineral Resource or Ore Reserve estimate. The Competent Person or Persons undertaking this activity should appreciate that they are accepting full responsibility for the estimate and supporting documentation under Stock Exchange listing rules and should not treat the procedure merely as a 'rubber-stamping' exercise.

REPORTING TERMINOLOGY

11. Public Reports dealing with Exploration Results, Mineral Resources or Ore Reserves must only use the terms set out in Figure 1.

The term 'Modifying Factors' is defined to include mining, metallurgical, economic, marketing, legal, environmental, social and governmental considerations.

Figure 1 sets out the framework for classifying tonnage and grade estimates to reflect different levels of geological confidence and different degrees of technical and economic evaluation. Mineral Resources can be estimated mainly by a geologist on the basis of geoscientific information with some input from other disciplines. Ore Reserves, which are a modified sub-set of the Indicated and Measured Mineral Resources (shown within the dashed outline in Figure 1), require consideration of the Modifying Factors affecting extraction, and

should in most instances be estimated with input from a range of disciplines.

Measured Mineral Resources may convert to either Proved Ore Reserves or Probable Ore Reserves. The Competent Person may convert Measured Mineral Resources to Probable Ore Reserves because of uncertainties associated with some or all of the Modifying Factors which are taken into account in the conversion from Mineral Resources to Ore Reserves. This relationship is shown by the broken arrow in Figure 1. Although the trend of the broken arrow includes a vertical component, it does not, in this instance, imply a reduction in the level of geological knowledge or confidence. In such a situation these Modifying Factors should be fully explained.

Refer also to the guidelines to Clause 31.

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THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

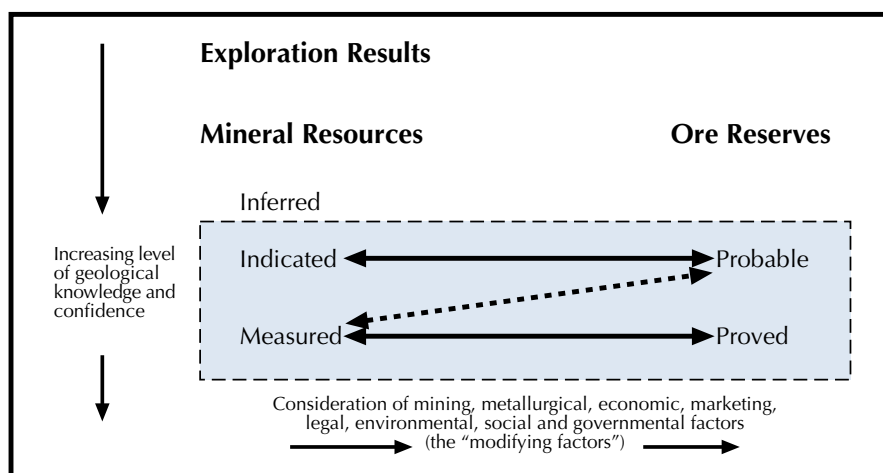


Figure 1. General relationship between Exploration Results, Mineral Resources and Ore Reserves

REPORTING – GENERAL

12. Public Reports concerning a company's Exploration Results, Mineral Resources or Ore Reserves should include a description of the style and nature of the mineralisation.
13. A company must disclose any relevant information concerning a mineral deposit that could materially influence the economic value of that deposit to the company. A company must promptly report any material changes in its Mineral Resources or Ore Reserves.
14. Companies must review and publicly report on their Mineral Resources and Ore Reserves at least annually.
15. Throughout the Code, if appropriate, 'quality' may be substituted for 'grade' and 'volume' may be substituted for 'tonnage'. (Refer Appendix 1 – Table of Generic Terms and Equivalents).

REPORTING OF EXPLORATION RESULTS

16. **Exploration Results include data and information generated by exploration programmes that may be of use to investors. The Exploration Results may or may not be part of a formal declaration of Mineral Resources or Ore Reserves.**

The reporting of such information is common in the early stages of exploration when the quantity of data available is generally not sufficient to allow any reasonable estimates of Mineral Resources.

If a company reports Exploration Results in relation to mineralisation not classified as a Mineral Resource or an Ore Reserve, then estimates of tonnages and average grade must not be assigned to the mineralisation unless the situation is covered by Clause 18, and then only in strict accordance with the requirements of that clause.

Examples of Exploration Results include results of outcrop sampling, assays of drill hole intercepts, geochemical results and geophysical survey results.

17. Public Reports of Exploration Results must contain sufficient information to allow a considered and balanced

judgement of their significance. Reports must include relevant information such as exploration context, type and method of sampling, sampling intervals and methods, relevant sample locations, distribution, dimensions and relative location of all relevant assay data, data aggregation methods, land tenure status plus information on any of the other criteria listed in Table 1 that are material to an assessment.

Public Reports of Exploration Results must not be presented so as to unreasonably imply that potentially economic mineralisation has been discovered. If true widths of mineralisation are not reported, an appropriate qualification must be included in the Public Report.

Where assay and analytical results are reported, they must be reported using one of the following methods, selected as the most appropriate by the Competent Person:

- either by listing all results, along with sample intervals (or size, in the case of bulk samples), or
- by reporting weighted average grades of mineralised zones, indicating clearly how the grades were calculated.

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THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

Reporting of selected information such as isolated assays, isolated drill holes, assays of panned concentrates or supergene enriched soils or surface samples, without placing them in perspective is unacceptable.

Table 1 is a check list and guideline to which those preparing reports on Exploration Results, Mineral Resources and Ore Reserves should refer. The check list is not prescriptive and, as always, relevance and materiality are overriding principles which determine what information should be publicly reported.

18. It is recognised that it is common practice for a company to comment on and discuss its exploration in terms of

target size and type. Any such information relating to exploration targets must be expressed so that it cannot be misrepresented or misconstrued as an estimate of Mineral Resources or Ore Reserves. The terms Resource(s) or Reserve(s) must not be used in this context. Any statement referring to potential quantity and grade of the target must be expressed as ranges and must include (1) a detailed explanation of the basis for the statement, and (2) a proximate statement that the potential quantity and grade is conceptual in nature, that there has been insufficient exploration to define a Mineral Resource and that it is uncertain if further exploration will result in the determination of a Mineral Resource.

REPORTING OF MINERAL RESOURCES

19. A 'Mineral Resource' is a concentration or occurrence of material of intrinsic economic interest in or on the Earth's crust in such form, quality and quantity that there are reasonable prospects for eventual economic extraction. The location, quantity, grade, geological characteristics and continuity of a Mineral Resource are known, estimated or interpreted from specific geological evidence and knowledge. Mineral Resources are sub-divided, in order of increasing geological confidence, into Inferred, Indicated and Measured categories.

Portions of a deposit that do not have reasonable prospects for eventual economic extraction must not be included in a Mineral Resource. If the judgement as to 'eventual economic extraction' relies on untested practices or assumptions, this is a material matter which must be disclosed in a public report.

The term 'Mineral Resource' covers mineralisation, including dumps and tailings, which has been identified and estimated through exploration and sampling and within which Ore Reserves may be defined by the consideration and application of the Modifying Factors.

The term 'reasonable prospects for eventual economic extraction' implies a judgement (albeit preliminary) by the Competent Person in respect of the technical and economic factors likely to influence the prospect of economic extraction, including the approximate mining parameters. In other words, a Mineral Resource is not an inventory of all mineralisation drilled or sampled, regardless of cut-off grade, likely mining dimensions, location or continuity. It is a realistic inventory of mineralisation which, under assumed and justifiable technical and economic conditions, might, in whole or in part, become economically extractable.

Where considered appropriate by the Competent Person, Mineral Resource estimates may include material below the selected cut-off grade to ensure

that the Mineral Resources comprise bodies of mineralisation of adequate size and continuity to properly consider the most appropriate approach to mining. Documentation of Mineral Resource estimates should clearly identify any diluting material included, and Public Reports should include commentary on the matter if considered material.

Any material assumptions made in determining the 'reasonable prospects for eventual economic extraction' should be clearly stated in the Public Report.

Interpretation of the word 'eventual' in this context may vary depending on the commodity or mineral involved. For example, for some coal, iron ore, bauxite and other bulk minerals or commodities, it may be reasonable to envisage 'eventual economic extraction' as covering time periods in excess of 50 years. However for the majority of gold deposits, application of the concept would normally be restricted to perhaps 10 to 15 years, and frequently to much shorter periods of time.

Any adjustment made to the data for the purpose of making the Mineral Resource estimate, for example by cutting or factoring grades, should be clearly stated and described in the Public Report.

Certain reports (eg: inventory coal reports, exploration reports to government and other similar reports not intended primarily for providing information for investment purposes) may require full disclosure of all mineralisation, including some material that does not have reasonable prospects for eventual economic extraction. Such estimates of mineralisation would not qualify as Mineral Resources or Ore Reserves in terms of the JORC Code (refer also to the guidelines to Clauses 5 and 37).

20. An 'Inferred Mineral Resource' is that part of a Mineral Resource for which tonnage, grade and mineral content can be estimated with a low level of confidence. It is inferred from geological evidence and assumed but not

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

verified geological and/or grade continuity. It is based on information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes which may be limited or of uncertain quality and reliability.

An Inferred Mineral Resource has a lower level of confidence than that applying to an Indicated Mineral Resource.

The Inferred category is intended to cover situations where a mineral concentration or occurrence has been identified and limited measurements and sampling completed, but where the data are insufficient to allow the geological and/or grade continuity to be confidently interpreted. Commonly, it would be reasonable to expect that the majority of Inferred Mineral Resources would upgrade to Indicated Mineral Resources with continued exploration. However, due to the uncertainty of Inferred Mineral Resources, it should not be assumed that such upgrading will always occur.

Confidence in the estimate of Inferred Mineral Resources is usually not sufficient to allow the results of the application of technical and economic parameters to be used for detailed planning. For this reason, there is no direct link from an Inferred Resource to any category of Ore Reserves (see Figure 1).

Caution should be exercised if this category is considered in technical and economic studies.

21. **An 'Indicated Mineral Resource' is that part of a Mineral Resource for which tonnage, densities, shape, physical characteristics, grade and mineral content can be estimated with a reasonable level of confidence. It is based on exploration, sampling and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes. The locations are too widely or inappropriately spaced to confirm geological and/or grade continuity but are spaced closely enough for continuity to be assumed.**

An Indicated Mineral Resource has a lower level of confidence than that applying to a Measured Mineral Resource, but has a higher level of confidence than that applying to an Inferred Mineral Resource.

Mineralisation may be classified as an Indicated Mineral Resource when the nature, quality, amount and distribution of data are such as to allow confident interpretation of the geological framework and to assume continuity of mineralisation.

Confidence in the estimate is sufficient to allow the application of technical and economic parameters, and to enable an evaluation of economic viability.

22. **A 'Measured Mineral Resource' is that part of a Mineral Resource for which tonnage, densities, shape, physical characteristics, grade and mineral content can be**

estimated with a high level of confidence. It is based on detailed and reliable exploration, sampling and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes. The locations are spaced closely enough to confirm geological and grade continuity.

Mineralisation may be classified as a Measured Mineral Resource when the nature, quality, amount and distribution of data are such as to leave no reasonable doubt, in the opinion of the Competent Person determining the Mineral Resource, that the tonnage and grade of the mineralisation can be estimated to within close limits, and that any variation from the estimate would be unlikely to significantly affect potential economic viability.

This category requires a high level of confidence in, and understanding of, the geology and controls of the mineral deposit.

Confidence in the estimate is sufficient to allow the application of technical and economic parameters and to enable an evaluation of economic viability that has a greater degree of certainty than an evaluation based on an Indicated Mineral Resource.

23. The choice of the appropriate category of Mineral Resource depends upon the quantity, distribution and quality of data available and the level of confidence that attaches to those data. The appropriate Mineral Resource category must be determined by a Competent Person or Persons.

Mineral Resource classification is a matter for skilled judgement and Competent Persons should take into account those items in Table 1 which relate to confidence in Mineral Resource estimation.

In deciding between Measured Mineral Resources and Indicated Mineral Resources, Competent Persons may find it useful to consider, in addition to the phrases in the two definitions relating to geological and grade continuity in Clauses 21 and 22, the phrase in the guideline to the definition for Measured Mineral Resources: '... any variation from the estimate would be unlikely to significantly affect potential economic viability'.

In deciding between Indicated Mineral Resources and Inferred Mineral Resources, Competent Persons may wish to take into account, in addition to the phrases in the two definitions in Clauses 20 and 21 relating to geological and grade continuity, the guideline to the definition for Indicated Mineral Resources: 'Confidence in the estimate is sufficient to allow the application of technical and economic parameters and to enable an evaluation of economic viability', which contrasts with the guideline to the definition for Inferred Mineral Resources: 'Confidence in the estimate of Inferred Mineral Resources is usually not sufficient to allow the results

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

of the application of technical and economic parameters to be used for detailed planning.’ and ‘Caution should be exercised if this category is considered in technical and economic studies’.

The Competent Person should take into consideration issues of the style of mineralisation and cut-off grade when assessing geological and grade continuity.

Cut-off grades chosen for the estimation should be realistic in relation to the style of mineralisation.

24. Mineral Resource estimates are not precise calculations, being dependent on the interpretation of limited information on the location, shape and continuity of the occurrence and on the available sampling results. Reporting of tonnage and grade figures should reflect the relative uncertainty of the estimate by rounding off to appropriately significant figures and, in the case of Inferred Mineral Resources, by qualification with terms such as ‘approximately’.

In most situations, rounding to the second significant figure should be sufficient. For example 10,863,000 tonnes at 8.23 per cent should be stated as 11 million tonnes at 8.2 per cent. There will be occasions, however, where rounding to the first significant figure may be necessary in order to convey properly the uncertainties in estimation. This would usually be the case with Inferred Mineral Resources.

To emphasise the imprecise nature of a Mineral Resource estimate, the final result should always be referred to as an estimate not a calculation.

Competent Persons are encouraged, where appropriate, to discuss the relative accuracy and/or confidence of the Mineral Resource estimates. The statement should specify whether it relates to global or local estimates, and, if local, state the relevant tonnage or volume. Where a statement of the relative accuracy and/or confidence is not possible, a qualitative discussion of the uncertainties should be provided (refer to Table 1).

25. Public Reports of Mineral Resources must specify one or more of the categories of ‘Inferred’, ‘Indicated’ and ‘Measured’. Categories must not be reported in a combined form unless details for the individual categories are also provided. Mineral Resources must not be reported in terms of contained metal or mineral content unless corresponding tonnages and grades are also presented. Mineral Resources must not be aggregated with Ore Reserves.

Public Reporting of tonnages and grades outside the categories covered by the Code is not permitted unless the situation is covered by Clause 18, and then only in strict accordance with the requirements of that clause.

Estimates of tonnage and grade outside of the categories covered by the Code may be useful for a

company in its internal calculations and evaluation processes, but their inclusion in Public Reports could cause confusion.

26. Table 1 provides, in a summary form, a list of the main criteria which should be considered when preparing reports on Exploration Results, Mineral Resources and Ore Reserves. These criteria need not be discussed in a Public Report unless they materially affect estimation or classification of the Mineral Resources.

It is not necessary, when publicly reporting, to comment on each item in Table 1, but it is essential to discuss any matters which might materially affect the reader’s understanding or interpretation of the results or estimates being reported. This is particularly important where inadequate or uncertain data affect the reliability of, or confidence in, a statement of Exploration Results or an estimate of Mineral Resources or Ore Reserves; for example, poor sample recovery, poor repeatability of assay or laboratory results, limited information on bulk densities etc.

If there is doubt about what should be reported, it is better to err on the side of providing too much information rather than too little.

Uncertainties in any of the criteria listed in Table 1 that could lead to under- or over-statement of resources should be disclosed.

Mineral Resource estimates are sometimes reported after adjustment from reconciliation with production data. Such adjustments should be clearly stated in a Public Report of Mineral Resources and the nature of the adjustment or modification described.

27. The words ‘ore’ and ‘reserves’ must not be used in describing Mineral Resource estimates as the terms imply technical feasibility and economic viability and are only appropriate when all relevant Modifying Factors have been considered. Reports and statements should continue to refer to the appropriate category or categories of Mineral Resources until technical feasibility and economic viability have been established. If re-evaluation indicates that the Ore Reserves are no longer viable, the Ore Reserves must be reclassified as Mineral Resources or removed from Mineral Resource/Ore Reserve statements.

It is not intended that re-classification from Ore Reserves to Mineral Resources or vice versa should be applied as a result of changes expected to be of a short term or temporary nature, or where company management has made a deliberate decision to operate on a non-economic basis. Examples of such situations might be commodity price fluctuations expected to be of short duration, mine emergency of a non-permanent nature, transport strike etc.

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REPORTING OF ORE RESERVES

28. An 'Ore Reserve' is the economically mineable part of a Measured and/or Indicated Mineral Resource. It includes diluting materials and allowances for losses, which may occur when the material is mined. Appropriate assessments and studies have been carried out, and include consideration of and modification by realistically assumed mining, metallurgical, economic, marketing, legal, environmental, social and governmental factors. These assessments demonstrate at the time of reporting that extraction could reasonably be justified. Ore Reserves are sub-divided in order of increasing confidence into Probable Ore Reserves and Proved Ore Reserves.

In reporting Ore Reserves, information on estimated mineral processing recovery factors is very important, and should always be included in Public Reports.

Ore Reserves are those portions of Mineral Resources which, after the application of all mining factors, result in an estimated tonnage and grade which, in the opinion of the Competent Person making the estimates, can be the basis of a viable project, after taking account of all relevant Modifying Factors.

Ore Reserves are reported as inclusive of marginally economic material and diluting material delivered for treatment or dispatched from the mine without treatment.

The term 'economically mineable' implies that extraction of the Ore Reserve has been demonstrated to be viable under reasonable financial assumptions. What constitutes the term 'realistically assumed' will vary with the type of deposit, the level of study that has been carried out and the financial criteria of the individual company. For this reason, there can be no fixed definition for the term 'economically mineable'.

In order to achieve the required level of confidence in the Modifying Factors, appropriate studies will have been carried out prior to determination of the Ore Reserves. The studies will have determined a mine plan that is technically achievable and economically viable and from which the Ore Reserves can be derived. It may not be necessary for these studies to be at the level of a final feasibility study.

The term 'Ore Reserve' need not necessarily signify that extraction facilities are in place or operative, or that all necessary approvals or sales contracts have been received. It does signify that there are reasonable expectations of such approvals or contracts. The Competent Person should consider the materiality of any unresolved matter that is dependent on a third party on which extraction is contingent. If there is doubt about what should be reported, it is better to err on the side of providing too much information rather than too little.

Any adjustment made to the data for the purpose of making the Ore Reserve estimate, for example by cutting or factoring grades, should be clearly stated and described in the Public Report.

Where companies prefer to use the term 'Mineral Reserves' in their Public Reports, e.g. for reporting industrial minerals or for reporting outside Australasia, they should state clearly that this is being used with the same meaning as 'Ore Reserves', defined in this Code. If preferred by the reporting company, 'Ore Reserve' and 'Mineral Resource' estimates for coal may be reported as 'Coal Reserve' and 'Coal Resource' estimates.

JORC prefers the term 'Ore Reserve' because it assists in maintaining a clear distinction between a 'Mineral Resource' and an 'Ore Reserve'.

29. A 'Probable Ore Reserve' is the economically mineable part of an Indicated, and in some circumstances, a Measured Mineral Resource. It includes diluting materials and allowances for losses which may occur when the material is mined. Appropriate assessments and studies have been carried out, and include consideration of and modification by realistically assumed mining, metallurgical, economic, marketing, legal, environmental, social and governmental factors. These assessments demonstrate at the time of reporting that extraction could reasonably be justified.

A Probable Ore Reserve has a lower level of confidence than a Proved Ore Reserve but is of sufficient quality to serve as the basis for a decision on the development of the deposit.

30. A 'Proved Ore Reserve' is the economically mineable part of a Measured Mineral Resource. It includes diluting materials and allowances for losses which may occur when the material is mined. Appropriate assessments and studies have been carried out, and include consideration of and modification by realistically assumed mining, metallurgical, economic, marketing, legal, environmental, social and governmental factors. These assessments demonstrate at the time of reporting that extraction could reasonably be justified.

A Proved Ore Reserve represents the highest confidence category of reserve estimate. The style of mineralisation or other factors could mean that Proved Ore Reserves are not achievable in some deposits.

31. The choice of the appropriate category of Ore Reserve is determined primarily by the relevant level of confidence in the Mineral Resource and after considering any uncertainties in the Modifying Factors. Allocation of the appropriate category must be made by a Competent Person or Persons.

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THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

The Code provides for a direct two-way relationship between Indicated Mineral Resources and Probable Ore Reserves and between Measured Mineral Resources and Proved Ore Reserves. In other words, the level of geological confidence for Probable Ore Reserves is similar to that required for the determination of Indicated Mineral Resources, and the level of geological confidence for Proved Ore Reserves is similar to that required for the determination of Measured Mineral Resources.

The Code also provides for a two-way relationship between Measured Mineral Resources and Probable Ore Reserves. This is to cover a situation where uncertainties associated with any of the Modifying Factors considered when converting Mineral Resources to Ore Reserves may result in there being a lower degree of confidence in the Ore Reserves than in the corresponding Mineral Resources. Such a conversion would not imply a reduction in the level of geological knowledge or confidence.

A Probable Ore Reserve derived from a Measured Mineral Resource may be converted to a Proved Ore Reserve if the uncertainties in the Modifying Factors are removed. No amount of confidence in the Modifying Factors for conversion of a Mineral Resource to an Ore Reserve can override the upper level of confidence that exists in the Mineral Resource. Under no circumstances can an Indicated Mineral Resource be converted directly to a Proved Ore Reserve (see Figure 1).

Application of the category of Proved Ore Reserve implies the highest degree of confidence in the estimate, with consequent expectations in the minds of the readers of the report. These expectations should be borne in mind when categorising a Mineral Resource as Measured.

Refer also to the guidelines in Clause 23 regarding classification of Mineral Resources.

32. Ore Reserve estimates are not precise calculations. Reporting of tonnage and grade figures should reflect the relative uncertainty of the estimate by rounding off to appropriately significant figures. Refer also to Clause 24.

To emphasise the imprecise nature of an Ore Reserve, the final result should always be referred to as an estimate not a calculation.

Competent Persons are encouraged, where appropriate, to discuss the relative accuracy and/or confidence of the Ore Reserve estimates. The statement should specify whether it relates to global or local estimates, and, if local, state the relevant tonnage or volume. Where a statement of the relative accuracy and/or confidence is not possible, a qualitative discussion of the uncertainties should be provided (refer to Table 1).

33. Public Reports of Ore Reserves must specify one or other or both of the categories of 'Proved' and 'Probable'. Reports must not contain combined Proved and Probable Ore Reserve figures unless the relevant figures for each of the categories are also provided. Reports must not present metal or mineral content figures unless corresponding tonnage and grade figures are also given.

Public Reporting of tonnage and grade outside the categories covered by the Code is not permitted unless the situation is covered by Clause 18, and then only in strict accordance with the requirements of that clause.

Estimates of tonnage and grade outside of the categories covered by the Code may be useful for a company in its internal calculations and evaluation processes, but their inclusion in Public Reports could cause confusion.

Ore Reserves may incorporate material (dilution) which is not part of the original Mineral Resource. It is essential that this fundamental difference between Mineral Resources and Ore Reserves is borne in mind and caution exercised if attempting to draw conclusions from a comparison of the two.

When revised Ore Reserve and Mineral Resource statements are publicly reported they should be accompanied by reconciliation with previous statements. A detailed account of differences between the figures is not essential, but sufficient comment should be made to enable significant changes to be understood by the reader.

34. In situations where figures for both Mineral Resources and Ore Reserves are reported, a statement must be included in the report which clearly indicates whether the Mineral Resources are inclusive of, or additional to the Ore Reserves.

Ore Reserve estimates must not be aggregated with Mineral Resource estimates to report a single combined figure.

In some situations there are reasons for reporting Mineral Resources inclusive of Ore Reserves and in other situations for reporting Mineral Resources additional to Ore Reserves. It must be made clear which form of reporting has been adopted. Appropriate forms of clarifying statements may be:

'The Measured and Indicated Mineral Resources are inclusive of those Mineral Resources modified to produce the Ore Reserves,' or 'The Measured and Indicated Mineral Resources are additional to the Ore Reserves.'

In the former case, if any Measured and Indicated Mineral Resources have not been modified to produce Ore Reserves for economic or other reasons, the relevant details of these unmodified Mineral Resources should be included in the report. This is

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

to assist the reader of the report in making a judgement of the likelihood of the unmodified Measured and Indicated Mineral Resources eventually being converted to Ore Reserves.

Inferred Mineral Resources are by definition always additional to Ore Reserves.

For reasons stated in the guidelines to Clause 33 and in this paragraph, the reported Ore Reserve figures must not be aggregated with the reported Mineral Resource figures. The resulting total is misleading and is capable of being misunderstood or of being misused to give a false impression of a company's prospects.

35. Table 1 provides, in a summary form, a list of the criteria which should be considered when preparing reports on Exploration Results, Mineral Resources and Ore Reserves. These criteria need not be discussed in a Public Report unless they materially affect estimation or classification of the Ore Reserves. Changes in economic or political factors alone may be the basis for significant changes in Ore Reserves and should be reported accordingly.

Ore Reserve estimates are sometimes reported after adjustment from reconciliation with production data. Such adjustments should be clearly stated in a Public Report of Ore Reserves and the nature of the adjustment or modification described.

REPORTING OF MINERALISED FILL, REMNANTS, PILLARS, LOW GRADE MINERALISATION, STOCKPILES, DUMPS AND TAILINGS

36. The Code applies to the reporting of all potentially economic mineralised material. This can include mineralised fill, remnants, pillars, low grade mineralisation, stockpiles, dumps and tailings (remnant materials) where there are reasonable prospects for eventual economic extraction in the case of Mineral Resources, and where extraction is reasonably justifiable in the case of Ore Reserves. Unless otherwise stated, all other clauses of the Code (including Figure 1) apply.

Any mineralised material as described in this clause can be considered to be similar to in situ mineralisation for the purposes of reporting Mineral Resources and Ore Reserves. Judgements about the mineability of such mineralised material should be made by professionals with relevant experience.

If there are no reasonable prospects for the eventual economic extraction of all or part of the mineralised material as described in this clause, then this material cannot be classified as either Mineral Resources or Ore Reserves. If some portion of the mineralised material is currently sub-economic, but there is a reasonable expectation that it will become

economic, then this material may be classified as a Mineral Resource. If technical and economic studies have demonstrated that economic extraction could reasonably be justified under realistically assumed conditions, then the material may be classified as an Ore Reserve.

The above guidelines apply equally to low grade in situ mineralisation, sometimes referred to as 'mineralised waste' or 'marginal grade material', and often intended for stockpiling and treatment towards the end of mine life. For clarity of understanding, it is recommended that tonnage and grade estimates of such material be itemised separately in Public Reports, although they may be aggregated with total Mineral Resource and Ore Reserve figures.

Stockpiles are defined to include both surface and underground stockpiles, including broken ore in stopes, and can include ore currently in the ore storage system. Mineralised material in the course of being processed (including leaching), if reported, should be reported separately.

REPORTING OF COAL RESOURCES AND RESERVES

37. Clauses 37 to 39 of the Code address matters that relate specifically to the Public Reporting of Coal Resources and Reserves. Unless otherwise stated, Clauses 1 to 36 of this Code (including Figure 1) apply. Table 1, as part of the guidelines, should be considered persuasive when reporting on Coal Resources and Reserves.

For purposes of Public Reporting, the requirements for coal are generally similar to those for other commodities with the replacement of terms such as 'mineral' by 'coal' and 'grade' by 'quality'.

For guidance on the estimation of Coal Resources and Reserves and on statutory reporting not primarily

intended for providing information to the investing public, readers are referred to the 2003 edition of the 'Australian Guidelines for Estimating and Reporting of Inventory Coal, Coal Resources and Coal Reserves'. These guidelines do not override the provisions and intentions of the JORC Code for Public Reporting.

Because of its impact on planning and land use, governments may require estimates of inventory coal that are not constrained by short to medium term economic considerations. The JORC Code does not cover such estimates. Refer also to the guidelines to Clauses 5 and 19.

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THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

38. The terms 'Mineral Resource(s)' and 'Ore Reserve(s)', and the subdivisions of these as defined above, apply also to coal reporting, but if preferred by the reporting company, the terms 'Coal Resource(s)' and 'Coal Reserve(s)' and the appropriate subdivisions may be substituted.
39. 'Marketable Coal Reserves', representing beneficiated or otherwise enhanced coal product where modifications due to mining, dilution and processing have been considered, may be publicly reported in conjunction with, but not instead of, reports of Ore (Coal) Reserves. The basis of the predicted yield to achieve Marketable Coal Reserves should be stated.

REPORTING OF DIAMOND EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES

40. Clauses 40 to 43 of the Code address matters that relate specifically to the Public Reporting of Exploration Results, Mineral Resources and Ore Reserves for diamonds and other gemstones. Unless otherwise stated, Clauses 1 to 36 of this Code (including Figure 1) apply. Table 1, as part of the guidelines, should be considered persuasive when reporting Exploration Results, Mineral Resources and Ore Reserves for diamonds and other gemstones.

For the purposes of Public Reporting, the requirements for diamonds and other gemstones are generally similar to those for other commodities with the replacement of terms such as 'mineral' by 'diamond' and 'grade' by 'grade and average diamond value'. The term 'quality' should not be substituted for 'grade,' since in diamond deposits these have distinctly separate meanings. Other industry guidelines on the estimation and reporting of diamond resources and reserves may be useful but will not under any circumstances override the provisions and intentions of the JORC Code.

A number of characteristics of diamond deposits are different from those of, for example, typical metalliferous and coal deposits and therefore require special consideration. These include the generally low mineral content and variability of primary and placer deposits, the particulate nature of diamonds, the specialised requirement for diamond valuation and the inherent difficulties and uncertainties in the estimation of diamond resources and reserves.

41. Reports of diamonds recovered from sampling programs must provide material information relating to the basis on which the sample is taken, the method of recovery and the recovery of the diamonds. The weight of diamonds recovered may only be omitted from the report when the diamonds are considered to be too small to be of commercial significance. This lower cut-off size should be stated.

The stone size distribution and price of diamonds and other gemstones are critical components of the resource and reserve estimates. At an early exploration stage, sampling and delineation drilling will not usually provide this information, which relies on large diameter drilling and, in particular, bulk sampling.

In order to demonstrate that a resource has reasonable prospects for economic extraction, some appreciation of the likely stone size distribution and price is necessary, however preliminary. To determine an Inferred Resource in simple, single-facies or single-phase deposits, such information may be obtainable by representative large diameter drilling. More often, some form of bulk sampling, such as pitting and trenching, would be employed to provide larger sample parcels.

In order to progress to an Indicated Resource, and from there to a Probable Reserve, it is likely that much more extensive bulk sampling would be needed to fully determine the stone size distribution and value. Commonly such bulk samples would be obtained by underground development designed to obtain sufficient diamonds to enable a confident estimate of price.

In complex deposits, it may be very difficult to ensure that the bulk samples taken are truly representative of the whole deposit. The lack of direct bulk sampling, and the uncertainty in demonstrating spatial continuity of size and price relationships should be persuasive in determining the appropriate resource category.

42. Where diamond Mineral Resource or Ore Reserve grades (carats per tonne) are based on correlations between the frequency of occurrence of micro-diamonds and of commercial size stones, this must be stated, the reliability of the procedure must be explained and the cut-off sieve size for micro-diamonds reported.

43. For Public Reports dealing with diamond or other gemstone mineralisation, it is a requirement that any reported valuation of a parcel of diamonds or gemstones be accompanied by a statement verifying the independence of the valuation. The valuation must be based on a report from a demonstrably reputable and qualified expert.

If a valuation of a parcel of diamonds is reported, the weight in carats and the lower cut-off size of the contained diamonds must be stated and the value of the diamonds must be given in US dollars per carat. Where the valuation is used in the estimation of diamond Mineral Resources or Ore Reserves, the valuation must be based on a parcel representative of the size, shape

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

and colour distributions of the diamond population in the deposit.

Diamond valuations should not be reported for samples of diamonds processed using total liberation methods.

Table 1 provides in summary form, a list of the main criteria which should be considered when preparing reports on Exploration Results, Mineral Resources and Ore Reserves for diamonds and other gemstones.

REPORTING OF INDUSTRIAL MINERALS EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES

44. Industrial minerals are covered by the JORC Code if they meet the criteria set out in Clauses 5 and 6 of the Code. For the purpose of the JORC Code, industrial minerals can be considered to cover commodities such as kaolin, phosphate, limestone, talc etc.

When reporting information and estimates for industrial minerals, the key principles and purpose of the JORC Code apply and should be borne in mind. Assays may not always be relevant, and other quality criteria may be more applicable. If criteria such as deleterious minerals or physical properties are of more relevance than the composition of the bulk mineral itself, then they should be reported accordingly.

The factors underpinning the estimation of Mineral Resources and Ore Reserves for industrial minerals are the same as those for other deposit types covered by the JORC Code. It may be necessary, prior to the reporting of a Mineral Resource or Ore Reserve, to take particular account of certain key characteristics or qualities such as likely product specifications,

proximity to markets and general product marketability.

For some industrial minerals, it is common practice to report the saleable product rather than the 'as-mined' product, which is traditionally regarded as the Ore Reserve. JORC's preference is that, if the saleable product is reported, it should be in conjunction with, not instead of, reporting of the Ore Reserve. However, it is recognised that commercial sensitivities may not always permit this preferred style of reporting. It is important that, in all situations where the saleable product is reported, a clarifying statement is included to ensure that the reader is fully informed as to what is being reported.

Some industrial mineral deposits may be capable of yielding products suitable for more than one application and/or specification. If considered material by the reporting company, such multiple products should be quantified either separately or as a percentage of the bulk deposit.

TABLE 1 CHECK LIST OF ASSESSMENT AND REPORTING CRITERIA

Table 1 is a check list and guideline which those preparing reports on Exploration Results, Mineral Resources and Ore Reserves should use as a reference. The check list is not prescriptive and, as always, relevance and materiality are overriding principles that determine what information should be publicly reported. It is, however, important to report any matters that might materially affect a reader's understanding or interpretation of the results or estimates being reported. This is particularly important where inadequate or uncertain data affect the reliability of, or confidence in, a statement of Exploration Results or an estimate of Mineral Resources or Ore Reserves.

The order and grouping of criteria in Table 1 reflects the normal systematic approach to exploration and evaluation. Criteria in the first group 'Sampling Techniques and Data' apply to all succeeding groups. In the remainder of the table, criteria listed in preceding groups would often apply to succeeding groups and should be considered when estimating and reporting.

Criteria	Explanation
Sampling Techniques and Data <i>(criteria in this group apply to all succeeding groups)</i>	
Sampling techniques.	Nature and quality of sampling (eg. cut channels, random chips etc.) and measures taken to ensure sample representativity.
Drilling techniques.	Drill type (eg. core, reverse circulation, open-hole hammer, rotary air blast, auger, Bangka etc.) and details (eg. core diameter, triple or standard tube, depth of diamond tails, face-sampling bit or other type, whether core is oriented and if so, by what method, etc.).

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

Criteria	Explanation
Sampling Techniques and Data (criteria in this group apply to all succeeding groups)	
<i>Drill sample recovery.</i>	• Whether core and chip sample recoveries have been properly recorded and results assessed. • Measures taken to maximise sample recovery and ensure representative nature of the samples. • Whether a relationship exists between sample recovery and grade and whether sample bias may have occurred due to preferential loss/gain of fine/coarse material.
<i>Logging.</i>	• Whether core and chip samples have been logged to a level of detail to support appropriate Mineral Resource estimation, mining studies and metallurgical studies. • Whether logging is qualitative or quantitative in nature. Core (or costean, channel etc.) photography.
<i>Sub-sampling techniques and sample preparation.</i>	• If core, whether cut or sawn and whether quarter, half or all core taken. • If non-core, whether riffled, tube sampled, rotary split etc. and whether sampled wet or dry. • For all sample types, the nature, quality and appropriateness of the sample preparation technique. • Quality control procedures adopted for all sub-sampling stages to maximise representivity of samples. • Measures taken to ensure that the sampling is representative of the in situ material collected. • Whether sample sizes are appropriate to the grainsize of the material being sampled.
<i>Quality of assay data and laboratory tests.</i>	• The nature, quality and appropriateness of the assaying and laboratory procedures used and whether the technique is considered partial or total. • Nature of quality control procedures adopted (eg. standards, blanks, duplicates, external laboratory checks) and whether acceptable levels of accuracy (ie. lack of bias) and precision have been established.
<i>Verification of sampling and assaying.</i>	• The verification of significant intersections by either independent or alternative company personnel. • The use of twinned holes.
<i>Location of data points.</i>	• Accuracy and quality of surveys used to locate drill holes (collar and down-hole surveys), trenches, mine workings and other locations used in Mineral Resource estimation. • Quality and adequacy of topographic control.
<i>Data spacing and distribution.</i>	• Data spacing for reporting of Exploration Results. • Whether the data spacing and distribution is sufficient to establish the degree of geological and grade continuity appropriate for the Mineral Resource and Ore Reserve estimation procedure(s) and classifications applied. • Whether sample compositing has been applied.
<i>Orientation of data in relation to geological structure.</i>	• Whether the orientation of sampling achieves unbiased sampling of possible structures and the extent to which this is known, considering the deposit type. • If the relationship between the drilling orientation and the orientation of key mineralised structures is considered to have introduced a sampling bias, this should be assessed and reported if material.
<i>Audits or reviews.</i>	• The results of any audits or reviews of sampling techniques and data.
Reporting of Exploration Results (criteria listed in the preceding group apply also to this group)	
<i>Mineral tenement and land tenure status.</i>	• Type, reference name/number, location and ownership including agreements or material issues with third parties such as joint ventures, partnerships, overriding royalties, native title interests, historical sites, wilderness or national park and environmental settings. • The security of the tenure held at the time of reporting along with any known impediments to obtaining a licence to operate in the area.
<i>Exploration done by other parties.</i>	• Acknowledgment and appraisal of exploration by other parties.
<i>Geology.</i>	• Deposit type, geological setting and style of mineralisation.

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

Criteria	Explanation
Reporting of Exploration Results (criteria listed in the preceding group apply also to this group)	
<i>Data aggregation methods.</i>	• In reporting Exploration Results, weighting averaging techniques, maximum and/or minimum grade truncations (eg. cutting of high grades) and cut-off grades are usually material and should be stated. • Where aggregate intercepts incorporate short lengths of high grade results and longer lengths of low grade results, the procedure used for such aggregation should be stated and some typical examples of such aggregations should be shown in detail. • The assumptions used for any reporting of metal equivalent values should be clearly stated.
<i>Relationship between mineralisation widths and intercept lengths.</i>	• These relationships are particularly important in the reporting of Exploration Results. • If the geometry of the mineralisation with respect to the drill hole angle is known, its nature should be reported. • If it is not known and only the down-hole lengths are reported, there should be a clear statement to this effect (eg. 'downhole length, true width not known').
<i>Diagrams.</i>	• Where possible, maps and sections (with scales) and tabulations of intercepts should be included for any material discovery being reported if such diagrams significantly clarify the report.
<i>Balanced reporting.</i>	• Where comprehensive reporting of all Exploration Results is not practicable, representative reporting of both low and high grades and/or widths should be practised to avoid misleading reporting of Exploration Results.
<i>Other substantive exploration data.</i>	• Other exploration data, if meaningful and material, should be reported including (but not limited to): geological observations; geophysical survey results; geochemical survey results; bulk samples – size and method of treatment; metallurgical test results; bulk density, groundwater, geotechnical and rock characteristics; potential deleterious or contaminating substances.
<i>Further work.</i>	• The nature and scale of planned further work (eg. tests for lateral extensions or depth extensions or large-scale step-out drilling).
Estimation and Reporting of Mineral Resources (criteria listed in the first group, and where relevant in the second group, apply also to this group)	
<i>Database integrity.</i>	• Measures taken to ensure that data has not been corrupted by, for example, transcription or keying errors, between its initial collection and its use for Mineral Resource estimation purposes. • Data validation procedures used.
<i>Geological interpretation.</i>	• Confidence in (or conversely, the uncertainty of) the geological interpretation of the mineral deposit. • Nature of the data used and of any assumptions made. • The effect, if any, of alternative interpretations on Mineral Resource estimation. • The use of geology in guiding and controlling Mineral Resource estimation. • The factors affecting continuity both of grade and geology.
<i>Dimensions.</i>	• The extent and variability of the Mineral Resource expressed as length (along strike or otherwise), plan width, and depth below surface to the upper and lower limits of the Mineral Resource.
<i>Estimation and modelling techniques.</i>	• The nature and appropriateness of the estimation technique(s) applied and key assumptions, including treatment of extreme grade values, domaining, interpolation parameters, maximum distance of extrapolation from data points. • The availability of check estimates, previous estimates and/or mine production records and whether the Mineral Resource estimate takes appropriate account of such data. • The assumptions made regarding recovery of by-products. • Estimation of deleterious elements or other non-grade variables of economic significance (e.g. sulphur for acid mine drainage characterisation).

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

Criteria	Explanation
	• In the case of block model interpolation, the block size in relation to the average sample spacing and the search employed. • Any assumptions behind modelling of selective mining units. • Any assumptions about correlation between variables. • The process of validation, the checking process used, the comparison of model data to drillhole data, and use of reconciliation data if available.
<i>Moisture.</i>	• Whether the tonnages are estimated on a dry basis or with natural moisture, and the method of determination of the moisture content.
<i>Cut-off parameters.</i>	• The basis of the adopted cut-off grade(s) or quality parameters applied.
<i>Mining factors or assumptions.</i>	• Assumptions made regarding possible mining methods, minimum mining dimensions and internal (or, if applicable, external) mining dilution. It may not always be possible to make assumptions regarding mining methods and parameters when estimating Mineral Resources. Where no assumptions have been made, this should be reported.
<i>Metallurgical factors or assumptions.</i>	• The basis for assumptions or predictions regarding metallurgical amenability. It may not always be possible to make assumptions regarding metallurgical treatment processes and parameters when reporting Mineral Resources. Where no assumptions have been made, this should be reported.
<i>Bulk density.</i>	• Whether assumed or determined. If assumed, the basis for the assumptions. If determined, the method used, whether wet or dry, the frequency of the measurements, the nature, size and representativeness of the samples.
<i>Classification.</i>	• The basis for the classification of the Mineral Resources into varying confidence categories. • Whether appropriate account has been taken of all relevant factors. i.e. relative confidence in tonnage/grade computations, confidence in continuity of geology and metal values, quality, quantity and distribution of the data. • Whether the result appropriately reflects the Competent Person(s)' view of the deposit.
<i>Audits or reviews.</i>	• The results of any audits or reviews of Mineral Resource estimates.
<i>Discussion of relative accuracy/confidence.</i>	• Where appropriate a statement of the relative accuracy and/or confidence in the Mineral Resource estimate using an approach or procedure deemed appropriate by the Competent Person. For example, the application of statistical or geostatistical procedures to quantify the relative accuracy of the resource within stated confidence limits, or, if such an approach is not deemed appropriate, a qualitative discussion of the factors which could affect the relative accuracy and confidence of the estimate. • The statement should specify whether it relates to global or local estimates, and, if local, state the relevant tonnages or volumes, which should be relevant to technical and economic evaluation. Documentation should include assumptions made and the procedures used. • These statements of relative accuracy and confidence of the estimate should be compared with production data, where available.
Estimation and Reporting of Ore Reserves <i>(criteria listed in the first group, and where relevant in other preceding groups, apply also to this group)</i>	
<i>Mineral Resource estimate for conversion to Ore Reserves.</i>	• Description of the Mineral Resource estimate used as a basis for the conversion to an Ore Reserve. • Clear statement as to whether the Mineral Resources are reported additional to, or inclusive of, the Ore Reserves.
<i>Study status.</i>	• The type and level of study undertaken to enable Mineral Resources to be converted to Ore Reserves. • The Code does not require that a final feasibility study has been undertaken to convert Mineral Resources to Ore Reserves, but it does require that appropriate studies will have been carried that will have determined a mine plan that is technically achievable and economically viable, and that all Modifying Factors have been considered.
<i>Cut-off parameters.</i>	• The basis of the cut-off grade(s) or quality parameters applied.

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

Criteria	Explanation
<i>Mining factors or assumptions.</i>	• The method and assumptions used to convert the Mineral Resource to an Ore Reserve (ie either by application of appropriate factors by optimisation or by preliminary or detailed design). • The choice of, the nature and the appropriateness of the selected mining method(s) and other mining parameters including associated design issues such as pre-strip, access, etc. • The assumptions made regarding geotechnical parameters (eg. pit slopes, stope sizes, etc.), grade control and pre-production drilling. • The major assumptions made and Mineral Resource model used for pit optimisation (if appropriate). • The mining dilution factors, mining recovery factors, and minimum mining widths used. • The infrastructure requirements of the selected mining methods.
<i>Metallurgical factors or assumptions.</i>	• The metallurgical process proposed and the appropriateness of that process to the style of mineralisation. • Whether the metallurgical process is well-tested technology or novel in nature. • The nature, amount and representativeness of metallurgical testwork undertaken and the metallurgical recovery factors applied. • Any assumptions or allowances made for deleterious elements. • The existence of any bulk sample or pilot scale testwork and the degree to which such samples are representative of the orebody as a whole.
<i>Cost and revenue factors.</i>	• The derivation of, or assumptions made, regarding projected capital and operating costs. • The assumptions made regarding revenue including head grade, metal or commodity price(s) exchange rates, transportation and treatment charges, penalties, etc. • The allowances made for royalties payable, both Government and private.
<i>Market assessment.</i>	• The demand, supply and stock situation for the particular commodity, consumption trends and factors likely to affect supply and demand into the future. • A customer and competitor analysis along with the identification of likely market windows for the product. • Price and volume forecasts and the basis for these forecasts. • For industrial minerals the customer specification, testing and acceptance requirements prior to a supply contract.
<i>Other.</i>	• The effect, if any, of natural risk, infrastructure, environmental, legal, marketing, social or governmental factors on the likely viability of a project and/or on the estimation and classification of the Ore Reserves. • The status of titles and approvals critical to the viability of the project, such as mining leases, discharge permits, government and statutory approvals.
<i>Classification.</i>	• The basis for the classification of the Ore Reserves into varying confidence categories. • Whether the result appropriately reflects the Competent Person(s)' view of the deposit. • The proportion of Probable Ore Reserves which have been derived from Measured Mineral Resources (if any).
<i>Audits or reviews.</i>	• The results of any audits or reviews of Ore Reserve estimates.
<i>Discussion of relative accuracy/confidence.</i>	• Where appropriate a statement of the relative accuracy and/or confidence in the Ore Reserve estimate using an approach or procedure deemed appropriate by the Competent Person. For example, the application of statistical or geostatistical procedures to quantify the relative accuracy of the reserve within stated confidence limits, or, if such an approach is not deemed appropriate, a qualitative discussion of the factors which could affect the relative accuracy and confidence of the estimate. • The statement should specify whether it relates to global or local estimates, and, if local, state the relevant tonnages or volumes, which should be relevant to technical and economic evaluation. Documentation should include assumptions made and the procedures used. • These statements of relative accuracy and confidence of the estimate should be compared with production data, where available.

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

Criteria	Explanation
Estimation and Reporting of Diamonds and other Gemstones <i>(criteria listed in other relevant groups also apply to this group; additional guidelines are available in the 'Guidelines for the Reporting of Diamond Exploration Results' issued by the Diamond Exploration Best Practices Committee established by the Canadian Institute of Mining, Metallurgy and Petroleum.)</i>	
Indicator minerals.	• Reports of indicator minerals, such as chemically/physically distinctive garnet, ilmenite, chrome spinel and chrome diopside, should be prepared by a suitably qualified laboratory.
Source of diamonds.	• Details of the form, shape, size and colour of the diamonds and the nature of the source of diamonds (primary or secondary) including the rock type and geological environment.
Sample collection.	• Type of sample, whether outcrop, boulders, drill core, reverse circulation drill cuttings, gravel, stream sediment or soil, and purpose, e.g. large diameter drilling to establish stones per unit of volume or bulk samples to establish stone size distribution. • Sample size, distribution and representativity.
Sample treatment.	• Type of facility, treatment rate, and accreditation. • Sample size reduction. Bottom screen size, top screen size and re-crush. • Processes (dense media separation, grease, X-ray, hand-sorting etc.). • Process efficiency, tailings auditing and granulometry. • Laboratory used, type of process for micro diamonds and accreditation.
Carat.	• One fifth (0.2) of a gram (often defined as a metric carat or MC).
Sample grade.	• Sample grade in this section of Table 1 is used in the context of carats per units of mass, area or volume. • The sample grade above the specified lower cut-off sieve size should be reported as carats per dry metric tonne and/or carats per 100 dry metric tonnes. For alluvial deposits, sample grades quoted in carats per square metre or carats per cubic metre are acceptable if accompanied by a volume to weight basis for calculation. • In addition to general requirements to assess volume and density there is a need to relate stone frequency (stones per cubic metre or tonne) to stone size (carats per stone) to derive sample grade (carats per tonne).
Reporting of Exploration Results.	• Complete set of sieve data using a standard progression of sieve sizes per facies. Bulk sampling results, global sample grade per facies. Spatial structure analysis and grade distribution. Stone size and number distribution. Sample head feed and tailings particle granulometry. • Sample density determination. • Percent concentrate and undersize per sample. • Sample grade with change in bottom cut-off screen size. • Adjustments made to size distribution for sample plant performance and performance on a commercial scale. • If appropriate or employed, geostatistical techniques applied to model stone size, distribution or frequency from size distribution of exploration diamond samples. • The weight of diamonds may only be omitted from the report when the diamonds are considered too small to be of commercial significance. This lower cut-off size should be stated.
Grade estimation for reporting Mineral Resources and Ore Reserves.	• Description of the sample type and the spatial arrangement of drilling or sampling designed for grade estimation. • The sample crush size and its relationship to that achievable in a commercial treatment plant. • Total number of diamonds greater than the specified and reported lower cut-off sieve size. • Total weight of diamonds greater than the specified and reported lower cut-off sieve size. • The sample grade above the specified lower cut-off sieve size.
Value estimation.	• Valuations should not be reported for samples of diamonds processed using total liberation method, which is commonly used for processing exploration samples. • To the extent that such information is not deemed commercially sensitive, Public Reports should include: – Diamonds quantities by appropriate screen size per facies or depth. – Details of parcel valued. – Number of stones, carats, lower size cut-off per facies or depth.

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STATEMENT OF COAL RESOURCES: BN COAL PROJECT BY MBGS

THE 2004 AUSTRALASIAN CODE FOR REPORTING EXPLORATION RESULTS, MINERAL RESOURCES AND ORE RESERVES (THE JORC CODE)

Criteria	Explanation
	• The average \$/carat and \$/tonne value at the selected bottom cut-off should be reported in US Dollars. The value per carat is of critical importance in demonstrating project value. • The basis for the price (e.g. dealer buying price, dealer selling price etc.). • An assessment of diamond breakage.
Security and integrity.	• Accredited process audit. • Whether samples were sealed after excavation. • Valuer location, escort, delivery, cleaning losses, reconciliation with recorded sample carats and number of stones. • Core samples washed prior to treatment for micro diamonds. • Audit samples treated at alternative facility. • Results of tailings checks. • Recovery of tracer monitors used in sampling and treatment. • Geophysical (logged) density and particle density. • Cross validation of sample weights, wet and dry, with hole volume and density, moisture factor.
Classification.	• In addition to general requirements to assess volume and density there is a need to relate stone frequency (stones per cubic metre or tonne) to stone size (carats per stone) to derive grade (carats per tonne). The elements of uncertainty in these estimates should be considered, and classification developed accordingly.

APPENDIX 1 GENERIC TERMS AND EQUIVALENTS

Throughout the Code, certain words are used in a general sense when a more specific meaning might be attached to them by particular commodity groups within the industry. In order to avoid unnecessary duplication, a non-exclusive list of generic terms is tabulated below together with other terms that may be regarded as synonymous for the purposes of this document.

Generic Term	Synonyms and Similar Terms	Intended Generalised Meaning
Tonnage	Quantity, Volume	An expression of the amount of material of interest irrespective of the units of measurement (which should be stated when figures are reported)
Grade	Quality, Assay, Analysis (Value)	Any physical or chemical measurement of the characteristics of the material of interest in samples or product. Note that the term quality has special meaning for diamonds and other gemstones. The units of measurement should be stated when figures are reported.
Metallurgy	Processing, Beneficiation, Preparation, Concentration	Physical and/or chemical separation of constituents of interest from a larger mass of material. Methods employed to prepare a final marketable product from material as mined. Examples include screening, flotation, magnetic separation, leaching, washing, roasting etc.
Recovery	Yield	The percentage of material of initial interest that is extracted during mining and/or processing. A measure of mining or processing efficiency.
Mineralisation	Type of deposit, orebody, style of mineralisation.	Any single mineral or combination of minerals occurring in a mass, or deposit, of economic interest. The term is intended to cover all forms in which mineralisation might occur, whether by class of deposit, mode of occurrence, genesis or composition.
Ore Reserves	Mineral Reserves	'Ore Reserves' is preferred under the JORC Code but 'Mineral Reserves' is in common use in other countries and is generally accepted. Other descriptors can be used to clarify the meaning e.g. coal reserves, diamond reserves etc.
Cut off grade	Product specifications	The lowest grade, or quality, of mineralised material that qualifies as economically mineable and available in a given deposit. May be defined on the basis of economic evaluation, or on physical or chemical attributes that define an acceptable product specification.

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JORC Reserve Report: Baruun Naran Coal Project, Mongolia

Report prepared by



March, 2011

Project Code: KER001

JORC RESERVE REPORT: BN COAL PROJECT BY SRK CONSULTING

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JORC RESERVE REPORT: BN COAL PROJECT BY SRK CONSULTING

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0	28/1/2011	Neville Terry	Report issued to Client
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3	23/03/2011	Neville Terry	Report issued to Client

JORC RESERVE REPORT: BN COAL PROJECT BY SRK CONSULTING

Executive Summary

Summary of Principal Objectives

SRK Consulting (Australasia) Pty Ltd trading as SRK Consulting ("SRK") has prepared an independent evaluation of the Coal Reserves of the Baruun Naran Coal Project ("BN"). The purpose of the evaluation is to provide an objective assessment of the Coal Reserves in accordance with the Australasian Code for Reporting of Mineral Resources and Ore Reserves (JORC Code), 2004 for public reporting. The Reserve report has been endorsed with appropriate qualifications by the Competent Person.

The coal tenement known as Baruun Naran is located in the south Gobi desert of the Umnogovi Province of Mongolia. The project area is situated approximately 600 kilometers ("km") south of Ulaan Baatar the capital city of Mongolia and approximately 60km east of Dalanzadgad the capital town of Umnogovi province.

This Statement of Coal Reserve has been carried out according to SRK's interpretation of the JORC Code. The JORC Resource Statement by Mr Paul Harrison of MBGS (McElroy Bryan Geological Services Pty Ltd) in February 2010 was used to develop the Recoverable Reserve tonnes after the application of mining parameters, mine design and other modifying factors as summarised in the Table ES1 below:

Table ES1: Modifying Factors

Seam roof & floor coal loss	0.2m
Seam roof & floor dilution	0.2m
Mining loss including loss in transportation and handling at port	5%
Minimum mining thickness minable coal seam	0.3m
ROM Moisture, air dried	2%
In-situ Moisture (Estimated)	6%
Product Moisture, Coking	11%
Product Moisture, Thermal	9%
High Wall Batter Angle (Based on Geotechnical Report Ross Seedsman)	Varies as per Geo-tech report
Low Wall Batter Angle(Based on Geotechnical Report Ross Seedsman)	17 ⁰
Mining Cost	SRK
Coal Processing – costs	DaDi Engineering
Power Costs Report	Sino Coal Institute
The Reserves for BN coal blocks are economic based on the information and costs used at the time of this report	SRK
Government Documents / approvals Supplied by Client	Client
JORC Resource Report McElroy Bryan Geological Services (MBGS)	MBGS
LOX Drilling Report for T & H Seams	MBGS
Environment Report	SMEC
Coal Quality Report	Bob Leach Pty Ltd
Geotechnical Report	Seedsman Geotechnics Pty Ltd
Hydrogeology Report - BUN West	SMEC
Hydrogeology Report - Mine Pit	Aquaterra
Water Pumping and Pipeline	Prestige Engineering

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Reserves Summary

The following table summarises the Reserves estimates within the area of Baruun Naran Coal Project, as at February 2011.

Table ES2: Statement of Coal Reserves for Baruun Naran, February 2011

Seam	Average Thickness (m)	Coal Reserves, Mt (Million tonnes)		
		With Mining Losses (0.2m) and Handling Losses (5%)		
		Probable (Mt)	Proved (Mt)	Total (Mt)
V500	4.61	2.60	-	2.60
U500	7.90	1.99	7.44	9.43
T500	16.20	0.08	24.73	24.82
R500	4.22	2.58	1.74	4.32
R400	3.12	1.15	0.25	1.40
R300	1.03	0.78	-	0.78
R200	3.03	2.11	-	2.11
Q500	4.39	1.27	2.52	3.79
N500	8.17	0.91	10.69	11.60
N400	7.07	1.49	7.50	8.98
K500	6.12	3.91	10.15	14.06
K400	2.17	0.57	1.18	1.75
J600	2.68	2.40	3.27	5.67
J500	4.40	4.84	4.93	9.78
J400	0.57	1.22	-	1.22
I500	4.83	2.54	10.37	12.91
H500	16.92	3.56	35.82	39.38
G500	6.82	0.97	10.32	11.29
G450	5.76	0.57	2.86	3.43
G400	7.79	1.23	7.26	8.49
F500	8.84	0.51	6.84	7.35
E500	5.54	0.02	0.10	0.12
Total Coal (Mt)		37.30	147.97	185.27
Total Waste (Mbcm)				1156.99
Average Stripping Ratio (bcm/t)				6.24

JORC RESERVE REPORT: BN COAL PROJECT BY SRK CONSULTING

Table of Contents

Executive Summary	iii
Summary of Principal Objectives	iii
Reserves Summary	iv
Disclaimer	vii
List of Abbreviations	viii
1. Introduction and Scope of Report	1
1.1 Background of the Project	1
2. Programme Objectives and Work Programme	2
2.1 Programme Objectives	2
2.2 Coal Reserves Estimates	2
2.3 Reporting Code	2
2.4 Methodology	2
2.5 Statement of SRK Independence	2
2.6 Statement of Competence	3
2.7 Material Compliances and Qualifications	4
2.8 Limitations	4
2.9 Consents	5
3. Location and Environment	6
4. Basis for Reserves Estimate	8
4.1 Estimation Methodology	8
4.2 Modifying Factors	8
4.2.2 Annual Production Rate	10
4.3 Parameters and Pit Limits	11
4.3.1 The Pit Limit Restrictions	11
4.3.2 Batters	11
4.4 Mining Parameters	12
4.5 Blasting	12
4.6 Mining Method	12
4.7 Mine Plan	13
4.7.1 Waste Dumps	14
4.7.2 Mining Volume/Tonnage	14
4.8 Cost and Revenue Factors	17
4.9 Marketing and Product Specifications	17
4.10 Other Relevant Factors	17
4.10.1 Hydrogeology	17
4.10.2 Environmental	17
4.10.3 Social and Political	17
4.11 Results	17
5. Conclusions and Recommendations	19
6. References	20

JORC RESERVE REPORT: BN COAL PROJECT BY SRK CONSULTING

List of Tables

Table 4-1: Summary of Modifying Factors.....	8
Table 4-2: Statement of Coal Reserves for Baruun Naran, February 2011.....	9
Table 4-3: Summary of Estimated Reserve Tonnes	10
Table 4-4: Annual Production Rate	11
Table 4-5: Mining Parameters.....	12
Table 4-6: Production Summary, Baruun Naran Coal Project.....	15
Table 4-7: ROM Coking and Thermal Coal Production Summary, Baruun Naran Coal Project	15

List of Figures

Figure 3-1: Location of Khangad's Baruun Naran coal project in southern Mongolia.....	6
Figure 3-2: Location of Baruun Naran Mining and Exploration Licenses in Southern Mongolia	7
Figure 4-1: Reserves by Seam.....	10
Figure 4-2: Final Pit Layout, Baruun Naran Coal Project.....	11
Figure 4-3: Syncline Axis, Bounding Faults & Seam subcrops at 1500m RL, Baruun Naran Coal Project.....	13
Figure 4-4: Mining Sequence, Baruun Naran Coal Project	14
Figure 4-5: Coal Mining, Waste Removal Schedule with Annual Stripping Ratio	16
Figure 4-6: ROM Coking Coal & Thermal Coal Production from Baruun Naran Mine	16

List of Appendices

Appendix 1: Capital Costs and Operating Costs
Appendix 2: In-situ Quality
Appendix 3: Recoverable Reserves
Appendix 4: Baruun Naran Economic Model

JORC RESERVE REPORT: BN COAL PROJECT BY SRK CONSULTING

Disclaimer

The opinions expressed in this Report have been based on the information supplied to SRK Consulting (Australasia) Pty Ltd (SRK) by Khangad Exploration LLC (Khangad). The opinions in this Report are provided in response to a specific request from Khangad to do so. SRK has exercised all due care in reviewing the supplied information. Whilst SRK has compared key supplied data with expected values, the accuracy of the results and conclusions from the review are entirely reliant on the accuracy and completeness of the supplied data. SRK does not accept responsibility for any errors or omissions in the supplied information and does not accept any consequential liability arising from commercial decisions or actions resulting from them. Opinions presented in this report apply to the site conditions and features as they existed at the time of SRK's investigations, and those reasonably foreseeable. These opinions do not necessarily apply to conditions and features that may arise after the date of this Report, about which SRK had no prior knowledge nor had the opportunity to evaluate.

List of Abbreviations

<u>Abbreviation</u>	<u>Meaning</u>
°	degrees
°C	degrees Celsius
admn	administration
AMSL	Above mean sea level
AusIMM	Australasian Institute of Mining and Metallurgy
bcm/t	bank cubic metre per tonne
cm	centimetre
Capex	Capital cost estimates
Dep	depreciation
Coal Reserve	A Coal Reserve is the economically mineable part of a Measured or Indicated Coal Resource. Coal Reserve estimates including diluting materials and are adjusted for losses that may occur when the coal is mined. Appropriate assessments, which may include feasibility studies, have been carried out. These assessments should include proper consideration of all relevant 'modifying factors' such as mining methods, beneficiation, and economic, marketing, legal, environmental, social and governmental factors. These assessments should demonstrate that at the time of reporting, economic extraction could reasonably be justified. Coal Reserves are subdivided in order of increasing confidence into Probable Coal Reserves and Proved Coal Reserves.
JORC Code	Australia Code for Reporting of Mineral Resources and Ore Reserves, prepared by the Joint Ore Reserves Committee of the Australasian Institute of Mining and Metallurgy, Australian Institute of Geoscientists and Minerals Council of Australia (JORC), September 1999. Updated December 2004. Internationally accepted reporting code.
JORC Committee	Joint Ore Reserves Committee of The Australasian Institute of Mining and Metallurgy, Australian Institute of Geoscientists and Minerals Council of Australia
ha	hectare
km	kilometre(s)
M\$	million US dollars
m	metre(s)
mm	millimetre(s)
NPV	net present value
Opex	Operating cost estimates
ROM	Run of Mine
SRK	SRK Consulting (Australasia) Pty Ltd trading as SRK Consulting
BN	Baruun Naran Coal Project
MBGS	McElroy Bryan Geological Services Pty Ltd
Mt	million tonnes
Mtpa	million tonnes per annum
Mj/kg	million joules per kilogram
Mbcm	million bank cubic metre
t	tonnes

1. Introduction and Scope of Report

Khangad Exploration LLC requested SRK to prepare a JORC-compliant Reserve Statement for the Baruun Naran Coal deposit in Umnigovi province in southern Mongolia. This report covers the methods, parameters and results for the Reserve tonnage estimation of the Baruun Naran coal project.

1.1 Background of the Project

The Baruun Naran coal deposit was first explored in 1983. Two additional phases of drilling were completed on the property by Soviet-Mongolian teams in 1990 and 1993. The property was later abandoned and QGX was granted an exploration license in 2002, now held by the Kuok Group, through Khangad Exploration LLC.

In April 2005, QGX commenced a systematic drilling program and engaged Norwest Corporation to provide geological consulting services including supervision of drilling and trenching programs. In 2007 a drilling program was carried out to assess water availability in the region to support a mining/coal processing operation. An oxidation drilling program was completed during 2008.

Considerable exploration was carried out in the main deposit during 2009. This defined the deposit geometry, identified where seams are faulted at depth and improved the understanding of coal quality variation. Geotechnical studies were also carried out during 2009.

The Baruun Naran mining license 14493A (Figure 3.2), in the Umnogovi Aimag (province), covers 4,485.64 ha and was converted to a mining license on December 1st, 2008. Surrounding the Baruun Naran mining license is the "Baruun Naran" exploration concession 4326X (total area 90,782.36 ha).

2. Programme Objectives and Work Programme

2.1 Programme Objectives

The objective of this work is to provide an independent evaluation of the Coal Reserves contained within Baruun Naran mining license 14493A which covers 4,485.64 ha.

The evaluation will provide an objective assessment of the Reserve in accordance with the Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves (JORC Code, 2004).

2.2 Coal Reserves Estimates

This Statement of Coal Reserves estimates for the Baruun Naran Coal Project has been prepared by Neville Terry of SRK. The purpose of this report is to provide an assessment of the coal reserves compliant with the Guidelines of the "Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves", (the "JORC Code") December 2004, prepared by the Joint Ore Reserves Committee of The Australasian Institute of Mining and Metallurgy ("AusIMM") and the Australasian Institute of Geoscientists and Minerals Council of Australia.

2.3 Reporting Code

This Statement of Coal Reserves has been carried out according to SRK's interpretation of the JORC Code. The Resource Statement: JORC Resource Report: Baruun Naran Coal Project, Umnogovi Province, Mongolia, used as the basis for reserves estimation has been compiled by Mr Paul Harrison of MBGS. Paul Harrison is a qualified geologist and is a Member of the AusIMM. He has sufficient experience in coal geology and resource evaluation to qualify as a Competent Person under the JORC code. Under the listing rules of the Australian Stock Exchange, a public report must be prepared in accordance with the 2004 JORC Code if it includes a statement of coal resources or coal reserves. The 2004 JORC Code has been accepted as the basis for consistent public reporting of resources and reserves by many international mining companies.

Under the JORC Code only Measured and Indicated Coal Resources can be considered for conversion to Coal Reserves after consideration of the "Modifying Factors" including mining, processing, economic, environmental, and social and government factors.

To convert Resources to Reserves it must be demonstrated that extraction could be justified after applying reasonable investment assumptions. The highest confidence level establishes Proved Reserves from Measured Resources and a lesser confidence level establishes Probable Reserves from Indicated Resources. A level of uncertainty in any one or more of the Modifying Factors may result in Measured Resources converting to Probable Reserves depending on materiality. A high level of uncertainty in any one or more of the Modifying Factors may preclude the conversion of the affected Resources to Reserves.

2.4 Methodology

This report was compiled from JORC Resource Report: Baruun Naran Coal Project, Umnogovi Province, Mongolia, February 2010.

2.5 Statement of SRK Independence

SRK has no prior association with Khangad Exploration LLC in regards to the mineral assets that are the subject of this Report. SRK has no beneficial interest in the outcome of the technical assessment being capable of affecting its independence.

JORC RESERVE REPORT: BN COAL PROJECT BY SRK CONSULTING

SRK's fee for completing this Report is based on its normal professional daily rates plus reimbursement of incidental expenses. The payment of that professional fee is not contingent upon the outcome of the Report.

2.6 Statement of Competence

The estimates of Coal Reserves for the Baruun Naran Coal Project, Umnigovi Province, Mongolia presented in this report have been carried out in accordance with the Guidelines of the "Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves", ("JORC Code") December 2004, prepared by the Joint Ore Reserves Committee of The Australasian Institute of Mining and Metallurgy ("AusIMM") and the Australasian Institute of Geoscientists and Minerals Council of Australia.

The information in the report to which this statement is attached, that relates to Baruun Naran Coal Block Reserves, is based on information reviewed by Mr Neville Terry, who is a Member of the AusIMM and is a full time employee of SRK.

He is a Principal Consultant (Mining) and has almost 30 years' experience working in the mining industry. He has held positions including Mine Manager, Operations Manager, and Senior Mining Engineer and has also been Managing Director of his own consultancy firm

Mr Terry has sufficient experience which is relevant to the style of mineralisation and type of deposit under consideration and to the activity which he is undertaking to qualify as a Competent Person as defined in the 2004 JORC Code.

Mr Terry consents to the inclusion in the report of the matters based on this information in the form and context in which it appears.



(Signed)

Neville Terry, BEng (Mining)
BAppSc (Applied Geology)
BEd, Grad Dip Management

Date: 23 March 2011

2.7 Material Compliances and Qualifications

Mr Neville Terry, a Competent Person in accordance with the requirements of the JORC Code, has estimated the Coal Reserve of the Baruun Naran Coal Project.

Mr Terry has visited the site and it was a greenfield project at the time of the site visit.

The Reserve estimation reporting complies with all of the major requirements of the JORC Code, with the following qualifications:

- The effective date of the Baruun Naran Reserve as reported by SRK is February 2011.
- The Reserve model and estimations were developed using Minex mine planning software system, a worldwide industry-proven system used primarily for coal mining operations.
- Seam roof and floor coal loss and dilution considered to be 0.2 m.
- Mining loss envisaged at 5% including loss in transportation and handling at borders.
- Minimum mining thickness of 0.3 m of coal seam.
- Mine economics were considered when estimating the reserves for Baruun Naran coal project.
- The mine boundary limits are within the limiting boundaries of MBGS JORC Resource Report, February 2010 for the Baruun Naran Coal Project.
- Other modifying factors like environmental, social, legal and governmental factors may influence the reserves given below (See Table ES1 and Figure 4-1).

2.8 Limitations

After due enquiry in accordance with the scope of work and subject to the limitations of the Report hereunder, SRK confirms that:

- The input, handling, computation and output of the geological data and Coal Resource and Reserve information have been conducted in a professional and accurate manner, to the high standards expected.
- The interpretation, estimation and reporting of the Coal Reserve Statement has been conducted in a professional and competent manner, to the high standards expected within the Geosciences and mining professions, and in accordance with the principles and definitions of the JORC Code.
- In conducting this assessment, SRK has addressed and assessed all activities and technical matters that might reasonably be considered relevant and material to such an assessment conducted to internationally accepted standards. Based on observations and a review of available documentation, SRK has, after reasonable enquiry, been satisfied that there are no other relevant material issues outstanding.
- The conclusions presented in this report are professional opinions based solely upon SRK's interpretations of the documentation received and other available information, as referenced in this Report. These conclusions are intended exclusively for the purposes stated herein.
- For these reasons, prospective estimators must make their own assumptions and their own assessments of the subject matter of this Report.

Opinions presented in this report apply to the conditions and features as noted in the documentation, and those reasonably foreseeable. These opinions cannot necessarily apply to conditions and features that may arise after the date of this report, about which SRK have had no prior knowledge nor had the opportunity to evaluate.

JORC RESERVE REPORT: BN COAL PROJECT BY SRK CONSULTING

2.9 Consents

SRK consents to this Report being included, in full, in the Khangad Exploration LLC prospectus, data room, and presentations etc, in the form and context in which the technical assessment is provided, and not for any other purpose.

SRK provides this consent on the basis that the technical assessments expressed in the Summary and in the individual sections of this Report are considered with, and not independently of, the information set out in the complete Report.

3. Location and Environment

The Baruun Naran property is located in southern Mongolia (Figure 3-1), in the Aimag (province) of Umnogovi approximately 500 km south of Ulaanbaatar, the capital of Mongolia. The town of Dalanzadgad (population 10,000), the provincial capital, is located 61 km to the west of the property. The property is being legally surveyed, and except for the commencement of certain mine works, is in an entirely natural state with no paved roads or permanent dwellings.



Figure 3-1: Location of Khangad's Baruun Naran coal project in southern Mongolia

The project area is characterized by gently rolling desert plains with scattered small hills and ridges. Scrubby desert plants and sparse grasses growing on a thin soil cover characterize the vegetation.

Topographic elevation in the project area ranges from 1500 to 1700 m above mean sea level (AMSL). The deposit is located within a discrete, ENE-trending valley, herein referred to as the Baruun Naran valley. This valley, from which the coal deposit takes its name, is approximately 22 km long and 2 to 3 km wide. The floor of the valley is relatively flat and is bounded to the north and south by low hills and ridges that rise approximately 25 m to 100 m above the valley floor.

The deposit is located in the South Gobi desert where the climate is generally hot and dry in the summer and cold and dry in the winter. The annual average maximum daily and minimum daily temperatures are +38°C and -36°C respectively. The area receives most of its rain from June to September. The prevailing winds are generally from the northwest and west and dust storms often occur during the spring and summer months. Winds are strongest in spring and summer whereas the autumn and winter winds are generally light.

The Baruun Naran mining license 14493A (Figure 3-2), in the Umnogovi Aimag (province), covers 4,485.64 ha and was converted to a mining license on December 1st, 2008. Surrounding the Baruun Naran mining license is the "Baruun Naran" exploration concession 4326X (total area 90,782.36 ha).

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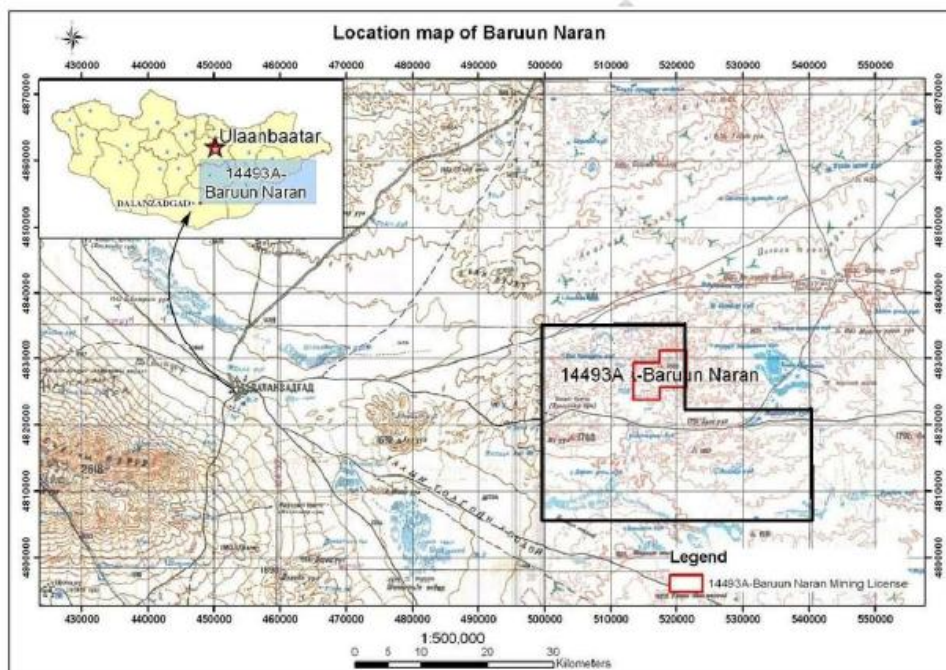


Figure 3-2: Location of Baruun Naran Mining and Exploration Licenses in Southern Mongolia

4. Basis for Reserves Estimate

4.1 Estimation Methodology

The geological model that has been used to prepare the current JORC Resource Report for the Baruun Naran Coal Project, has also been used to generate pit designs and estimate the reserves. In the estimation of Coal Reserves a number of issues/parameters /Modifying Factors have to be addressed.

Examples of possible Modifying Factors are

- Mining Parameters;
- Cost Revenue Factors;
- Metallurgical factors;
- Cut off Parameters and Pit Limits;
- Geo-technical parameters.

A more comprehensive list the various Modifying Factors that may be considered in developing an estimate of Reserve tonnes when converting Resource Tonnes to Reserves, is shown below.

4.2 Modifying Factors

Figure 4-1 outlines the factors used to estimate the Reserve Tonnage for the Baruun Naran operation.

Table 4-1: Summary of Modifying Factors

Seam roof & floor coal loss	0.2m
Seam roof & floor dilution	0.2m
Mining loss including loss in transportation and handling at port	5%
Minimum mining thickness minable coal seam	0.3m
ROM Moisture, air dried	2%
In-situ Moisture (Estimated)	6%
Product Moisture, Coking	11%
Product Moisture, Thermal	9%
High Wall Batter Angle (Based on Geotechnical Report Ross Seedsman)	Varies as per Geo-tech report
Low Wall Batter Angle(Based on Geotechnical Report Ross Seedsman)	17 ⁰
Mining Cost	SRK
Coal Processing – costs	DaDi Engineering
Power Costs Report by Sino Coal	Sino Coal Institute
The Reserves for BN coal blocks are economic based on the information and costs used at the time of this report	SRK
Government Documents / approvals Supplied by Client	Client
JORC Resource Report McElroy Bryan Geological Services (MBGS)	MBGS
LOX Drilling Report for T & H Seams	MBGS
Environment Report by SMEC	SMEC
Coal Quality Report	Bob Leach Pty Ltd
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Hydrogeology Report - BUN West	SMEC
Hydrogeology Report - Mine Pit	Aquaterra
Water Pumping and Pipeline	Prestige Engineering

JORC RESERVE REPORT: BN COAL PROJECT BY SRK CONSULTING

4.2.1 Reserves

This Statement of Coal Reserves has been carried out according to SRK's interpretation of the JORC Code. The JORC Resource Statement by Mr Paul Harrison of MBGS in February 2010 was used to develop the Recoverable Reserve tonnes after the application of mining parameters, mine design and other modifying factors.

The Statement of Coal Reserves for Baruun Naran is shown in Table 4-2.

Table 4-2: Statement of Coal Reserves for Baruun Naran, February 2011

Seam	Average Thickness (m)	Coal Reserves, Mt (Million tonnes)		
		With Mining Losses (0.2m) and Handling Losses (5%)		
		Probable (Mt)	Proved (Mt)	Total (Mt)
V500	4.61	2.60	-	2.60
U500	7.90	1.99	7.44	9.43
T500	16.20	0.08	24.73	24.82
R500	4.22	2.58	1.74	4.32
R400	3.12	1.15	0.25	1.40
R300	1.03	0.78	-	0.78
R200	3.03	2.11	-	2.11
Q500	4.39	1.27	2.52	3.79
N500	8.17	0.91	10.69	11.60
N400	7.07	1.49	7.50	8.98
K500	6.12	3.91	10.15	14.06
K400	2.17	0.57	1.18	1.75
J600	2.68	2.40	3.27	5.67
J500	4.40	4.84	4.93	9.78
J400	0.57	1.22	-	1.22
I500	4.83	2.54	10.37	12.91
H500	16.92	3.56	35.82	39.38
G500	6.82	0.97	10.32	11.29
G450	5.76	0.57	2.86	3.43
G400	7.79	1.23	7.26	8.49
F500	8.84	0.51	6.84	7.35
E500	5.54	0.02	0.10	0.12
Total Coal (Mt)		37.30	147.97	185.27
Total Waste (Mbcm)				1156.99
Average Stripping Ratio (bcm/t)				6.24

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Figure 4-1 summarises the estimated Reserve tonnes by seam.

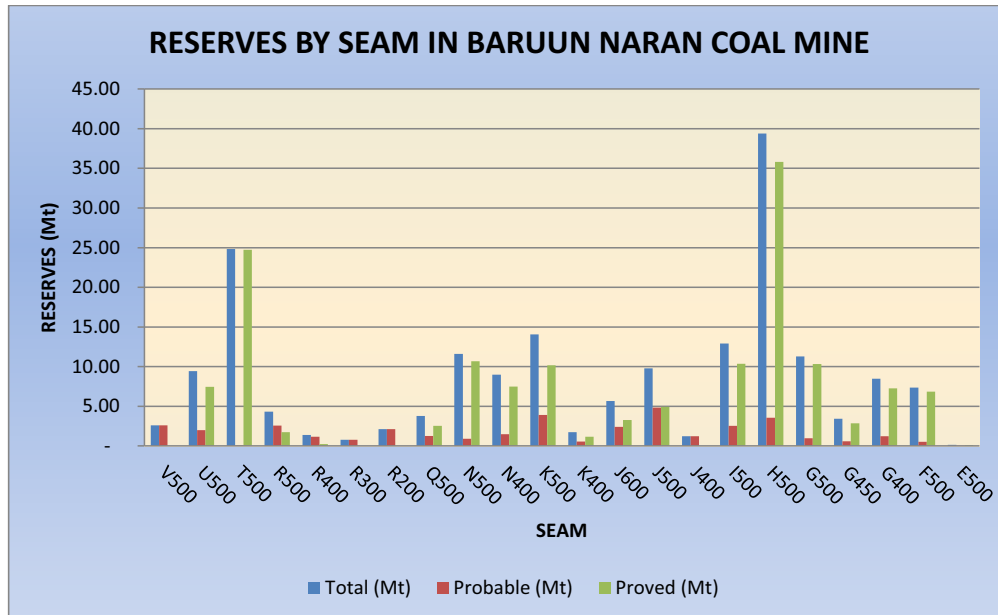


Figure 4-1: Reserves by Seam

In summary, there is an estimated total of 185.27 Mt of Reserves, comprising of 37.30 Mt of Probable and 147.97 Mt of Proved Reserves. Of these Reserves, there is an estimated 120.82 Mt of Coking Coal and 64.45 Mt of Thermal Coal as shown in Table 4-3 below.

Table 4-3: Summary of Estimated Reserve Tonnes

Coal Reserves (Mt)			
Type	Total (Mt)	Probable (Mt)	Proved (Mt)
Coking	120.82	20.85	99.97
Thermal	64.45	16.45	48.00
Total	185.27	37.30	147.97

4.2.2 Annual Production Rate

The total Reserves Proven and Probable are 185.27 Mt at an average stripping ratio of 6.24. (See Figure 4-2) Based on this tonnage and coal production target suggested by the client, the annual production was estimated at 10 million tonnes per annum (Mtpa) giving a 20+ year life of mine. Figure 4-4 outlines the assumed annual production rate. It will be achieved by mining seam T500 initially in the central part of the block and later from Seams H500 and others in the eastern part of the block.

The following is the production rate given in Table 4-4 which gives total mine life of 21 years for Baruun Naran coal project.

Table 4-4: Annual Production Rate

Year	1	2	3	4	5	6	7	8	9	10	11-21	Total
Coal Production (Mt)	1.02	3.06	7.09	10.03	10.03	10.00	10.00	10.01	10.02	10.05	103.97	185.27

4.3 Parameters and Pit Limits

4.3.1 The Pit Limit Restrictions

Figure 4-2 shows a plan of the Baruun Naran mine lease area and final pit layout. The pit limit restrictions are governed by the geological resource boundary. The mining limits have been determined by considering physical limitations within the geological resource, mining parameters, economic factors and general modifying factors as outlined in Table 4-1.

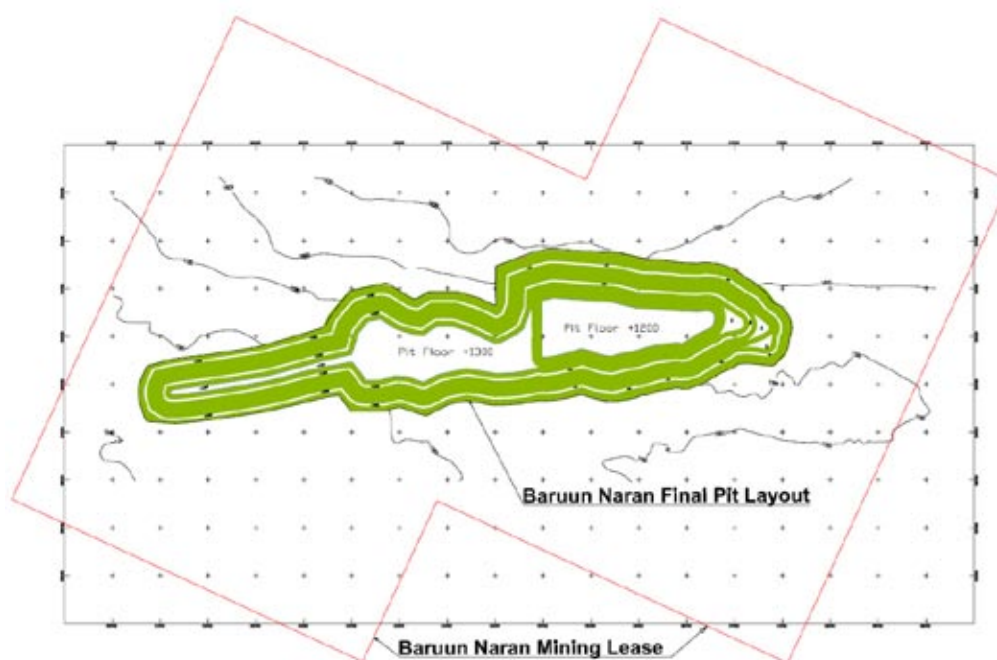


Figure 4-2: Final Pit Layout, Baruun Naran Coal Project

4.3.2 Batters

The high wall batters (slope) adopted were those recommended by the Geotechnical Investigation conducted by the **Seedsman Geotechnics Pty Ltd.**

To facilitate mine planning at feasibility level, a design line for high wall slope with the form of maximum bench height = $68.8 - 0.6 \times \text{bedding dip}$ has been recommended by the study. Recognising the presence of small scale normal faults and the possibility of buckling of thin slabs, a 6-8 m wide bench has been used at the final wall. This resulted in the inter-ramp slopes in between 32° and 50° (Recommended $37^\circ - 68^\circ$).

Surficial deposits and the weathered strata were laid back at 45° on batters of 20 m height, with benches of a minimum of 5 m width.

The **low wall batter** has been set at an average of 17° based on the horizontal pit floor. SRK recommends that further geotechnical investigations should be conducted to investigate the stability of the toe of the low wall and the maximum height of the low wall dump which has been designed at this stage at about 380-400 m. The Ex-pit dump has been designed at 14-17° for the varying dump height of 60-100 m.

4.4 Mining Parameters

The mining parameters applied to the resource model for deriving mining quantities were selected based on the use of excavators and trucks.

An allowance of 5% loss has been made to modelled opencut coal tonnages to cater for geological losses which are not defined at this time. The 5% loss also considers general mining losses which are separate from and additional to seam loss and dilution due to exposure and mining (which are estimated separately below). These general mining losses includes strip edge losses, blasting losses, and losses around access ramps etc.

Because of the number of plys and partings in many of the seams it has been assumed that partings less than 300 mm will be mined as coal.

Coal seam/ply losses due to exposure and mining have been estimated based on the proposed excavator and truck mining method at 0.1 m on the roof and 0.1 m on the seam/ply floor, making a total loss of 0.2 m per seam/ply. Dilution has been allowed of 0.1 m on the roof and 0.1 m on the seam floor, making a total waste gain of 0.2 m per seam/ply.

Table 4-5: Mining Parameters

Mining Parameters for Baruun Naran Coal Project			
Sl. No.	Particulars	Unit	Value
1	Roof loss	cm	10
2	Floor loss	cm	10
3	Roof dilution	cm	10
4	Floor dilution	cm	10
5	Minimum Mining Thickness	cm	30
6	Overall Mining Loss	%	5

4.5 Blasting

Coal will be free dig but overburden and interburden will require drilling and blasting for its removal.

4.6 Mining Method

The shape of the Baruun Naran coal deposit delineates the mining area of Baruun Naran project. The deposit is a plunging synclinal structure. Coal seams at Baruun Naran are folded into an asymmetrical syncline which plunges west at approximately 24°. Coal seams subcrop from east to west and can be traced from the southern to the northern limb, around the syncline nose (Figure 4-3). The north limb is very steep, dip averaging 75°. The south limb has a gentler dip of about 40° near the syncline nose (east) but progressively steepens to 75° dip towards the west.

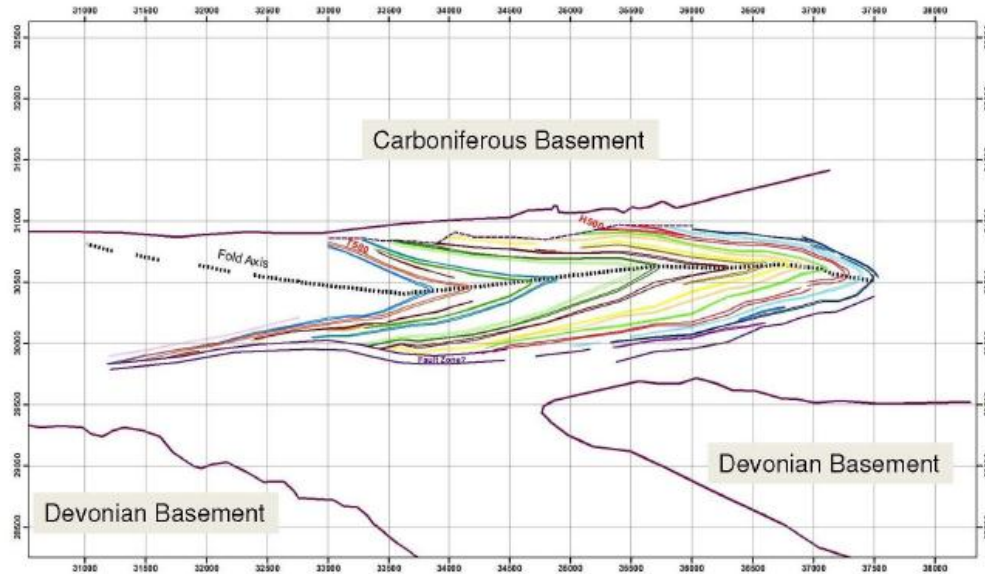


Figure 4-3: Syncline Axis, Bounding Faults & Seam subcrops at 1500m RL, Baruun Naran Coal Project

There are 22 seams identified and within these seam there exists multiple plies of coal, interburden and partings. Some 120 to 130 coal plies have been identified. Some of these plies are thick enough to be mined separately while others are thin and have thin partings of waste in-between. Any parting within a seam that is less than 300 mm will be mined as coal any parting above 300 mm has been planned to be mined separately as waste material.

The open cut operation will consist of a multi seam strip mining operation, utilising trucks and excavators. It is anticipated that all mining and coal handling and preparation will be carried on an owner operator basis.

4.7 Mine Plan

The open cut operation will consist of opening of two box cuts both in the central part of the property on T seam and in the eastern part of the block over H seam. Mining will continue simultaneously in both the pits for next 2 years. However, from year 3, mining will be concentrated in the central pit, which will also move towards in the western area and continue up-to year 8. From Year 9, mining activities will be carried out only in the eastern pit. In both the pits, multi seam strip mining operation will be carried out by utilising trucks and excavators.

The basic assumption for the selected mining sequence was to get optimum steady annual quantities of coking coal as well as thermal coal from the Baruun Naran pit. Mining sequences have been developed in such a way that the overall stripping ratio is consistent over longer period of mine life. The proposed mining sequence is also consistent with the annual product coking coal requirement, mine equipment requirement, early back fill and ease of mine operation.

This exposes low ratio coal and offers the shortest haul distance for the waste to the out of pit waste dump. Mining will progress in a westerly direction initially in the central pit. In pit dumping will commence as soon as possible from year 9 when mining operations shift in the eastern pit thus keeping the out of pit dumping of waste to a minimum.

Coal will be mined and transported to the Run of Mine ("ROM"), where it will be stockpiled. The ROM Coal will be crushed and washed at the CHPP at site before selling it to the market in China. Initially, product coal will be transported by road trucks to the buyer but it is proposed to be transported by rail which is upcoming at nearby Mongolian Mining Corporation "Ukhuaa Hudog" mine about 40 km from the Baruun Naran mine for which a spur will be built to the Baruun Naran mine. There will be two types of product coal available from the Baruun Naran mine, coking coal and thermal coal.

Figure 4-4 shows the mining sequence over the life of the mine.

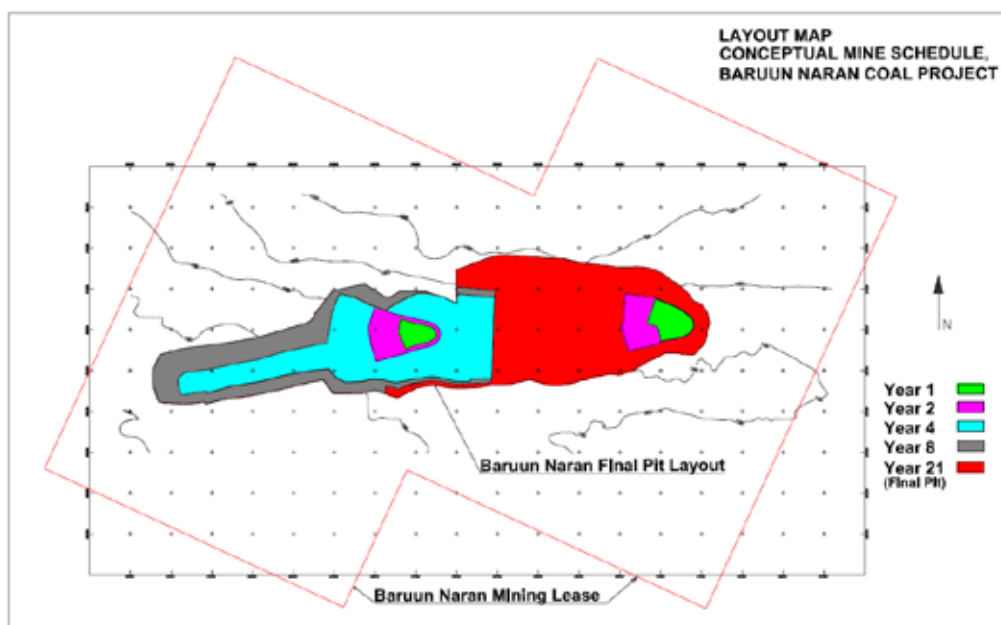


Figure 4-4: Mining Sequence, Baruun Naran Coal Project

4.7.1 Waste Dumps

Initially, waste will be trucked to an out of pit waste dump located in the south of the Baruun Naran central and east pit within the lease boundary. Back filling of previously mined out areas will commence from year 9.

4.7.2 Mining Volume/Tonnage

Table 4-6 and Figure 4-5 summarizes the waste and coal mined over the mine life of 21 years. Annual ROM coking and thermal coal production is given in Table 4-7 and Table 4-6.

Table 4-6: Production Summary, Barun Naran Coal Project

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	Total
Waste, Mbcm	9.38	25.40	59.00	66.66	68.47	69.56	69.56	70.25	73.35	73.57	70.79	67.69	50.04	53.57	53.22	51.17	51.17	51.17	51.97	52.30	18.68	1156.99
Coal, Mt	1.02	3.06	7.09	10.03	10.03	10.00	10.00	10.01	10.02	10.05	10.06	10.05	10.03	10.04	10.04	10.03	10.03	10.03	10.02	10.06	3.59	185.27
Stripping Ratio, bcm/t	9.20	8.30	8.32	6.65	6.83	6.96	6.96	7.02	7.32	7.32	7.04	6.74	4.99	5.34	5.30	5.10	5.10	5.10	5.19	5.20	5.20	6.24

Table 4-7: ROM Coking and Thermal Coal Production Summary, Barun Naran Coal Project

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	Total
Coking Coal, Mt	0.99	2.61	4.51	6.29	6.24	6.19	6.19	6.27	6.64	6.66	6.61	6.21	6.20	6.25	6.34	6.79	6.79	6.79	6.87	6.91	2.47	120.82
Thermal Coal, Mt	0.03	0.45	2.58	3.74	3.79	3.81	3.81	3.74	3.38	3.39	3.44	3.84	3.83	3.79	3.70	3.24	3.24	3.24	3.15	3.15	1.12	64.45
Total Coal, Mt	1.02	3.06	7.09	10.03	10.03	10.00	10.00	10.01	10.02	10.05	10.06	10.05	10.03	10.04	10.04	10.03	10.03	10.03	10.02	10.06	3.59	185.27

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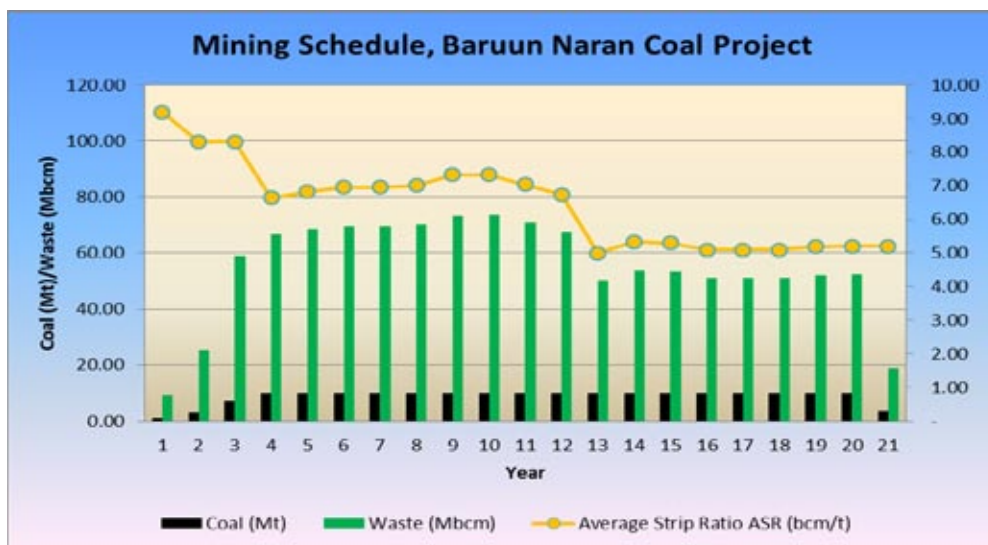


Figure 4-5: Coal Mining, Waste Removal Schedule with Annual Stripping Ratio

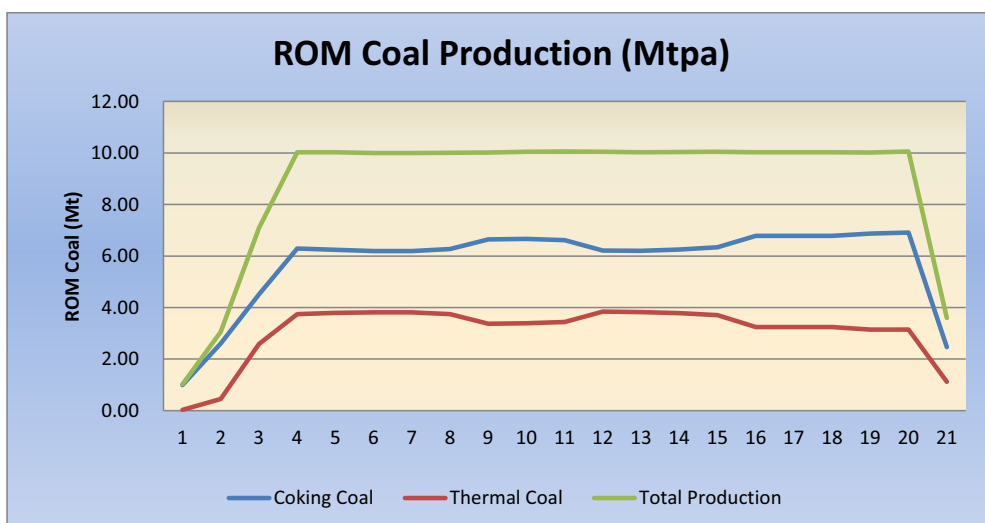


Figure 4-6: ROM Coking Coal & Thermal Coal Production from Baruun Naran Mine

4.8 Cost and Revenue Factors

SRK estimated the operating and capital costs (see Appendix 1) and also used an in-house NPV based economic model (see Appendix 4) to show the project and reserves are "economic".

4.9 Marketing and Product Specifications

Appendix 2 summarises the in-situ quality of the seams.

It has been assumed that the coal will be processed after crushing. It is also assumed that the two types of product coal, coking coal and thermal coal will be sold in the market.

4.10 Other Relevant Factors

This mining lease, Baruun Naran, will be a standalone mine.

It is anticipated that further work including additional exploration/production drilling, optimisation studies and detailed mine planning will occur in the region which may then require further updated Coal Resources and Coal Reserves estimates. If this is the case, then the results may impact on the conclusions contained in this report by the resource and reserve tonnes being increased.

4.10.1 Hydrogeology

Khangad Exploration LLC has completed a hydrology and hydro geological study for the area and it is concluded that no issues will impede the operation.

4.10.2 Environmental

SMEC have conducted the environmental study for Baruun Naran area and have submitted the draft report. SRK have reviewed the report and believe it provides adequate guidelines to facilitate mining the Baruun Naran area.

4.10.3 Social and Political

Khangad Exploration LLC is in possession of the land within the Baruun Naran Mining Lease and also has the land use right.

4.11 Results

Total Open Cut Recoverable Coal Reserves allowing for mining and handling losses are 185 Million tonnes ("Mt") including 148 Mt of Proved Recoverable Coal Reserves and 37 Mt of Probable Recoverable Coal Reserves.

The Summary of Recoverable Reserve estimates are shown by seam in Appendix 3.

As started earlier, this Statement of Coal Reserves has been carried out according to SRK's interpretation of the JORC Code. The JORC Resource Statement by Mr Paul Harrison of MBGS in February 2010 was used to develop the Recoverable Reserve tonnes after the application of mining parameters, mine design and other modifying factors.

It is worthy of note that, based on the above modifying factors, virtually all of the Resource Tonnes, as identified in the resource report by MBGS, were Measured or Indicated. These were able to be converted to Reserve Tonnes after the application of the modifying factors as stated in Section 4.2.

In addition, it is reasonable to say that the depth of drilling limited the economic pit-shell. And, it is reasonable to determine that with further geologic work and drilling, the reserves and pit could be extended.

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Therefore, there is a potential that further ongoing infill and deeper drilling between existing drill holes and further exploration drilling could result in additional coal tonnes being located at depths below the current designed pit shell. This may then lead to an update/increase of the Coal Resources and Coal Reserves estimates.

It must also be noted that, this will result in the final depth of the open cut to be significantly deeper than the current designed depths. This will lead to additional modifying factors that will have to be applied.

The major anticipated modifying factor will be the Geotechnical Parameters/Issues. A detailed and extensive Geotechnical Study will have to be conducted, and at these depths, one may have to revise the mining method.

These are only two factors and there will be others. However, considering the possible the current coal price trend and future price of coal it is worthy to consider a preliminary investigation estimating the possible addition tonnes that could be mined at a deeper depth.

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5. Conclusions and Recommendations

Total Open Cut Recoverable Coal Reserves allowing for mining and handling losses are 185 Million tonnes ("Mt") including 148 Mt of Proved Recoverable Coal Reserves and 37 Mt of Probable Recoverable Coal Reserves. Of these total reserves, 121 Mt is Coking Coal and 64 Mt is Thermal Coal.

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Appendices

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Appendix 1: Capital Costs and Operating Costs

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Capital Expenditure on Baruun Naran Mine Fleet (US\$M)

Equipment	Size		Unit price	Total capital
		Population	US\$M	US\$M
Waste				
Hydraulic Excavator	550+ tonne	2	11.42	22.84
Hydraulic Excavator	350 tonne	4	6.65	26.60
Hydraulic Excavator	250 tonne	3	4.91	14.74
Haul Truck	240 Ton	14	4.15	58.14
Haul Truck	150 Ton	44	2.49	109.77
Drill	219-279 mm hole dia.	3	1.54	4.61
Track Dozer	860 HP "U" blade	4	1.76	7.04
Track Dozer	580 HP "SU" blade	5	1.25	6.25
Sub-total (Waste)				249.99
Coal				
Hydraulic Excavator	250 tonne	2	4.67	9.34
Haul Truck	150 Ton	10	2.49	24.95
Track Dozer	580 HP coal blade	2	1.47	2.93
ROM Wheel Dozer	500 HP coal blade	1	1.33	1.33
Sub-total (Coal)				38.55
Support				
Grader	280HP	7	0.78	5.48
Diesel B'hoie	2.8 m3 bucket	1	0.59	0.59
Front End Loader	7 to 12m3 coal bucket	2	0.72	1.44
Front End Loader	20 to 25m3 coal bucket	2	2.22	4.44
Diesel Fuel Truck	100 Ton	2	0.96	1.93
Service Lube/Fuel/Coolant	50 Ton	2	0.62	1.24
Boom Truck		2	0.35	0.70
120 T Crane		1	1.23	1.23
Fire Tender		1	0.06	0.06
Tyre handler (Front-end Loader)		2	0.92	1.83
Water Truck fitted with fire fighting	100 Ton	6	0.90	5.39
Sub-total (Support)				24.33
Total Capital (Mine Fleet), US\$M as at 11th February 2011				312.87

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Estimates on Baruun Naran Mine Infrastructure Capital Expenditure (US\$)

Particulars	Unit	Capex
Road works including 25 km coal road to ER to china	USD	345,000
Industrial building Including Admn facilities	USD	11,575,320
Accommodation camp	USD	9,397,370
Coal laboratory	USD	920,290
Communications & IT	USD	3,029,729
Water works and pipeline incl. BN Well	USD	21,288,381
Generator sets and Light towers	USD	3,596,900
Power supply incl BN Power plant	USD	59,742,082
Rail Spur to BN	USD	55,200,000
Light Vehicles	USD	4,297,978
Furniture & fittings, computers and softwares	USD	652,128
Survey equipments etc	USD	2,010,000
Feasibility and other studies incl. production drilling	USD	5,200,000
Concrete Batching Plant, Weighbridges & crusher	USD	2,371,760
Mine Fencing	USD	122,733
Mine Dewatering & Surface Water Management	USD	14,957,554
CHPP	USD	174,029,226
Total Capital Expenditure on Mine Infrastructure (US\$M) as at 11th February 2011		368.74

Unit Cost Summary for Baruun Naran Coal Project

A. Cash Cost		
Direct Mining Operating Cost		
Labour Cost	USD/ROM t	2.12
Repair & Maintenance	USD/ROM t	5.99
Fuel	USD/ROM t	7.57
Explosives	USD/ROM t	1.84
Insurance, land and admn overhead	USD/ROM t	3.10
Direct Mining Opex	USD/ROM t	20.62
Mine Infra Operating Cost		
CHPP	USD/ROM t	4.17
BN Power Plant	USD/ROM t	0.43
Other Mine Infrastructure Cost	USD/ROM t	1.74
Mine Infra Opex	USD/ROM t	6.34
Mine Operating Cost (Opex)	USD/ROM t	26.96
Mine Operating Cost (Opex)	USD/Product t	39.57
B. Unit Capital and Loan Interest Cost		
Unit cost on Capex (Depreciation)	USD/ROM t	5.54
Unit cost on Loan (Interest)	USD/ROM t	1.08
Unit Cost of Production (Dep & Interest)	USD/ROM t	6.62
Unit Cost of Production (Dep & Interest)	USD/Product t	9.72
Baruun Naran Cost of Operations		
Total Unit Cost of Production	USD/ROM t	33.58
Total Unit Cost of Production	USD/Product t	49.29

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Appendix 2: In-situ Quality

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Raw Coal Quality, Baruun Naran Coal Project

- Air dried moisture (ad) 2%,
- Variable ash ply by ply (8% to 40%),
- Total Sulphur (TS) varying from 0.4% to 1.5%,
- Calorific value typically 34Mj/kg to 35Mj/kg on a dry, ash free basis (CVdaf),
- Raw CSN 2 to 7. All seams showed some capacity to provide caking swell indicating the coal is generally be suited to coking coal production (subject to the influence of other properties).
- Chlorine averaged 0.03% to 0.04%.

Seam	In-situ density g/cc @ 6% in-situ Moisture	Average ash % ad	Raw CSN (Average)
V500	1.48	20.00	3
U500	1.55	33.00	3
T500	1.42	15.80	4
R500	1.54	28.20	3
R400	1.55	33.50	3
R300	1.55	40.00	3
R200	1.54	30.30	3
Q500	1.53	28.20	3
N500	1.48	27.20	3
N400	1.54	30.00	3
K500	1.53	29.60	3.5
K400	1.64	36.20	3.5
J600	1.46	22.30	3
J500	1.41	18.30	3
J400	1.55	30.80	3
I500	1.40	18.80	4
H500	1.40	19.90	4
G500	1.57	34.90	3
G450	1.59	38.00	3
G400	1.60	36.90	3
F500	1.51	26.20	2
E500	1.56	37.10	

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Appendix 3: Recoverable Reserves

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Seam	Recoverable Coal Reserves, Mt (Million tonnes)		
	With Mining Losses (0.2m) and Handling Losses (5%)		
	Probable (Mt)	Proved (Mt)	Total (Mt)
V500	2.60	-	2.60
U500	1.99	7.44	9.43
T500	0.08	24.73	24.82
R500	2.58	1.74	4.32
R400	1.15	0.25	1.40
R300	0.78	-	0.78
R200	2.11	-	2.11
Q500	1.27	2.52	3.79
N500	0.91	10.69	11.60
N400	1.49	7.50	8.98
K500	3.91	10.15	14.06
K400	0.57	1.18	1.75
J600	2.40	3.27	5.67
J500	4.84	4.93	9.78
J400	1.22	-	1.22
I500	2.54	10.37	12.91
H500	3.56	35.82	39.38
G500	0.97	10.32	11.29
G450	0.57	2.86	3.43
G400	1.23	7.26	8.49
F500	0.51	6.84	7.35
E500	0.02	0.10	0.12
Total Coal (Mt)	37.30	147.97	185.27
Total Waste (Mbcm)			1156.99
Average Stripping Ratio (bcm/t)			6.24

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Appendix 4: Baruun Naran Economic Model

DEFINITIONS

In this announcement, unless the context otherwise requires, the following terms shall have the meanings set forth below. Certain other terms are explained in the section headed “Glossary” in this announcement.

“2006 Minerals Law”	the Minerals Law of Mongolia, enacted on July 8, 2006, and effective from August 26, 2006, and as amended and supplemented from time to time
“affiliate(s)”	any other person, directly or indirectly, controlling or controlled by or under direct or indirect common control with a specified person
“aimag”	the highest level of Mongolian administrative subdivision (essentially equivalent to a province), of which there are 21 in Mongolia
“Aquaterra”	Aquaterra Engineering LLC (Australia), an international water and environmental consultancy and is now part of the RPS Group, a United Kingdom based international consultancy group that provides advice and support in the planning, environment, energy and water sector development and management
“Articles” or “Articles of Association”	the amended and restated articles of association of our Company, adopted on September 17, 2010 and as amended from time to time
“BN”	Baruun Naran
“BN deposit”	means our BN deposit located in South Gobi Province which includes both aboveground (<300m) and underground (>300m) deposits
“BN mine”	means the aboveground (<300m) portion of our BN deposit
“Board”	the board of directors of the Company
“BOT”	Build-Operate-Transfer agreement, a type of contract arrangement in which a private sector entity builds an infrastructure project, operates it and eventually transfers ownership of the project to the government
“BOT Agreement”	Build-Operate-Transfer Agreement executed by and between Gobi Road LLC and the Ministry of Road, Transportation and Urban Development of Mongolia on June 9, 2010
“CAGR”	Compound Annual Growth rate

“CFR”	Cost and Freight, meaning the seller must pay the costs and freight to bring the goods to the port of destination. The risk is transferred to the buyer once the goods are loaded on the vessel
“CHPP”	coal handling and preparation plant
“China” or “PRC”	the People’s Republic of China, and for the purposes of this announcement, excluding Hong Kong, Macau and Taiwan
“Collateral”	the capital stock of Mongolia Coal Corporation Limited and Mongolian Coal Corporation S.à.r.l., owned by the Company and Mongolian Coal Corporation Limited, respectively
“Company”, “our Company”, “Group”, “our Group”, “we”, “us”, “our” or “Mongolian Mining Corporation”	Mongolian Mining Corporation, an exempted company incorporated in the Cayman Islands with limited liability on May 18, 2010 and except where the context indicates otherwise (i) our subsidiaries; and (ii) with respect to the period before our Company became the holding company of our present subsidiaries, the business operated by our present subsidiaries or (as the case may be) their predecessors
“DAP”	Delivered At Place, the seller delivers the goods to the buyer on the arriving means of transport, ready for unloading at the named place of destination, pays for carriage to the named place, except for costs related to import clearance, and assumes all risks prior to the point that the goods are ready for unloading by the buyer
“DEG”	Deutsche Investitions-und Entwicklungsgesellschaft mbH (the German Investment and Development Company)
“Deutsche Bahn”	DBI, GmbH, a provider of consultancy, management and planning services for infrastructure and transport projects, from project development to acceptance/commissioning and operational management
“DGMC”	the Department of Geological and Mining Cadaster, a subordinate agency of MRAM responsible for registration of exploration licenses and mining license rights in Mongolia
“Director(s)”	director(s) of our Company
“EBRD”	European Bank for Reconstruction and Development, an international financial institution that supports projects in 29 countries, from central Europe to central Asia

“EBRD, FMO and DEG Loan Agreements”	an aggregate of US\$180 million loan facility agreements with (i) EBRD dated May 12, 2010, amended and restated on August 11, 2010 and further amended on October 8, 2010, (ii) FMO dated August 11, 2010 and further amended on October 13, 2010, and (iii) DEG dated August 11, 2010 and further amended on October 13, 2010, and each of the them further amended on March 5, 2012
“EPCM”	Engineering, Procurement, Construction and Management, a form of contract where the contractor will design and install the equipment, procure and install the necessary materials, and be responsible of managing the process of the installation
“EPL”	Environmental Protection Law of Mongolia, enacted on March 30, 1995 and effective on June 5, 1995, as may be amended and supplemented from time to time
“ER LLC”	Energy Resources LLC, a limited liability corporation organized under Mongolian law on April 22, 2005
“Erdenes MGL”	Erdenes MGL LLC, a state-owned enterprise
“Erdenes Tavan Tolgoi”	Erdenes Tavan Tolgoi Joint Stock Company, a subsidiary of Erdenes MGL, which was established on October 20, 2010 by the Government by Resolution No. 272
“Existing Standard Bank Facilities Agreement”	the US\$400 million loan facility agreement we entered into with Standard Bank dated June 24, 2011
“FMO”	Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V. (Entrepreneurial Development Bank of Netherlands)
“FOB”	Free on Board, meaning the risk passes to the buyer, including payment of all transportation and insurance costs, once goods are delivered on board of the ship by the seller
“FOR”	Free on Rail, meaning the risk passes to the buyer, including payment of all transportation and insurance costs, once goods are delivered on the wagon of rail by the seller
“FOT”	Free on Truck, meaning the risk passes to the buyer, including payment of all transportation and insurance costs, once goods are delivered on a truck at a named loading point
“GDP”	gross domestic product
“GM”	Ganqimaodu or Gants Mod, the Chinese side of the Sino-Mongolian border crossing

“Government of Mongolia” or “Government”	the Government of Mongolia
“Group”	the Company and its subsidiaries
“GS”	Gashuun Sukhait, the Mongolia side of the Sino-Mongolian border crossing
“Hong Kong” or “HK”	the Hong Kong Special Administrative Region of China
“Huanghua”	located in the Bohai Gulf coastal regions of Hebei province in northeastern China, and home to the Huanghua Port
“IDR”	issuer default ratings
“IFRS”	International Financial Reporting Standards
“IMF”	International Monetary Fund
“Initial Purchasers”	ING Bank N.V., Singapore Branch, J.P. Morgan Securities Ltd. and Merrill Lynch International
“Investment Agreement”	an agreement that a mining license holder may, at its option, enter into with the Government of Mongolia concerning stability of tax rates, the right to sell products at international market prices, a guarantee that the license holder may receive and dispose of income from such sales, and provisions with respect to the amount and term of the license holder’s investment
“Joint Lead Managers”	ING Bank N.V., Singapore Branch, J.P. Morgan Securities Ltd., Merrill Lynch International, Standard Bank Plc and Standard Chartered Bank
“Joint Bookrunners”	ING Bank N.V., Singapore Branch, J.P. Morgan Securities Ltd. and Merrill Lynch International
“Khan Bank Loan Agreement”	the US\$13 million loan agreement ER LLC entered into with Khan Bank dated December 26, 2011
“Law on VAT”	Law on Value-Added Tax
“Leighton”	Leighton Asia Limited (Hong Kong), a contract mining company
“LIBOR”	the London Interbank Offered Rate, the rate charged by one bank to another for lending money
“Listing Rules”	Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited

“MAK”	Mongolyn Alt Corporation
“MBGS”	McElroy Bryan Geological Services Pty Ltd, a provider of consulting services to the coal mining industry
“MBGS Resource Report”	the JORC Resource Report dated February 2010 prepared by MBGS
“MCS Group”	MCS Holding and its subsidiaries (other than our Group)
“MCS Holding”	MCS Holding LLC, a limited liability corporation organized under Mongolian law on March 29, 2001
“Mineral Deposit of Strategic Importance”	under the 2006 Minerals Law, a deposit that may have the potential to impact national security, or the economic and social development of Mongolia at the national and regional levels, or that is generating, or has the potential to generate, more than 5% of Mongolia’s GDP product in any given year
“Minerals License Transfer Agreement”	the minerals license transfer agreement entered into between ER LLC and the Government of Mongolia on March 21, 2008, pursuant to which ER LLC agreed to transfer all of the mining licenses held by it at the time, except for the one covering our UHG deposit, to a state owned enterprise at nil consideration
“MMRE”	the Ministry of Mineral Resources and Energy, a cabinet-level ministry of the Government of Mongolia
“MNT”	togrog, the lawful currency of Mongolia
“Mongolian Licensing Law”	The Licensing Law of Mongolia enacted on February 1, 2001, and effective from January 1, 2002, as the same may be amended and supplemented from time to time
“Moody’s”	Moody’s Investors Services Inc
“MRAM”	the Mineral Resources Authority of Mongolia, a subordinate agency of the MMRE, under which the DGMC operates
“New Standard Bank Facilities Agreement”	the US\$300 million term loan facilities agreement we entered into with Standard Bank dated March 8, 2012
“NIC”	NIC LLC, an oil import and distribution company in Mongolia. It is majority owned by Petrovis LLC
“Norwest”	Norwest Corporation, a provider of consulting services to the energy, mining, and natural resources industries and our independent technical expert
“Notes”	Guaranteed Senior Notes due 2017

“NS”	Nariin Sukhait, located in Gurvan tes soum of South Gobi Province, approximately 56 km north of Shivee Khuren-ceke crossing point of the Sino-Mongolian border and 110 km east of Ulaanbaatar
“Operations Management Contract”	the contract for operations management services we entered into with Sedgman in December 2010 for operations management of the first module of our CHPP
“OT”	Ovoot Tolgoi, located in the southwest corner of South Gobi Province, approximately 45 km north of the Sino-Mongolian border and 950 km south of Ulaanbaatar
“Parliament of Mongolia” or “State Great Hural”	the legislature in Mongolia
“Qinghua”	Inner Mongolia Qinghua Group
“Qinhuangdao”	a city in Hebei province in northeastern China and home to the Qinhuangdao Port, which is a strategically important port in China and is the largest coal shipping port in China
“QGX Convertible Bonds”	convertible bonds in the aggregate principal amount of US\$85 million as part of the consideration paid for our acquisition of BN
“Risun”	Risun Coal Chemicals Group
“RMB”	Renminbi, the lawful currency of China
“SACMS”	State Administration of Coal Mine Safety
“SEC”	the U.S. Securities and Exchange Commission
“Securities Act”	the U.S. Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder
“Sedgman”	Sedgman Consulting (China) and Sedgman Limited, a provider of multi-disciplinary engineering, project delivery and operations services
“Shanxi Fenwei”	Shanxi Fenwei Energy Consulting Co., Ltd., our industry consultant
“Shanxi Fenwei Report”	an independent expert report on the energy sector in China and Mongolia prepared by Shanxi Fenwei
“Shenhua”	Shenhua Bayannaoer Energy Co., Ltd.
“SK”	Shivee-Khuren, the Mongolian side of the Shivee-Khuren and Ceke Sino-Mongolian border

“Small TT”	the existing so-called “Small” Tavan Tolgoi mine owned by Company Joint Stock Tavan Tolgoi
“soum”	the second level of Mongolian administrative subdivisions (essentially equivalent to a sub-province or district)
“South Gobi Province”	Umnugobi Aimag, a province located in southern Mongolia
“SRK Consulting”	SRK Consulting (Australasia) Pty Ltd, a provider of consulting services to the earth and water resources industries
“SRK Reserve Report”	the JORC Reserve Report for BN dated March 23, 2011 prepared by SRK Consulting
“State Professional Inspection Agency”	an agency of the Government of Mongolia that is in charge of laws and regulations of the State, including labor, safety and health
“Strategic Deposits List”	a list of 15 deposits designated by the Parliament to be Mineral Deposits of Strategic Importance by Resolution No. 27, adopted on February 6, 2007 (Tier 1 Deposits List)
“Subsidiary Guarantors”	Mongolian Coal Corporation Limited, Mongolian Coal Corporation S.à.r.l., Energy Resources Corporation LLC, Energy Resources LLC, Energy Resources Mining LLC and Transgobi LLC
“Tavan Tolgoi”	means the coal formation located in South Gobi, Mongolia, which includes our UHG deposit
“Tianjin”	a metropolis in northeastern China and home to the Tianjin Port Free Trade Zone
“Tier 2 Deposits List”	a list of 39 deposits designated in Resolution No. 27, adopted on February 6, 2007, to be further evaluated and determined if one or more of such deposits should be recommended by the Government of Mongolia to Parliament for designation as a Mineral Deposit of Strategic Importance
“TKH”	Tsagaan Khad, located in Khanbogd soum of South Gobi Province, approximately 21 km from GM
“TMR”	target market region, including Inner Mongolia, Hebei, Shandong and Jiangsu provinces
“Tsogttsetsii”	Tsogttsetsii soum is the location where Tavan Tolgoi sits
“UHG”	Ukhaa Khudag, located in Tsogttsetsii soum of South Gobi Province

“UHG deposit”	means our Ukhaa Khudag deposit located in the Tavan Tolgoi coalfield which includes both aboveground (<300m) and underground (>300m) deposits
“UHG mine”	means the aboveground (<300m) portion of our UHG deposit and its related infrastructure
“UK”	the United Kingdom
“United States” or “U.S.”	the United States of America
“US\$”	U.S. dollar, the lawful currency of the United States
“VAT”	value added tax
“Wood Mackenzie”	Wood Mackenzie (Australia) Pty Ltd, a provider of consulting services to the energy and metals industries

GLOSSARY

The glossary of technical terms contains explanation of certain terms used in this announcement as they relate to our Company and as they are used in this announcement in connection with our Group and our business. These terms and their given meanings may not correspond to standard industry definitions.

“1/2 ZN”	1/2 sticky coal
“1/3 JM”	1/3 coking coal or semi-soft coking coal
“assay”	qualitative or quantitative analysis of a substance to determine its components; the result of such an analysis
“BCM”	bank cubic meter
“broad gauge”	1,520 mm rail track gauge, also known as “Russian gauge”
“coke”	bituminous coal from which the volatile components have been removed
“coking coal”	coal used as a raw material in the process of manufacturing steel and iron. It is also known as metallurgical coal
“CSN”	Crucible Swelling Number. This number is used to compare the shape and the coking volume increase of a finely ground coal sample when 1 gram is heated in a closed crucible quickly over a brief time period. Results are only used as a comparative indication of the coking potential of the coal and not a measure of strength. Values for CSN range from 1-9
“CSR”	Coke Strength after Reaction, a quantitative measurement of the strength of the coke produced by a particular coking coal. This strength rating is evaluated in a laboratory setting, with a high CSR value being highly regarded in the market, primarily because this measurement is related to blast furnace performance
“Environmental Impact Assessment” or “EIA”	a feasibility study by international standards which assesses in detail the environmental impact of an undeveloped mining project
“feasibility study”	a feasibility study by international standards which assesses in detail the technical soundness and economic viability of an undeveloped mining project, and serves as the basis for the investment decision and as a bankable document for project financing. The study is based on a detailed mine plan and constitutes an audit of all geological, engineering, environmental, legal and economic information accumulated on the project. Generally, a separate environmental impact study is required

“FM”	fat coal, a form of hard coking coal
“G Index”	a measure of caking or cohesive behavior of bituminous coal. The caking behavior is critical to making coke strong and not powdery
“HCC”	hard coking coal; see “Business – Coal Products”
“indicated mineral resource”	that part of a mineral resource for which tonnage, densities, shape, physical characteristics, quality and mineral content can be estimated with a reasonable level of confidence. It is based on exploration, sampling and testing information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes. The locations are too widely or inappropriately spaced to confirm geological and/or quality continuity but are spaced closely enough for continuity to be assumed
“Industry Guidance 7”	Industry Guide 7 – Description of Property by Issuers Engaged or to be Engaged in Significant Mining Operations, adopted by the SEC
“inferred mineral resource”	that part of a mineral resource for which tonnage, quality and mineral content can be estimated with a low level of confidence. It is inferred from geological evidence and of assumed but not verified geological and/or quality continuity. It is based on information gathered through appropriate techniques from locations such as outcrops, trenches, pits, workings and drill holes which may be limited or of uncertain quality and reliability
“JM”	primary coking coal, a form of hard coking coal
“JORC”	Joint Ore Reserves Committee of The Australian Institute of Mining and Metallurgy, Australian Institute of Geoscientists and Minerals Council of Australia
“JORC Code”	Australasian Code for Reporting of Mineral Resources and Ore Reserves
“km”	kilometer
“lignite”	the lowest rank of coal with the lowest energy content, typically containing 25-35% carbon. Lignite tends to be found in relatively young coal deposits that were not subjected to extreme heat or pressure, is crumbly, has high moisture content and is mainly used as fuel at power plants to generate electricity

“Liulin Coking”	Liulin Coking is a mine owned by the Huajin Coking Coal Company. Located in the Hedong coalfield in Shanxi province, Liulin Coking supplies low sulphur, low ash and low volatile matter coking and lean coal, which are considered as benchmark metallurgical coal types in China
“m”	meter
“metallurgical coal”	see “coking coal”
“metric tonne”	1,000 kilograms
“middlings”	secondary thermal product from processing of coking coal
“mine plan/mine planning”	by international standards includes the current documentation of the state of development and projected exploitation of a deposit during its economic life including current mining plans. It is generally made by the operator of the mine. The study takes into consideration the quantity and quality of the minerals extracted during the reporting time, changes in economic viability categories due to changes in prices and costs, development of relevant technology, newly imposed environmental or other regulations, and data on exploration conducted concurrently with mining. A map of the deposit is included showing the roadway layout, production cell areas and the projected annual sequence of extraction
“mineral reserve”	the economically mineable part of a measured or indicated mineral resource demonstrated by at least a preliminary feasibility study. This study must include adequate information on mining, processing, economic and other relevant factors that demonstrate, at the time of reporting, that economic extraction can be justified. A mineral reserve includes diluting materials and allowances for 8 losses that may occur when the material is mined
“mineral resource”	a concentration or occurrence of material of intrinsic economic interest in or on the earth’s crust in such form, quality and quantity that there are reasonable prospects for eventual economic extraction. The location, quantity, quality, geological characteristics and continuity of a mineral resource are known, estimated or interpreted from specific geological evidence and knowledge. Mineral resources are sub-divided, in order of increasing geological confidence, into inferred, indicated and measured categories
“mining rights”	the rights to mine mineral resources and obtain mineral products in areas where mining activities are licensed

“Mt”	million tonnes
“Mtpa”	million tonnes per annum
“MW”	megawatt
“open-pit”	the main type of mine designed to extract minerals close to the surface; also known as “open cut”
“overburden”	barren rock material, either loose or consolidated, overlying a mineral deposit, which must be removed prior to mining
“PCI coal”	the term refers to coal that is used for Pulverized Coal Injection. PCI coal is characterized by its high rank, low volatile matter and generally has ash levels of less than 10.5%. PCI coal is fired directly into the lower level of the blast furnace as an effective means of injecting carbon, thereby reducing the quantity of coke required per tonne of hot metal produced. The higher the volume of PCI coal that can be utilized, the lower the volume of coke required. A wide range of coal is suitable for PCI, including thermal and semi-soft coking coal and as such it is cheaper than most coal purchased for producing coke
“Permian”	a geological period from around 299 million years ago to around 251 million years ago
“probable reserve”	the economically mineable part of an indicated and, in some circumstances, a measured mineral resource demonstrated by at least a preliminary feasibility study. This study must include adequate information on mining, processing, metallurgical, economic and other relevant factors that demonstrate, at the time of reporting, that economic extraction can be justified
“productivity”	measurements of worker efficiency usually expressed in terms of tonnes per unit of time
“proven reserve”	the economically mineable part of a measured mineral resource. It includes diluting materials and allowances for losses which may occur when the material is mined. Appropriate assessments, which may include feasibility studies, have been carried out, and include consideration of and modification by realistically assumed mining, economic, marketing, legal, environmental, social and governmental factors. These assessments demonstrate at the time of reporting that extraction could reasonably be justified
“PS”	meager lean coal

“qualified person/qualified personnel”	an individual who: (a) is an engineer or geoscientist with at least five years of experience in mineral exploration, mine development or operation, or mineral project assessment, or any combination of these; (b) has experience relevant to the subject matter of the mineral project and the technical report; and (c) is a member or licensee in good standing of a professional association
“QF”	gas fat coal
“QM”	gas coal
“raw coal”	generally means coal that has not been washed and processed
“recoverable reserve”	the part of the reserve base which could be economically extracted or produced at time of determination
“resource recovery rate”	quantity of recovered resources divided by (the quantity of recovered resources plus the final quantity of processed waste)
“ROM”	run-of-mine, the as-mined coal, that includes out-of-seam dilution material which is processed through our CHPP
“seam”	a stratum or bed of coal; generally applied to large deposits of coal
“SHCC”	semi-hard coking coal; see “Business – Coal Products”
“SM”	lean coal
“standard gauge”	1,435 mm rail track gauge
“steel industry supply chain”	industries involved in the steel producing process (including iron ore and coking coal)
“strip ratio” or “stripping ratio”	the ratio of the amount of waste removed (in bank cubic meters) to the amount of coal (in tonnes) extracted by open-pit mining methods
“thermal coal”	also referred to as “steam coal” or “steaming coal,” thermal coal is used in combustion processes by power generation plants and industrial users to produce steam for power and heat. Thermal coal tends not to have the carbonization properties possessed by coking coal and generally has lower heat value and higher volatility than coking coal
“tonne”	metric tonne
“tpa”	tonnes per annum

“transshipment”	transfer of shipment from one carrier to another
“underground mining”	refers to a group of underground mining techniques used to extract coal
“washed coal”	hard coking coal that has been washed and processed to reduce its ash content
“Y Index”	indicates the maximum thickness of gelinite (or plastic layer) in bituminous coal. Plasticity refers to the melting and bonding behavior of the coal and is an important requirement in the coke blend. Plasticity is also required for end product coke strength
“yield”	the percentage of saleable portion of coking coal recovered from processed material

For and on behalf of the Board
Mongolian Mining Corporation
Odjargal Jambaljamts
Chairman

Hong Kong, March 14, 2012

As at the date of this announcement, the Board consists of Mr. Odjargal Jambaljamts and Dr. Battengel Gotov, being the executive directors of the Company, Mr. Gantumur Lingov, Ms. Enkhtuvshin Gombo, Mr. Enkh-Amgalan Luvsantseren, Dr. Oyungerel Janchiv, Mr. Philip Hubert ter Woort and Mr. Batsaikhan Purev, being the non-executive directors of the Company, and Mr. Ochirbat Punsalmaa, Mr. Unenbat Jigjid and Mr. Chan Tze Ching, Ignatius, being the independent non-executive directors of the Company.