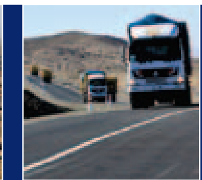
MONGOLIAN
MINING
CORPORATION

(Incorporated in the Cayman Islands with limited liability)
Stock Code: 975

ANNUAL REPORT 2012



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Company Profile

Mongolian Mining Corporation ("**MMC**" or the **"Company"** and together with its subsidiaries, the "**Group**", The Stock Exchange of Hong Kong Limited ("**SEHK**" or "**Stock Exchange**") Stock Code: 975) is the largest producer and exporter of high-quality hard coking coal in Mongolia. MMC owns and operates an open-pit coking coal mine at the Ukhaa Khudag ("**UHG**") deposit located within the Tavan Tolgoi coal formation, and the Baruun Naran ("**BN**") coking coal deposit, both located in South Gobi, Mongolia.

MISSION, VISION AND VALUES

Our mission:

To undertake safe and profitable mining and processing of mineral resources while promoting the development of Mongolia, through combining modern technology with human endeavor

Our vision:

We will strive to become a leading mining company in the region by maximising value for our shareholders and for the communities where we operate

Our values and objectives:

We recognise that people are our key asset. Therefore:

– MMC makes the safety of our personnel the highest priority

– As a responsible employer, MMC provides equal employment opportunities within a meritocratic workplace

We believe that modern and cost-efficient technology will bring sustainable growth and prosperity. Therefore:

– MMC aims to use technology and innovate in the same to make quality products safely at the lowest cost

– MMC will contribute to the development of technical standards in the global extractive industry

We are committed to environmental sustainability in our operations. Therefore:

– MMC will strive to minimise the impact on the environment

– MMC will comply with all required environmental standards, and take further measures to prevent and mitigate potential environmental impact

We are committed to socially responsible mining practices. Therefore:

– MMC will strive to build mutually beneficial relationships with local communities and officials

– MMC will contribute to social development through community development initiatives and other programs

We are committed to transparent and fair business practices. Therefore:

– MMC will foster mutually beneficial relationships with our suppliers and contractors

– MMC will develop, maintain and value long-term relationships with our customers

We believe sound corporate governance is a cornerstone of MMC's management and operations. Therefore:

– MMC will comply with the best international practices

– MMC will cultivate a culture of corporate governance as an integral part of its ongoing organisational development

Corporate Information

BOARD OF DIRECTORS

Executive Directors

Odjargal Jambaljamts (Chairman)
Battsengel Gotov (Chief Executive Officer)

Non-Executive Directors

Oyungerel Janchiv
Batsaikhan Purev
Od Jambaljamts
Enkhtuvshin Gombo

Independent Non-Executive Directors

Ochirbat Punsalmaa
Unenbat Jigjid
Chan Tze Ching, Ignatius

REGISTERED OFFICE

Cricket Square, Hutchins Drive
PO Box 2681
Grand Cayman, KY1-1111
Cayman Islands

PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Level 28, Three Pacific Place
1 Queen's Road East
Hong Kong

HEADQUARTERS AND PRINCIPAL PLACE OF BUSINESS IN MONGOLIA

16th Floor, Central Tower
Sukhbaatar District
Ulaanbaatar 14200
Mongolia

COMPANY SECRETARY

Ng Sin Yee, Clare

INDEPENDENT AUDITOR

KPMG
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

AUTHORIZED REPRESENTATIVES

Battsengel Gotov
Ng Sin Yee, Clare

COMPLIANCE ADVISER

Anglo Chinese Corporate Finance, Limited
40th Floor, Two Exchange Square
8 Connaught Place
Central, Hong Kong

LEGAL ADVISERS

Milbank, Tweed, Hadley & McCloy
30th Floor, Alexandra House
18 Chater Road
Central, Hong Kong

Economic & Legal Consultancy LLC
Suite 1003, Central Tower
Sukhbaatar District
Ulaanbaatar 14200
Mongolia

Conyers Dill & Pearman
2901, One Exchange Square
8 Connaught Place
Central, Hong Kong

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Royal Bank of Canada Trust Company (Cayman) Limited
4th Floor, Royal Bank House
24 Shedden Road, George Town
Grand Cayman KY1-1110
Cayman Islands

HONG KONG SHARE REGISTRAR

Computershare Hong Kong Investor Services Limited
Shops 1712-1716, 17th Floor
Hopewell Centre
183 Queen's Road East
Wanchai, Hong Kong

PRINCIPAL BANKERS

EBRD – European Bank for Reconstruction and Development, London, United Kingdom
FMO – Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V. (Entrepreneurial Development Bank of Netherlands)
DEG – Deutsche Investitions-und Entwicklungsgesellschaft mbH (The German Investment and Development Company)
The Standard Bank of South Africa Ltd.
Citibank, N.A., Hong Kong Branch
The Bank of East Asia, Limited, Hong Kong
Standard Chartered Bank (Hong Kong) Limited
ING Group N.V.
Golomt Bank of Mongolia
Khan Bank of Mongolia
Trade and Development Bank of Mongolia

COMPANY WEBSITE

www.mmc.mn

STOCK CODE

975

Directors and Senior Management

BOARD OF DIRECTORS (THE "BOARD")

Odjargal Jambaljamts, aged 47, is an executive Director and Chairman of the Board. Mr. Jambaljamts was appointed as an executive Director of the Company on 18 May 2010. Mr. Jambaljamts is also the Chairman of the Nomination Committee and member of the Remuneration Committee. From 1993 to the present, Mr. Jambaljamts has been the Chairman of MCS Holding LLC (together with its subsidiaries, the "**MCS Group**"), an associate of MCS Mining Group Limited (a controlling shareholder of the Company). Mr. Jambaljamts is a director of Starain Limited since January 2011, director of Novel International Investment Limited and director of Novel Holdings Group Limited, a controlling shareholder of the Company, since March 2012. He was appointed as a director of MCS (Mongolia) Limited, also a controlling shareholder, and MCS Mining Group Limited on 3 July 2012. Mr. Jambaljamts is the brother of Mr. Od Jambaljamts, a non-executive Director and controlling shareholder of the Company. From 1989 to 1991, Mr. Jambaljamts was an automation engineer at the Energy Authority of Ulaanbaatar, Mongolia. From 1992 to 1993, he was an economist at the Hydropower LLC for the Project of Egiin River. Mr. Jambaljamts was awarded a bachelor's degree in cybernetics of electrical system by the Kiev Polytechnic Institute, Ukraine, and holds his master's degree in business administration from the Maastricht School of Management, Ulaanbaatar, Mongolia.

Battsengel Gotov, aged 40, is an executive Director and Chief Executive Officer of the Company. Dr. Gotov was appointed as an executive Director of the Company on 18 May 2010. He joined the Group in June 2008 as the Chief Executive Officer of Energy Resources LLC. Since 2004, Dr. Gotov has served at various managerial positions in the MCS Group. He was appointed as the Chief Executive Officer of Khangad Exploration LLC on 7 December 2012. From 1996 to 2000, Dr. Gotov was an Assistant Professor at Comenius University in Bratislava. He moved to the University of Cologne, Germany in September 2000 as a research fellow sponsored by the Alexander von Humboldt Foundation, and stayed at the University of Cologne from September 2000 until October 2003 as a postdoctoral fellow. Dr. Gotov is a board member of the Mongolian National Mining Association, the Mineral Industry Safety Association and the South Gobi Business Council. Dr. Gotov was awarded a master's degree in science and a PhD in organic chemistry by the Comenius University, Slovakia.

Directors and Senior Management

Oyungerel Janchiv, aged 58, is a non-executive Director of the Company. She was appointed as a non-executive Director of the Company on 16 September 2010. She is a representative of Petrovis Resources Inc., a shareholder of the Company. Between 1979 and 1982, Dr. Janchiv served as a petroleum economist at the Oil Supply Management Authority. From 1988-1990, she served as a chief economist at the Oil Supply Management Authority. From 1990 to 1996, she was the general director of the board of directors of the Neft Import Concern and was responsible for managing the importation and distribution of petroleum products. Since 2008, Dr. Janchiv has been the Chairperson of Petrovis LLC which is the largest shareholder of Petro Matad Limited and the largest petroleum import and distribution company in Mongolia. Since September 2012, Dr. Janchiv has been the deputy chair of Petro Matad Limited which was listed on the Alternative Investment Market of the London Stock Exchange. Dr. Janchiv was awarded a diploma of engineer-economist for the petroleum and gas industry and a PhD by the Gubkin State University of Oil and Gas in Moscow, Russia.

Batsaikhan Purev, aged 46, is a non-executive Director of the Company. He was appointed as a non-executive Director of the Company on 16 September 2010. He is a representative of Shunkhlai Mining, a shareholder of the Company. He is a founder of Shunkhlai LLC, one of the first private companies in Mongolia and one of Mongolia's largest petroleum companies. He has been the General Director of Shunkhlai LLC and Shunkhlai Group LLC, and an executive director of Shunkhlai Mining LLC since 1993. Mr. Purev has been the Chairman and President of Shunkhlai Group LLC since January 2012. He is a Chairman of APU Company, a company listed on the Mongolian Stock Exchange. Mr. Purev was awarded a bachelor's degree in mechanical engineering by the Mongolian Technical University.

Od Jambaljamts, aged 48, is a non-executive Director of the Company. Mr. Jambaljamts was appointed as a non-executive Director of the Company on 4 July 2012. He is also a member of the Corporate Governance Committee. Mr. Jambaljamts is the president of MCS Group and a director of a number of subsidiaries within the MCS Group. He also works as the Honorary Council General of Denmark. Mr. Jambaljamts has over 20 years of experience in both private and public sectors and has extensive experience in working with companies in a diversity of fields. Mr. Jambaljamts is the brother of Mr. Odjargal Jambaljamts, the Chairman of the Board, an executive Director and a controlling shareholder of the Company. Mr. Jambaljamts is also a director of MCS (Mongolia) Limited and MCS Mining Group Limited since July 2012 and director of Trimunkh Limited since July 2011, all of which are controlling shareholders of the Company. Mr. Jambaljamts was awarded a bachelor's degree in International Relations by the Institute for International Relations, Moscow, Russia in 1988 and master's degree in arts majoring in foreign affairs by the University of Oxford, United Kingdom in 1993. Mr. Jambaljamts was awarded the Honorary Labour Medal of Mongolia in 1997, and twice awarded with the Polestar medal of Mongolia.

Enkhtuvshin Gombo, aged 41, is a non-executive Director of the Company. She was appointed as a non-executive Director of the Company on 16 September 2010. Ms. Gombo is also a member of the Audit Committee. She is a representative of MCS Holding LLC. Ms. Gombo is currently the Vice President for Finance and Investment of MCS Holding LLC. Ms. Gombo joined the MCS Group in 2003 as a financial analyst of MCS Holding LLC and became the head of the planning unit of the finance department in 2006. Ms. Gombo was appointed as a director of MCS Group's finance department in 2008. Ms. Gombo was awarded a bachelor's degree in banking and finance by the Economic College of Mongolia, a master's degree in business administration from the University of Birmingham, UK, and a master's degree in finance by the University of Colorado, United States.

Directors and Senior Management

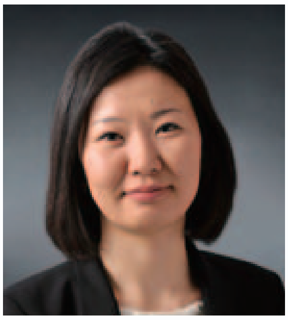
Ochirbat Punsalmaa, aged 71, is an independent non-executive Director of the Company. Mr. Punsalmaa was appointed as an independent non-executive Director of the Company on 16 September 2010. Mr. Punsalmaa is the Chairman of the Remuneration Committee and member of the Audit Committee and the Nomination Committee. During 1972 to 1990, Mr. Punsalmaa held various positions with the Government of Mongolia ("**GoM**"), including deputy minister of the ministry of power energy and mining, minister of the ministry of fuel and power energy of Mongolia, chairman of the state committee of external economic relations and cooperation of Mongolia and minister of the external economic relation of Mongolia. Mr. Punsalmaa was the President of Mongolia between 1990 and 1997. Since 1997, he has been the chairman of the board of Ochirbat Foundation. He was awarded a PhD in Technical Sciences by the Moscow Mining Institute, and Honorary Doctorate by Dankook University, South Korea, Mongolian Technical University and Saint Petersburg Mining Institute, Russia. He has been an Academician of Mongolian Academy of Science since July 2011. Mr. Punsalmaa was credited as a Barrister Emeritus by the School of Law, Texas Wesleyan University, United States.

Unenbat Jigjid, aged 50, is an independent non-executive Director of the Company. Mr. Jigjid was appointed as an independent non-executive Director of the Company on 16 September 2010. Mr. Jigjid is the Chairman of the Corporate Governance Committee and member of the Audit Committee, Nomination Committee and Remuneration Committee. From 1990 to 2000, Mr. Jigjid held various positions in the Bank of Mongolia, including economist, senior economist, director of the monetary policy department and governor. During the period from 2000 to 2006, Mr. Jigjid was the executive director of the Mongolian Bankers Association. Since 2009, Mr. Jigjid has been an executive director of the Corporate Governance Development Center in Mongolia. He is also a member of the supervisory board of the Bank of Mongolia and the board of Micro Finance Development Fund. From October 2010, Mr. Jigjid serves as a director of Golomt Bank and Resources Investment Capital. He has been the board member of Open Society Forum in Mongolia since March 2011. Mr. Jigjid was awarded a master's degree in economics by the Moscow Institute of Economics and Statistics, Russia, and a master's degree in international affairs by Columbia University, United States.

Chan Tze Ching, **Ignatius**, aged 56, is an independent non-executive Director of the Company. Mr. Chan was appointed as an independent non-executive Director of the Company on 16 September 2010. He is the Chairman of the Audit Committee and member of the Corporate Governance Committee. From 1980 to 2007, Mr. Chan held various positions in Citigroup, including management associate, country treasurer and head of sales and trading, head of corporate banking business for Hong Kong, country officer for Taiwan, chief operating officer for Greater China, country officer for Hong Kong and head of corporate and investment banking business for Greater China. In 2008, he was the deputy chief executive of the Bank of China (Hong Kong) Limited. Mr. Chan was appointed as a senior advisor of The Bank of East Asia Limited in March 2009 and senior advisor of CVC Capital Partners Limited in November 2010. He was appointed as an Honorary Advisory Vice President of The Hong Kong Institute of Bankers in February 2011. Mr. Chan is a member of the Disciplinary Appeals Committee of the Hong Kong Securities Clearing Company Limited and an independent non-executive director of Hong Kong Exchanges and Clearing Limited, the shares of which are listed on the Stock Exchange. He is also a non-executive director of Rizal Commercial Banking Corporation, the shares of which are listed on the Philippines Stock Exchange. On 28 November 2012, Mr. Chan was appointed as an independent non-executive director of Larry Jewelry International Company Limited, the shares of which are listed on the Stock Exchange. Mr. Chan was awarded bachelor's and master's degrees in business administration by the University of Hawaii, United States, and is a Certified Public Accountant with the American Institute of Certified Public Accountants.

SENIOR MANAGEMENT

Enkhzaya Nyamdorj, aged 38, is the Executive Vice President and Chief Financial Officer of the Company. Prior to joining the Company, Ms. Nyamdorj was a senior manager at Ernst & Young LLP's Chicago office, where she had been working since 2000. With over 10 years of experience in public accounting, finance and business development, Ms. Nyamdorj is a Certified Public Accountant in the United States and a member of the California Society of Certified Public Accountants. Ms. Nyamdorj was awarded a bachelor's degree in Business Administration, Economics and Marketing by the National University of Mongolia in 1997 and a master's degree in Business Administration in International Business and Finance by the Schiller International University, United States.

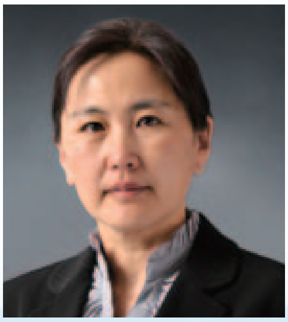


Ulemj Baskhuu, aged 34, is the Executive Vice President and Chief Investment Officer of the Company. Ms. Baskhuu was appointed as vice president responsible for investment of Energy Resources Rail LLC in December 2008. Ms. Baskhuu has worked for major banks and held various senior positions such as director of financial Institutions at the Trade and Development Bank of Mongolia and head of investment banking at Khan Bank. Ms. Baskhuu was awarded a bachelor's degree in business administration from the Mercer University, United States.

Enkhtuvshin Dashtseren, aged 37, is the Executive Vice President and Chief Marketing Officer of the Company. Mr. Dashtseren has held various positions with MCS Holding LLC including chief financial officer and vice president for the corporate strategy since he joined the MCS Group in 1997. He joined Energy Resources LLC in 2008 as the vice president and chief marketing officer and has played a key role in obtaining and maintaining the current customer base of the Company. Mr. Dashtseren was awarded a bachelor's degree in finance and management from the National University of Mongolia, Mongolia.

Samuel Bowles, aged 31, is the Executive Vice President and Chief Operating Officer of the Company. Mr. Bowles was appointed as the Company's Chief Operating Officer responsible for mining and processing operations on 1 October 2012 and Chief Executive Officer of Enrestechnology LLC on 27 September 2012. Mr. Bowles has over 10 years of experience in mining sector, and held various engineering, operational and project management positions in coal mining operations with companies such as Leighton LLC, Rio Tinto Coal Australia Pty Ltd and Anglo Coal Australia Pty Ltd. He has extensive industry knowledge and expertise, including short and long term mine planning, capital and operating cost estimations, surface and underground coal mining operations and technical and operational personnel development. Mr. Bowles is a member of the Australian Institute of Mining and Metallurgy. Mr. Bowles holds a bachelor's degree in mining engineering by the University of New South Wales, Australia.

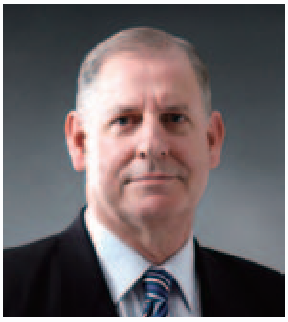
Oyunbat Lkhagvatsend, aged 36, is the Executive Vice President and Chief Logistics Officer of the Company. On 8 February 2011, Mr. Lkhagvatsend was appointed as the Chief Executive Officer of Energy Resources Rail LLC, Transgobi LLC, Tavan Tolgoi Airport LLC and Gobi Road LLC. Mr. Lkhagvatsend has about 12 years of experience in the business sector of Mongolia, holding senior positions in various businesses in the country. From 2003 to 2005, Mr. Lkhagvatsend was the chief executive officer of Newcom Group and was responsible for strategy planning and business development. From May 2005 to December 2006, he was the president and chief executive officer of Eznis Airways and was in charge of strategy planning, project management and other corporate affairs. He joined the Group in 2008 as the chief executive officer of Energy Resources Rail LLC and was responsible for overall business strategy and planning. Mr. Lkhagvatsend was awarded a bachelor's degree in law by the National University of Mongolia, Mongolia. He also underwent executive trainings held by the Michigan Business School, United States.



Uurtsaikh Dorjgotov, aged 48, is the Executive Vice President and Chief Legal Counsel of the Company. Ms. Dorjgotov joined the Group in December 2009. Prior to joining the Company, Ms. Dorjgotov was the director of the legal and administration department and chief legal counsel of MCS Holding LLC. She also worked for 6 years on the USAID-funded Mongolia Privatisation Program of Barents Group of Bearing Point, Inc. as in-house lawyer and for 9 years at the Prosecutor General Office of Mongolia as a supervising prosecutor. Ms. Dorjgotov was awarded a master's degree (LLM) by the University of Waikato, New Zealand, and also a diploma of lawyer by the University of Irkutsk, Russia.

TECHNICAL MANAGEMENT

Gary Ballantine, aged 44, is the Executive General Manager responsible for exploration and geology of the Company. Mr. Ballantine has over 23 years of experience in mining and geology, and has held positions in Australian mining companies, such as Micromine Pty Limited and BHP Billiton. Mr. Ballantine was appointed as Executive General Manager responsible for exploration and geology of the Company in July 2010 and has been advising on upcoming resource reviews and approval of borehole data for JORC compliance as well as for the designing, budgeting and supervising of the 5 year exploration program and the setting up of the geology department of the Company. Mr. Ballantine was awarded a bachelor's degree in geology by the University College of Southern Queensland, Australia, and a postgraduate diploma in geology by James Cook University, Australia. Mr. Ballantine has been a member of the Australian Institute of Mining and Metallurgy since 1987.



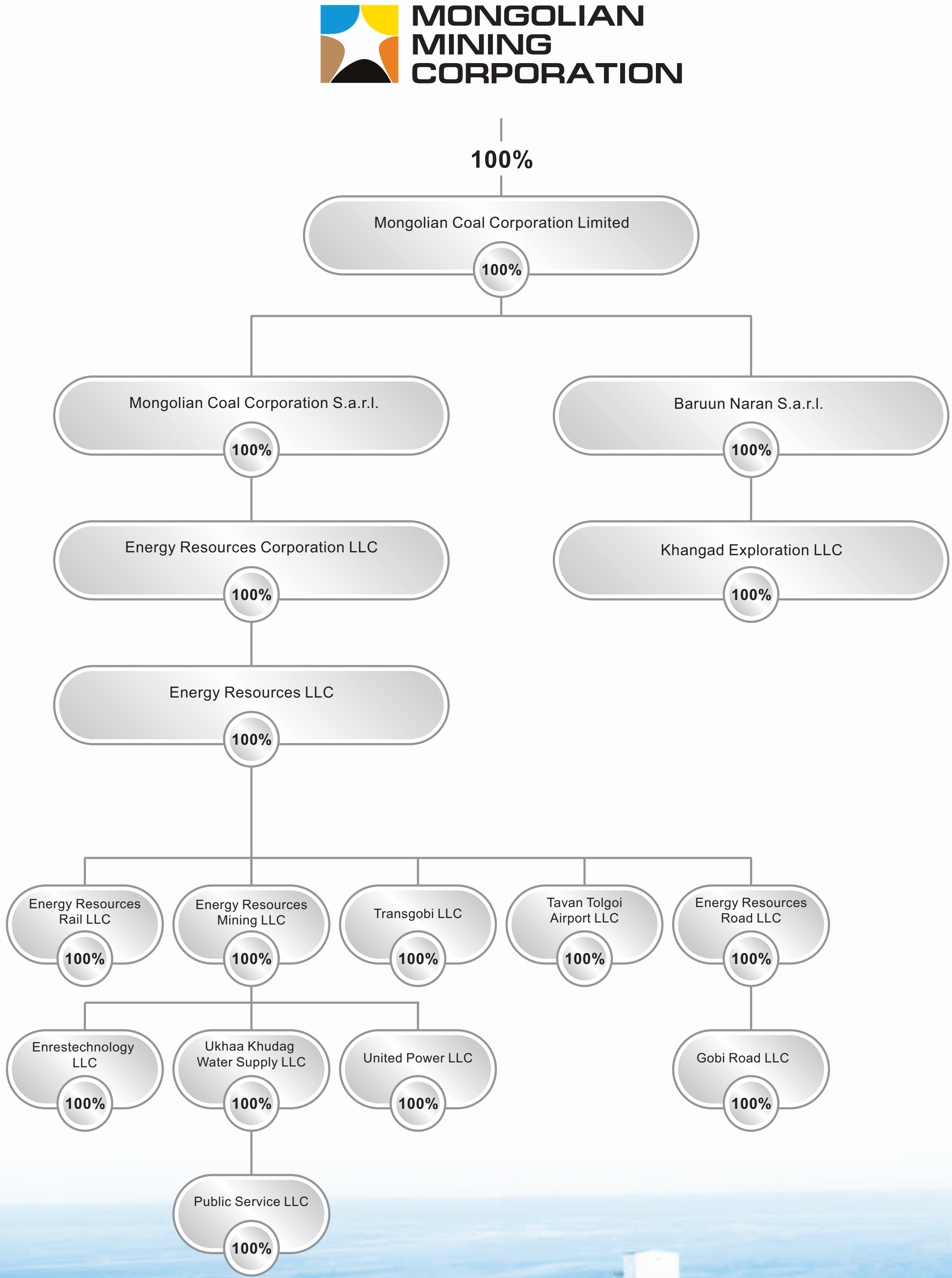
Andrew Philip Duncan Little, aged 60, is the Executive General Manager responsible for technical services of the Company. Mr. Little has been a member of the Australian Institute of Mining and Metallurgy for 23 years and is also a member of the Australian Coal Preparation Society. Mr. Little has over 36 years of experience in the mining industry, including 8 years in the Australian coal mining industry with Utah Development Company at Peak Downs coking coal mine and Capricorn Coal Management at German Creek coking coal mine. He has also held operational and technical positions with Hedges Gold Mine (Alcoa), Alcoa Alumina and Minproc Engineers. From 1997 to 2007, Mr. Little was technical director responsible for mining and metals with JPMorgan. Mr. Little joined the Group in April 2008 as technical director with primary responsibility for the technical development of the UHG coal project. Mr. Little was awarded a diploma in mining engineering by RMIT University, Melbourne, Australia, and a graduate diploma in business (management studies) by Edith Cowan University, Australia.

Dennis Phillips, aged 58, is the Executive General Manager for Coal Processing of the Company. Dr. Phillips was appointed as the Executive General Manager responsible for Coal Processing of the Company in October 2012. Dr. Phillips has over 25 years of experience in the management, technical support, and design of coal processing plants. He has extensive industry knowledge and expertise in coal processing operations from his various senior management positions at Mechel Bluestone, United Coal, Taggart Global, Massey Coal, and US Steel, including in the management of multiple coal processing plants, as well as operational safety and efficiency, cost control and coal blending optimisation. Dr. Phillips is a registered professional engineer and a member of the Society of Mining Engineers in United States. Dr. Phillips was awarded a bachelor's degree in civil engineering by West Virginia University, a master's degree in business administration by West Virginia College of Graduate Studies, and a PhD in Mining Engineering with specialisation in coal and mineral processing by Virginia Polytechnic Institute, United States.

COMPANY SECRETARY

NG Sin Yee, Clare, aged 52, was appointed as the Company Secretary of the Company in July 2010. Ms. Ng is a director of the Corporate Services Department of Tricor Services Limited. She is a Fellow of the Hong Kong Institute of Chartered Secretaries and the Institute of Chartered Secretaries and Administrators in the UK. Before joining the Tricor Group, Ms. Ng has worked in the Company Secretarial Department of Secretaries Limited, a professional service company wholly owned by Deloitte Touche Tohmatsu. Ms. Ng has more than 27 years of experience in company secretarial field and has been providing corporate services to both multi-national companies and listed companies in Hong Kong.

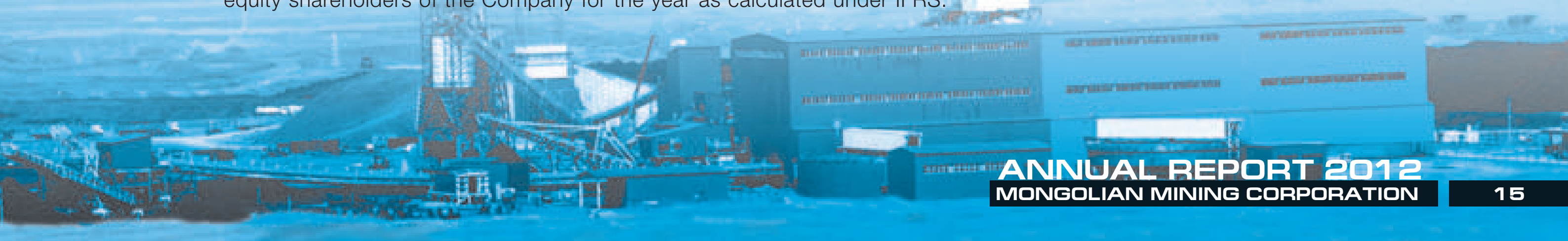
Group Structure



Financial Highlights

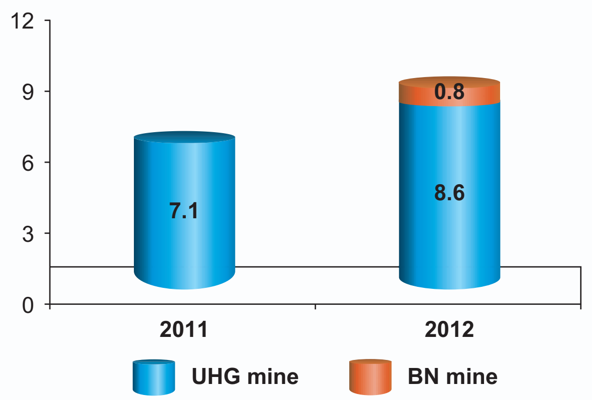
	2012 USD'000	2011 USD'000	Change
FINANCIAL			
Revenue	**474,480**	542,568	-12.6%
Cost of revenue	**420,400**	336,368	25.0%
Gross profit	**54,080**	206,200	-73.8%
Gross profit margin	**11.4%**	38.0%	-26.6 ppt
(Loss)/profit attributable to the equity shareholders of the Company	**(2,542)**	119,090	-102.1%
Net (loss)/profit margin	**-0.5%**	21.9%	-22.4 ppt
Basic (loss)/earnings per share	**(0.07) cents**	3.21 cents	-3.28 cents
Diluted (loss)/earnings per share	**(0.07) cents**	3.07 cents	-3.14 cents
Total non-current assets	**1,594,751**	1,233,194	29.3%
Total current assets	**582,526**	394,821	47.5%
Total current liabilities	**418,035**	553,511	-24.5%
Total non-current liabilities	**1,007,229**	305,640	229.6%
Net assets	**752,013**	768,864	-2.2%
Equity attributable to the equity shareholders of the Company	**752,013**	768,864	-2.2%
Net cash (used in)/generated from operating activities	**(61,723)**	20,985	-394.1%
Net cash used in investing activities	**320,422**	215,417	48.7%
Net cash generated from/(used in) financing activities	**385,710**	(79,871)	-582.9%
Debt to total assets	**46.3%**	34.5%	11.8 ppt
Debt to Equity	**134.1%**	73.1%	61.0 ppt
Debt to Earnings before interest, tax, depreciation and amortisation ("**EBITDA**")[1]	**15.3x**	3.3x	12.0x
Interest coverage ratio (EBITDA/Finance cost)	**1.3x**	12.3x	-11.0x
Operational			
Production volume (million tonnes ("**Mt**"))	**9.4**	7.1	32.4%
UHG mine (Mt)	**8.6**	7.1	21.1%
BN mine (Mt)	**0.8**	–	N/A
Strip ratio	**5.63**	5.16	
UHG mine	**5.55**	5.16	7.6%
BN mine	**6.41**	–	N/A
Cost per total material movement			
UHG mine (United States Dollar ("**USD**")/bank cubic metre ("**BCM**"))	**4.53**	4.52	0.2%
BN mine (USD/BCM)	**3.28**	–	N/A
Sales volume	**5.6**	4.8	16.7%
Sales volume (Mt, washed hard coking coal ("**HCC**"))	**3.4**	1.5	126.7%
Sales volume (Mt, washed semi-soft coking coal ("**SSCC**"))	**0.2**	–	N/A
Sales volume (Mt, washed thermal coal ("**middlings**"))	**1.6**	–	N/A
Sales volume (Mt, raw coal/run-of-mine ("**ROM**") coal)	**0.4**	3.3	-87.9%
Estimated share in Mongolia's total coal export	**26.9%**	22.7%	4.2 ppt
Average selling price ("**ASP**") per tonne			
ASP per tonne (USD, HCC)	**108.4**	155.6	-30.3%
ASP per tonne (USD, SSCC)	**78.1**	–	N/A
ASP per tonne (USD, middlings)	**36.9**	34.0	8.5%
ASP per tonne (USD, raw coal/ROM coal)	**72.9**	95.0	-23.3%

1 EBITDA is calculated by adding income tax, share of losses of associates, finance costs, depreciation and amortisation and allowance for doubtful debts and subtracting share profits of associates, finance income from profit attributable to the equity shareholders of the Company for the year as calculated under IFRS.

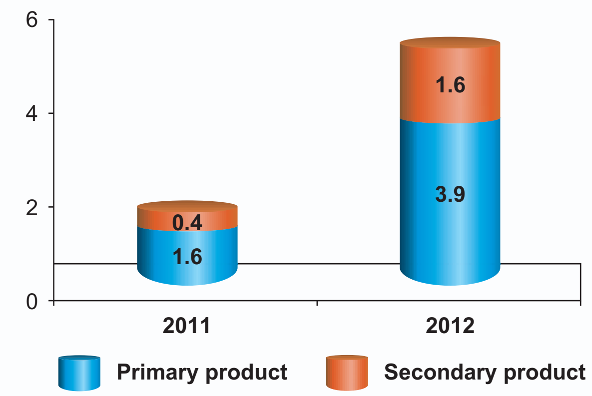


Financial Highlights

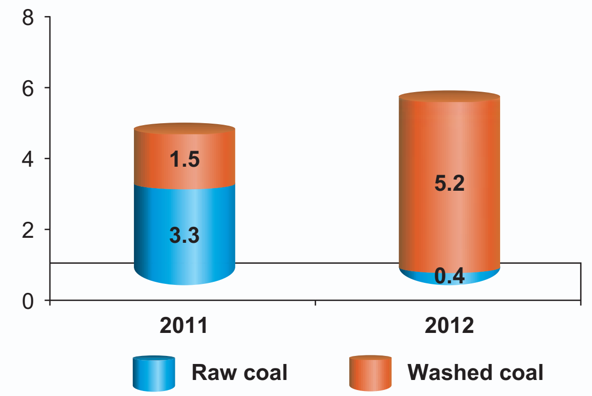
ROM coal production (Mt)



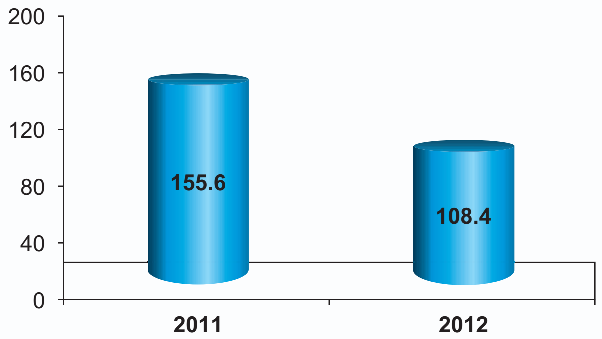
CHPP production (Mt)



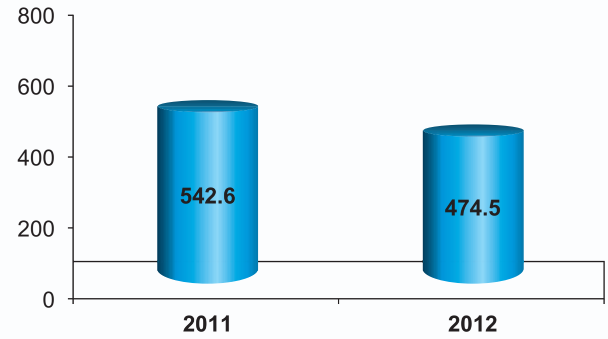
Coal sales volume (Mt)



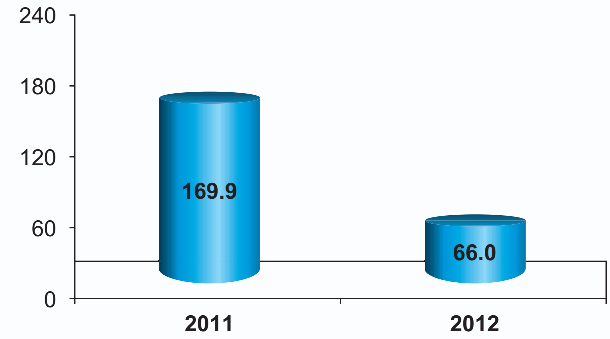
ASP of HCC (USD/tonne)



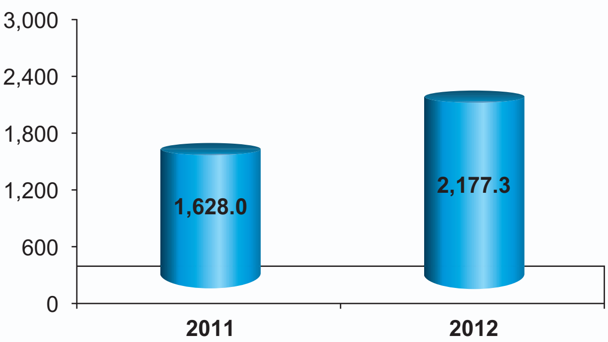
Sales revenue (million USD)



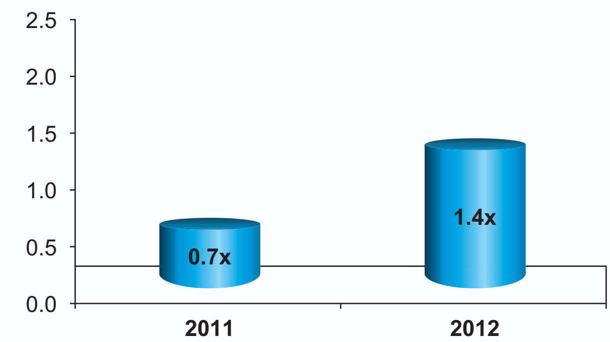
EBITDA (million USD)



Total assets (million USD)



Current ratio



Chairman's Statement

Dear Shareholders,

As we look back on 2012, the year was marked by MMC making good progress towards its goal of becoming one of the leading mining companies in the region, while showcasing its strengths and ability to effectively respond to a challenging market environment. We maintained satisfactory operating results under difficult conditions during the year, arising from lower prices for coking coal products supplied by the Group on the back of an economic slowdown in the People's Republic of China, our principle market. Demand from steel mills and coke plants was affected by global economic conditions.

In 2012, MMC has improved all production metrics and consolidated its foundation for future business growth. This includes the transformation to multiple asset based operations after launching commercial coal production at our BN mine in February, and the Group's combined run-of-mine coal production volume at the UHG and BN mines reaching 9.4 Mt, representing a 32% year-on-year growth.

In line with our development objectives, the Group's total annualised processing capacity reached 10.0 Mt in 2012, and our Coal Handling and Preparation Plant ("**CHPP**") at UHG processed 7.4 Mt of coal, representing a phenomenal 196% year-on-year growth. Our CHPP is a modern and first-of-its-kind facility in Mongolia, featuring an annual processing capacity of 15.0 Mt following the commissioning of the third module in 2013. It is an integral part of our operations and a key component in our long-term strategy, which will let MMC strengthen its position as a reliable supplier of high quality coking coal products to end-user customers.

The paved road between the UHG mine and the Gashuun Sukhait ("**GS**") border checkpoint served as our primary infrastructure for transporting our products in 2012. The utilisation of the paved road increased the overall efficiency of our transportation operations, and at the same time significantly improved transportation reliability and safety, while reducing overall environmental impact. Additionally, MMC completed the construction of 32-km heavy haul road between the BN and UHG mines, with the expansion of the GS border checkpoint increasing border-crossing capacity to eliminate bottlenecks on the Mongolian side of the border. These initiatives completed our efforts to build up the transportation infrastructure to support production growth and development.

In 2012, the GoM, recognising the socio-economic importance of the railway infrastructure construction projects and as a measure to accelerate the implementation of railway network development, resolved to consolidate them into unified railway project. This would be funded, managed and implemented under government authority, with the participation of domestic and foreign investors. We believe that the consolidated railway project will enhance the competitiveness of the Mongolian mining industry by creating multiple access points to the target markets.

We continued to build and grow our long-term relationships with end-user customers. In 2012, MMC entered into a long-term cooperation agreement with Jinan Iron and Steel Group Co., Ltd. ("**Jigang Group**"), a subsidiary of Shandong Iron and Steel Group in China, to supply our HCC products, as well as with Datang to supply our high calorific value thermal coal products. Additionally, the Group also successfully launched pilot shipments of HCC to seaborne market customers in 2012, which included Japan, Taiwan and India. During 2012, the Group delivered around 5.6 Mt of coal products to its customers, representing a year-on-year growth of nearly 17%.

In 2012, we continued with initiatives focusing on internal improvements and the successful implementation of prudent financial policies, stringent cost control measures, further enhance our internal capabilities. The Group also issued USD600 million in Guaranteed Senior Notes at the start of the year (the "**Senior Notes**"), and was able to secure sufficient reserves to maintain a strong cash position to support our development initiatives.

I am proud to note that our pioneering work to introduce regular public consultation and disclosure in Mongolian mining sector has gained public recognition and support. Moreover, we stay committed to playing an integral role in providing educational opportunities and in raising the standards of living in the host communities where our businesses are located.

Finally, the success of our internal improvement measures and the way the Group dealt with challenges throughout the year have strengthened our conviction that we have a strong foundation to continue delivering long-term value to our shareholders, through continued improvement in our operations by maximising efficiencies and our commitment to long-term economic and socially responsible development.

On behalf of the Board, I would like to express my sincere gratitude to our shareholders for their continued long-term support. I would also like to especially thank our staff at MMC for their dedication and commitment in helping us enter 2013 on a positive note after completing our growth and development strategies.

Odjargal Jambaljamts
Chairman

11 March 2013

Management Discussion and Analysis

In 2012, the Group continued to implement its strategy of creating a fully integrated coking coal mining, processing, transportation and marketing platform. As a result, the Group solidified its position as the largest coal producer and exporter of washed coking coal in Mongolia. According to data issued by the National Statistical Office ("**NSO**") of Mongolia, the Group exported approximately 5.6 Mt of coal products in 2012, representing around 26.9% volume share in the Mongolian total coal exports (2011: 4.8 Mt and 22.7%, respectively).

This strategy has enabled the Group to produce and sell washed coal products under its own brand name, further strengthening its position as a reliable supplier of high quality coking coal products, expanding its end-user customer base, and boosting its competitiveness in the international market.

The Chinese market remains the Group's primary destination for its coal products, and the Group has continued to strengthen relations with its Chinese end-user customers. In addition, the Group began to explore diversification opportunities and has successfully delivered initial bulk shipments of its HCC to customers at seaborne market such as Japan, India and Taiwan.

In line with the Group's long-term vision to diversify its business portfolio by transforming from a single asset company to a multiple asset based operations, BN mine launched its commercial mining operations in February 2012. The Group believes that the close proximity of the UHG and the BN mines provides a unique opportunity for synergic development. The sharing of coal handling and processing facilities, increased utilisation of coal transportation and logistics infrastructure, joint functional and operational management and marketing platform are expected to reduce the requirements for operating costs and the capital expenditure for development.

The Group's current coal handling and processing annual capacity has reached 10.0 Mt and is scheduled to reach 15.0 Mt with the expected commissioning of the third module in the first half of 2013.

In March 2012, the Group successfully issued the Senior Notes. This enabled the Group to maintain its cash position under challenging market conditions and support the major production and infrastructure developments it had planned.

INDUSTRY OVERVIEW

Chinese steel sector performance

The global economy in 2012 went through a challenging period amid a slower than expected recovery in the United States and the uncertainty linked to the European sovereign debt crisis. Affected by declines in the export sector, and also by the Chinese government's continuation to tighten policies designed to curb inflation in the property sector, the Chinese domestic economic growth rate slowed down to 7.4% in the third quarter of last year and stood at 7.9% as at the end of 2012 compared to 8.9% reported in the fourth quarter of 2011.

According to a report from the Ministry of Industry and Information Technology ("**MIIT**") and the National Bureau of Statistics of China, China produced 716.5 Mt of crude steel in 2012, up by 3.1% over the previous year; 657.9 Mt of iron, up by 3.7%; and 951.9 Mt of steel, up by 7.7%. Compared with the previous year, the growth rates of these three products fell by 4.2%, 4.7% and 2.2% points, respectively.

As a reflection of the overall economic situation and market conditions in the Group's principal market, China's major steel companies reported a sharp drop in profits in 2012, impacted by weak demand amid an economic slowdown. China Iron and Steel Association reported that 80 medium-to-large steel makers realised a combined total profit of Renminbi ("**RMB**")1.6 billion in 2012, reflecting a decline of 98.2% year-on-year. Moreover, 23 out of these 80 major steel makers still suffered a combined total loss of RMB28.9 billion, representing a loss of 7 times greater than the one incurred by 8 steel makers in 2011.

Besides weaker demand, the long-existing overcapacity is one of the main factors hampering the Chinese steel industry's profitability according to China Iron and Steel Association. The overcapacity capped steel prices in the environment characterised by weaker demand and growth, thus limiting steel mills' ability to accept higher prices for steel making material, including coking coal, in 2012.

Chinese coking coal imports and Mongolian coking coal exports dynamics

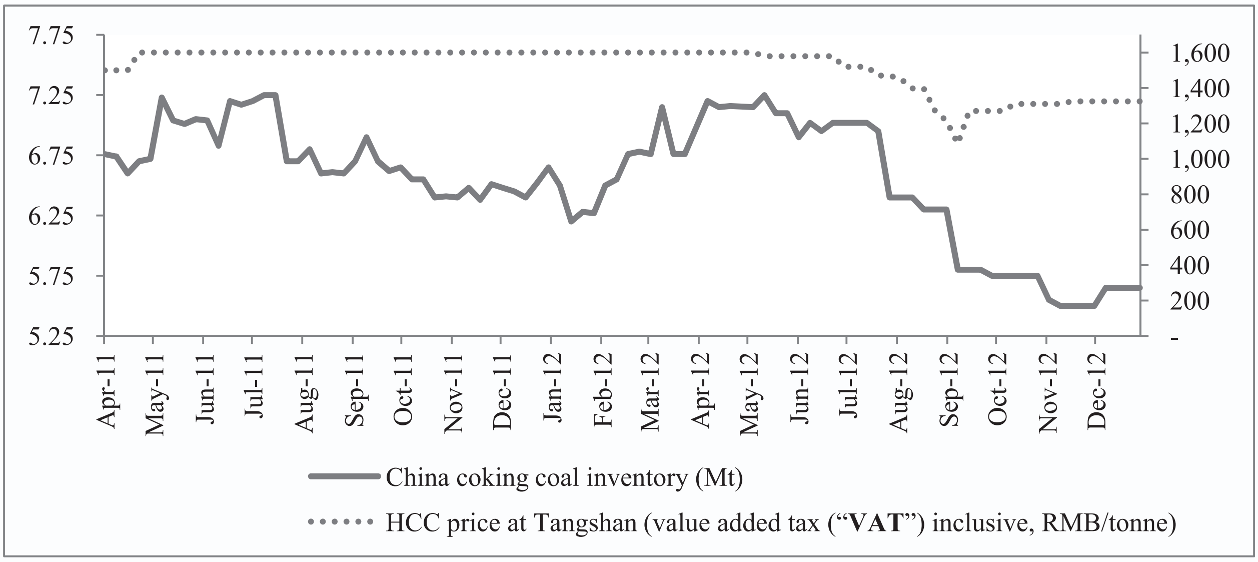
The global coking coal trade dynamics in 2012 was largely impacted by the falling demand in North America and Europe and also stagnating consumption from Asian countries like Japan, China, India and South Korea. However, at the same time, Australian mining companies began returning to full production capacity after recovering from damage caused by flooding in Queensland in 2011. This oversupply subsequently led to a decline in seaborne coking coal prices, particularly in the second half of 2012.

Due to this situation, Chinese coking coal consumers increased import volumes, particularly the steel mills located in the coastal area which took advantage of weak seaborne prices for coking coal, as well as better and cheaper logistics. According to Chinese customs clearance statistics, China imported around 53.6 Mt of coking coal in 2012 compared to 44.7 Mt imported in 2011, representing 19.9% increase year-on-year.

In terms of demand, the apparent consumption of coking coal in China has fallen in line with the slower growth of steel production and the de-stocking and reduction of inventory levels by coke and steel producers. The discounts for lower grade coking coal have increased and as such, the market for inferior grades of coking coal has become very challenging, even forcing some lower grade coking coal into the thermal coal market as an alternative consumption.

However, following the market correction, Chinese coking coal reported inventories reaching normalised levels from the fourth quarter of 2012, and re-stocking activities are expected to positively influence coking coal prices in the short-term (Figure 1). In the mid to long-term, coking coal prices will be driven by improving global economic conditions and the successful implementation of the Chinese government's policies which should maintain a sustainable growth rate.

Figure 1. Chinese coking coal stockpile levels and HCC pricing



Source: China Coal Resource

According to MIIT, Chinese crude steel production is expected to rise by 4.6% in 2013 to a record of 750.0 Mt. China is the world's largest steel producer, and Chinese crude steel output reached 716.5 Mt in 2012, representing a 3.1% increase year-on-year. This is the second-slowest growth rate recorded after a 1.8% decline in 2008 following the global financial crisis. Crude steel production is likely to be boosted by the expected approvals of many mega-infrastructure projects in sectors such as hydro and nuclear power, dams, railways and rural city construction. These projects are also expected to increase the demand for coking coal, one of the main components in steel production.

In addition, the Japanese economy is also expected to forge ahead after the newly elected government announced its USD265 billion economic stimulus measures. As this package is primarily aimed at supporting investments in infrastructure and export oriented industries, including ship-building and car-making, it is expected to have a positive impact on the Japanese steel consumption and as such, influence the demand for coking coal at the seaborne market.

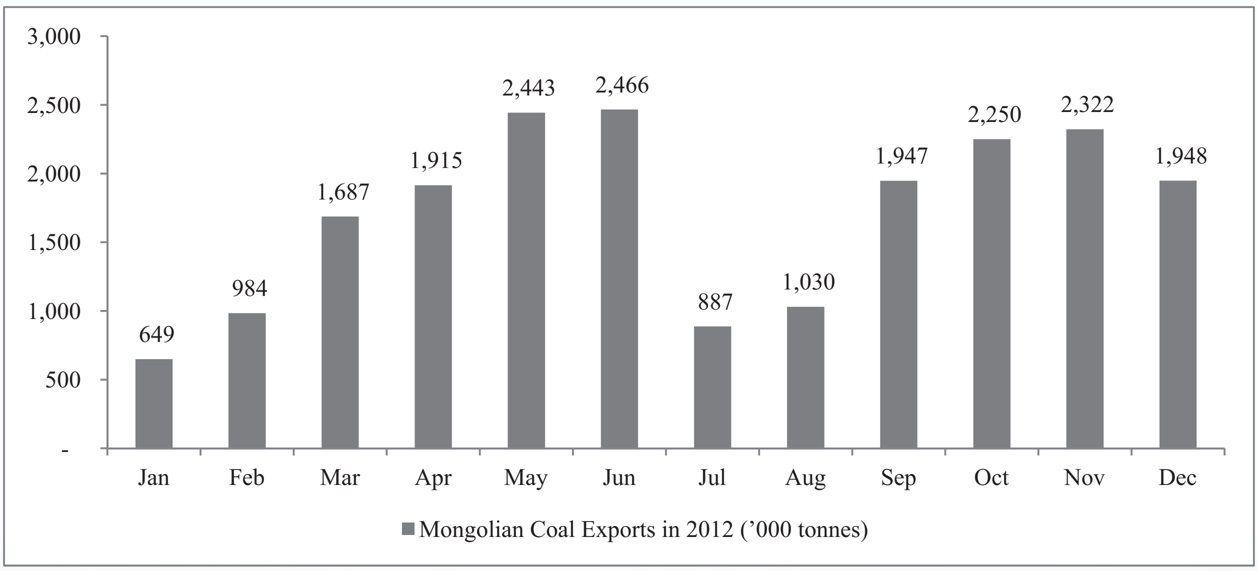
China has more than 12,000 coal mines and domestic production in the country, which reached 3.7 billion tonnes in 2012, up by 4.0% compared to the previous year. The clampdown on the country's notoriously unsafe and polluting coal industry has been one of the main drivers for increased coal imports. In 2012, China imported 234.3 Mt of coal which constituted a significant increase of 28.7% over the previous year. China's State Administration of Work Safety is planning to close roughly 5,000 small mines in 2013 in its continuing efforts to improve safety in the mines. Moreover, it will no longer approve new coal mines that do not meet production capacity requirements in 2013 in order to ensure work safety. High-gas coal mines with an annual production of less than 300,000 tonnes, as well as coal and gas outburst mines with an annual production of less than 450,000 tonnes, will not be approved. In 2012, China shut down 628 medium sized coal mines, improved technological processes of 622 mines, merged 388 mines and phased out 97.8 Mt of outdated production facilities.

Effective from 1 January 2013, China is annulling a 40% export tax on metallurgical coke exports. Traditionally, China has been a major exporter of metallurgical coke, but the exports plunged after they imposed the tax in 2008 and it was about 1.0 Mt in 2012 amid the curbs, from an annual average of 15 Mt between 2000 and 2007. However, the abolishment of the 40% export tax under World Trade Organisation regulations is expected to rekindle demand for coking coal as a feed material. Under the changed tax regime it is expected that an additional demand of 20.0 Mt will be generated by China.

As reported by the NSO and the Mongolian Customs General Administration ("**Mongolian Customs**"), Mongolian coal exports (including lignite) reached approximately 20.9 Mt in 2012 compared to 21.1 Mt in 2011. Moreover, the number of mines producing and exporting more than 100 thousand tonnes of coal in the year increased from 6 to 9, including the Group's UHG and BN mines.

In the first half of 2012, Mongolian coal exports still have shown a relatively robust year-on-year increase of around 33.8% but the majority of coal exporters temporarily halted and/or limited their coal export shipments in the third quarter amid weak demand and low pricing. Since prices bottomed in September, as shown in the graph below, coal export shipments then began picking up accordingly in the last quarter of 2012 (Figure 2).

Figure 2. Mongolian monthly coal export volumes in 2012



Source: NSO and Mongolian Customs

Moreover, as detailed in Table 1, with its exports accounting for approximately 35.7% volume share in the total Chinese coking coal imports, Mongolia still preserved its position as the largest supplier of coking coal to China, albeit a decline compared to the 44.7% volume share reported in 2011.

Table 1. China's coking coal import volumes by country of origin (Mt)

	For the year ending 31 December		
	2012	2011	Change
Total	**53.5**	44.7	19.7%
Mongolia	**19.1**	20.0	(4.5%)
Australia	**14.0**	10.3	35.9%
Canada	**7.2**	3.2	125.0%
Russia	**4.8**	3.7	29.7%
United States	**4.5**	4.3	4.7%

Source: China Coal Resource

OPERATING ENVIRONMENT

Legal framework

Major regulatory changes passed and implemented by the Mongolian Parliament in 2012 included the approval of the Law on Regulation of Foreign Investment in Business Entities which Operate in Sectors of Strategic Importance ("**Foreign Investment Regulation Law**") and amendments made in the Environmental Laws.

On 17 May 2012, the Parliament of Mongolia passed the Foreign Investment Regulation Law and this came into effect on the same date. Pursuant to the Foreign Investment Regulation Law, the sectors of strategic importance include the mineral, banking and finance, media and communication sectors.

Pursuant to Article 6.1, transactions involving privately-owned foreign investors will require the approval of the GoM, if as a result of such transactions a foreign entity will acquire 33% or more of the shares in a business entity operating in a sector of strategic importance. Also, the GoM approval will be required regardless of the percentage of equity interest, if as a result of a proposed transaction and acquisition of an interest in a business entity operating in the sector of strategic importance, a foreign investor has the right to the following:

– Solely appoint the executive management or a majority of the board and veto decisions of the executive management or board of directors;

– Determine or implement management decisions and/or operations;

– May potentially give rise to a monopoly (to either the seller or buyer) over mineral products on international or domestic commodity markets; or

– May directly or indirectly influence the market conditions or the pricing for mineral products exported from Mongolia.

Any acquisition or operations by a state-owned foreign investor or by an international organisation will require an approval of the GoM.

Moreover, as defined by Article 3.7, if foreign investments in such business entities exceed 49% and the transaction value exceeds the threshold of Mongolian Togrog ("**MNT**") 100 billion (equivalent to USD75 million at current exchange rate), Parliament approval for such investment by any foreign entity is required.

The exact details of the approval procedure will be determined by the GoM. However, the Foreign Investment Regulation Law defines that a foreign investor wishing to enter into a transaction to which this law applies, must first make a request for approval to the relevant government agency. The agency must submit its proposal to the GoM on whether to grant approval within 45 days of receipt, and in turn the GoM has 45 days to make a final decision on whether to approve the transaction. Within 5 days after the GoM decision is made, the agency must inform the applicant about the final outcome.

As a majority Mongolian owned company, the Group understands that the Foreign Investment Regulation Law which has become effective from 17 May 2012 does not retrospectively apply and as such does not impact the Group's operations.

On 17 May 2012, the Parliament of Mongolia also amended a number of environmental laws, such as the Law on Environmental Resource Utilisation Fee and the Law on Environmental Impact Assessment, whose amendments came into effect on 22 June 2012.

In accordance with the changes, the water utilisation cost is expected to increase in the future. Pursuant to the amendment, the water utilisation fee will be calculated based on the eco-economic value of the water. For underground water utilised by mining and mineral resource processing entities, the exact fee percentage will range from 20% to 60% of the eco-economic value of the water. However, any such water reused for industrial operations will be made exempt from the water utilisation fee.

On 2 November 2012, the Parliament approved the Law on Termination of the Laws on Ratification of Intergovernmental Conventions for Avoidance for Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital made with Luxembourg, the Netherlands, the United Arab Emirates and Kuwait. These laws will trigger termination clauses of these Conventions which could have a potential impact on taxation applied for dividends paid by Mongolian registered entities to their respective holding companies in the abovementioned jurisdictions commencing at different dates as follows:

– Double Taxation Agreement with Luxembourg on 1 January 2014;

– Double Taxation Agreement with the Netherlands on 1 January 2014;

– Double Taxation Agreement with the United Arab Emirates on 1 January 2015;

– Double Taxation Agreement with Kuwait on 1 April 2015.

In December 2012, the President's Office of Mongolia developed draft amendments to the Mining Law and released it to the public for discussion. The main focus of this draft law is to encourage and enhance the involvement of local communities to participate more effectively in investment decisions and benefits arising from mine development. It also includes measures to tighten environmental protections and minimise challenges associated with the environmental impact of exploration and mining activities. To date the draft Mining Law is still under stakeholder consultations initiated by the President's Office of Mongolia and no information has been released to the public on the timing of its submission to the Parliament for review and approval.

Political landscape

Since the country's transition to democracy and a free market economy in the early 90's and its first multi-party parliamentary elections held in 1990, Mongolians voted in their seventh parliamentary election on 28 June 2012 which was the main political event which has occurred in the country in the reporting period.

More than 550 candidates and 15 political parties and coalitions competed in this nationwide election for 76 seats of the State Great Khural, the Parliament of Mongolia. According to the Election Law, 48 mandates in 26 election districts were filled according to the most popular votes for individual candidates as a party/coalition nominees or independents. The remaining 28 seats, meanwhile, were filled based on the party/coalition preference voting totals nationwide, and with a 5% threshold implied to enter the Parliament.

As declared by the Election General Committee, the Democratic Party won 31 seats, the Mongolian People's Party won 25 and the Justice Coalition won 11, and the Civil Will-Green Party won two. Three independent candidates also succeeded in getting elected. Of the four remaining seats, re-elections are expected for two mandates due to the failure of the candidates to achieve the more than 28% popular-vote threshold as stipulated by the law, and the final two seats were under dispute and were sent to the court for review.

Currently, out of the total 76 seats, 74 Parliament members have taken their oaths of office and have officially begun their terms in the newly elected Parliament. Re-elections are expected for one of the remaining mandates, and the final mandate is still under dispute and awaiting the final outcome of judicial review.

The majority in the Parliament was formed by the Democratic Party, Justice Coalition and Civil Will-Green Party representatives.

Mr. Enkhbold Zandaakhuu from the Democratic Party was elected as a Chairman of the State Great Khural (Speaker of the Parliament), and Mr. Altankhuyag Norov, Chairman of Democratic Party, was appointed as the Prime Minister of Mongolia by securing majority support in the Parliament.

BUSINESS OVERVIEW

Coal resources, reserves and exploration activities

Ukhaa Khudag (UHG) deposit

The Group's UHG licensed area covers an area of approximately 2,960 hectares. Over the last four years (2009-2012), the Group's geological team has conducted extensive exploration activities at the UHG deposit with the following objectives in mind:

Ukhaa Khudag coking coal mine

- To define oxidation limits for mine-planning purposes by determining the locations of any oxidised coal to be mined as thermal coal;

- To undertake close-spaced (50m x 50m) open-hole drilling and geophysical logging prior to mining so as to determine localised geological structures for future short and mid-term mine planning purpose;

- To undertake close-spaced (100m x 100m) core drilling to produce coal samples for testing and analysis for key quality parameters such as but not limited to moisture, ash, volatile matter, sulphur and phosphorous content, calorific value, caking index (G), crucible swelling number (CSN), and Sapozhnikov plastometer indexes (X and Y);

- To prove the general initial observation that the coal has actual lower in-situ ash content than was predicted by the original geological model;

- To produce a bulk sample of the Seam 0 plies and a number of additional seams in the western section of the deposit so as to enable coking coal sections to be identified and to explore blending possibilities that may produce HCC products; and

– To complete a 2D seismic program to identify the continuity of coal seams and potential fault areas impacting the mining methodology and development schedules.

Approximately 166,385 metres of drilling was carried out during this period of exploration with 1,435 boreholes completed and geophysical logged. The laboratory test work was also carried out on a total 32,556 analytical coal samples collected.

MMC geologists working on coal samples

The Group collaborated with Velseis Processing Pty Ltd to interpret data collected from 71 km of a high resolution 2D seismic in-field measurement program, which was carried out by Polaris Seismic International Ltd and used to identify coal seams continuity and structure, as well as to obtain new, valuable information on the potential of the deposit's underground resources.

Finally, a large-diameter, bulk-sample drilling program has been completed on the Seam 0 plies and a number of additional seams in the western section of the deposit, and the samples gathered have been analysed by ALS Laboratories in Mongolia for washability and metallurgical testing. All this exploration data was used to update the geological and coal quality model, and hence the JORC-compliant resource estimates as at 30 June 2012.

An independent peer audit was conducted by Mr. Todd Sercombe from GasCoal Pty Ltd which confirmed the compliance of the Group's work carried out to update the UHG geological model, thus JORC-compliant estimates for coal resources, estimated on an air-dry basis (Table 2).

Table 2. Updated UHG coal resources by depth and category (Mt) as at 30 June 2012

Total Coal Resources		Resources Category (air-dry basis)			
Depth Limits	Measured	Indicated	Inferred	Total (M+I)	Total (M+I+I)
From -100m to subcrop	114.3	55.3	26.2	169.6	195.8
From -200m to -100m	93.5	55.2	25.8	148.7	174.5
From -300m to -200m	80.1	51.0	16.8	131.1	147.9
From -400m to -300m	49.7	33.2	11.4	82.9	94.3
Below -400m	41.8	34.3	12.2	76.1	88.3
Sub-Total above -300m	287.9	161.5	68.8	449.4	518.2
Sub-Total below -300m	91.5	67.5	23.6	159.0	182.6
Total	**379.4**	**229.0**	**92.4**	**608.4**	**700.8**

Based on an air-dry raw coal qualities, seam groups were defined as a coal with moderate-high coking potential or coal with low coking potential. For above 300m to base of weathering 373.3 Mt of coal with moderate-high coking potential was estimated; 196.2 Mt in measured category, 130.6 Mt in indicated category, and 46.5 Mt in inferred category respectively. In addition, 145.1 Mt of coal resources were determined as a coal with low coking potential; 91.8 Mt in measured category, 31.0 Mt in indicated category, and 22.3 Mt in inferred category respectively.

For coal resources located below 300m depth limit, 105.3 Mt of coal with moderate-high coking potential was estimated; 56.8 Mt in measured category, 38.4 Mt in indicated category, and 10.1 Mt in inferred category respectively. In addition, 77.1 Mt of coal resources were determined as a coal with low coking potential; 34.6 Mt in measured category, 29.0 Mt in indicated category, and 13.5 Mt in inferred category respectively.

According to a previous JORC-compliant reserve report prepared by Norwest, the UHG deposit had 275.0 Mt of proven and probable coal reserves estimated as at 31 December 2011. The updated geological model will serve as a base to update the Group's long-term mining schedule at UHG mine and hence the preparation of the updated JORC-compliant reserve estimation for UHG mine, with expected completion in the first half of 2013 (Note).

Note: Technical information in UHG coal resources estimation report has been compiled by Mr. Gary Ballantine, Executive General Manager for Exploration and Geology, Mongolian Mining Corporation. Mr. Ballantine is a member of the Australasian Institute of Mining and Metallurgy (Member #109105) and has over 23 years of experience relevant to the style and type of coal deposit under consideration and to the activity which is being undertaken to qualify as a Competent Person as defined by the Australasian Code for Reporting of Minerals Resources and Reserves (JORC) 2004. Mr. Ballantine consents to the inclusion in the release of the matters based on this information in the form and context in which it appears. The estimates of the Coal Resources presented in this report are considered to be a true reflection of the UHG coal resources as at 30 June 2012 and have been carried out in accordance with the principles and guidelines of the Australian Code for Reporting of Coal Resources and Coal Reserves published in September 2004 (JORC Code).

Baruun Naran coking coal mine

Baruun Naran (BN) deposit

In June 2011, the Group acquired the entire issued capital of Baruun Naran Limited (formerly QGX Coal Limited), which ultimately owns the BN mine. The Group's mining license for the BN mine covers an area of approximately 4,482 hectares. McElroy Bryan Geological Services Pty Ltd prepared the geological model for the BN mine in February 2010 in accordance with JORC standards.

As part of the due diligence completed for the purchase of the BN mine, in 2011, 73.5 km of a 2D seismic program was completed to confirm known structures and to identify unknown structures, if they were present, and to confirm continuity of the seam. Polaris Seismic International Ltd completed the survey and Velseis Processing Pty Ltd interpreted the seismic. With this new information and the start of mining activities during 2012, McElroy Bryan Geological Services Pty Ltd was commissioned to update the BN JORC-compliant resources as at 30 June 2012. This was determined to be 281.7 Mt of JORC compliant measured, indicated and inferred coal resources, based on an in-situ density calculated for a 6% moisture content (Table 3).

Table 3. BN coal resources by depth and category (Mt) as at 30 June 2012

Total Coal Resources	Resources Category (as at 6% moisture)				
Depth Limits	**Measured**	**Indicated**	**Inferred**	**Total (M+I)**	**Total (M+I+I)**
From -100m to subcrop	45.0	9.0	–	54.0	54.0
From -200m to -100m	65.5	15.1	–	80.6	80.6
From -300m to -200m	57.9	19.0	–	76.9	76.9
From -400m to -300m	40.2	29.5	0.5	69.7	70.2
Below -400m	–	–	–	–	–
Sub-Total above -300m	168.4	43.1	–	211.5	211.5
Sub-Total below -300m	40.2	29.5	0.5	69.7	70.2
Total	**208.6**	**72.6**	**0.5**	**281.2**	**281.7**

Based on the coal seams determined by SRK Consulting to be either coking or thermal coal in the reserve estimate, the split between coking and thermal coal resources is 152.4 Mt as coking coal and 129.3 Mt as thermal coal.

In March 2011, SRK Consulting completed a reserve estimation report for the BN mine, identifying 185.3 Mt of open-pit mineable, JORC-compliant proven and probable coal reserves. In November 2012, the independent technical study outcomes confirmed the final total reserve quantities as defined in the share purchase agreement entered by the Company and its subsidiary Mongolian Coal Corporation Limited with Quincunx (BVI) Ltd and Kerry Mining (Mongolia) Limited in relation to the acquisition of the entire issued share capital of QGX Coal Ltd (the "**Share Purchase Agreement**").

The Company anticipates this reserve estimate may change as it has begun to conduct its own studies and analyses for the future development of the BN mine in synergy and conjugation with the UHG mining schedule and development, with the aim of preparing a combined life-of-mine mining study and hence the preparation of updated JORC-compliant reserve estimation for BN mine with expected completion in the first half of 2013 (Note).

Note: Technical information in BN coal resources estimation report has been compiled by Mr. Paul Harrison, Senior Geologist, McElroy Bryan Geological Services Pty. Ltd. Mr. Harrison is a member of the Australasian Institute of Mining and Metallurgy (Member #110251) and has over 25 years of experience relevant to the style and type of coal deposit under consideration and to the activity which is being undertaken to qualify as a Competent Person as defined by the Australasian Code for Reporting of Minerals Resources and Reserves (JORC) 2004. Mr. Harrison consents to the inclusion in the release of the matters based on this information in the form and context in which it appears. The estimates of the Coal Resources presented in this report are considered to be a true reflection of the BN coal resources as at 30 June 2012 and have been carried out in accordance with the principles and guidelines of the Australian Code for Reporting of Coal Resources and Coal Reserves published in September 2004 (JORC Code).

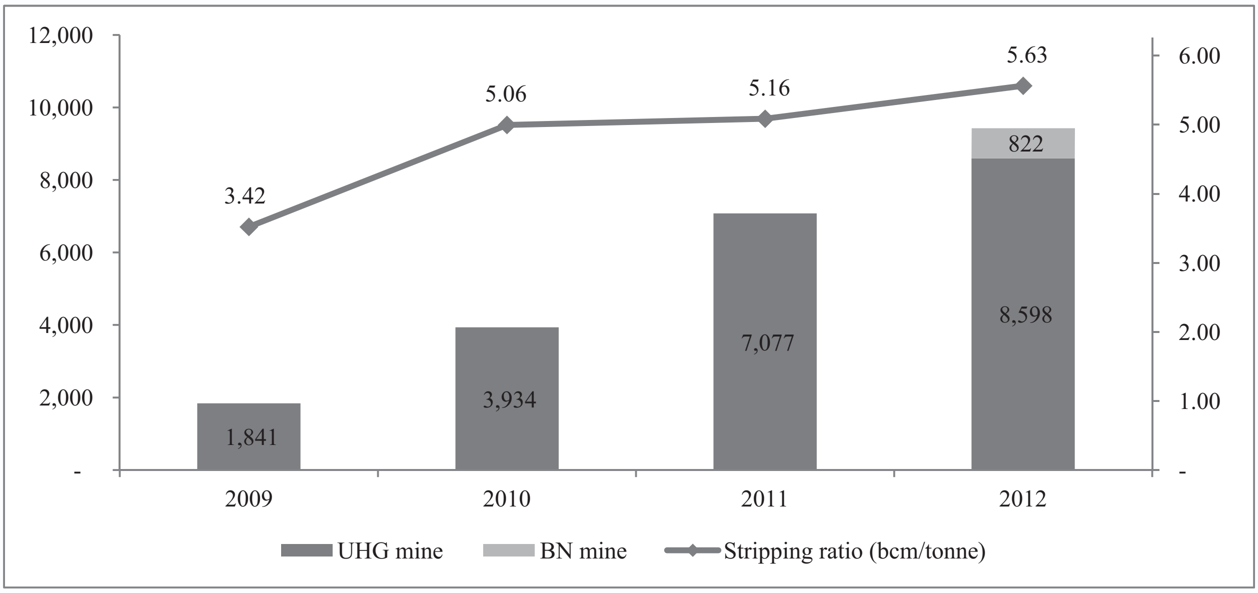
Production and transportation

Coal mining and processing

The Group continued with ramping up its coal mining operations at UHG mine and started its coal mining operations at BN mine in February 2012 after being given official mining permission from the relevant Mongolian government authorities on 30 January 2012.

In 2012, the Group's combined ROM coal production at the UHG and BN mines reached approximately 9.4 Mt, representing an approximate 32.4% increase year-on-year. The ROM coal output was adjusted to match the CHPP ROM coal in-feed rates, whilst maintaining appropriate in-pit and ROM stockpile inventories to allow sustainable CHPP operation progressing with overburden removal as scheduled (Figure 3).

Figure 3. Historical annual ROM coal production volume (in thousand tonnes) and stripping ratio (bcm/tonne)



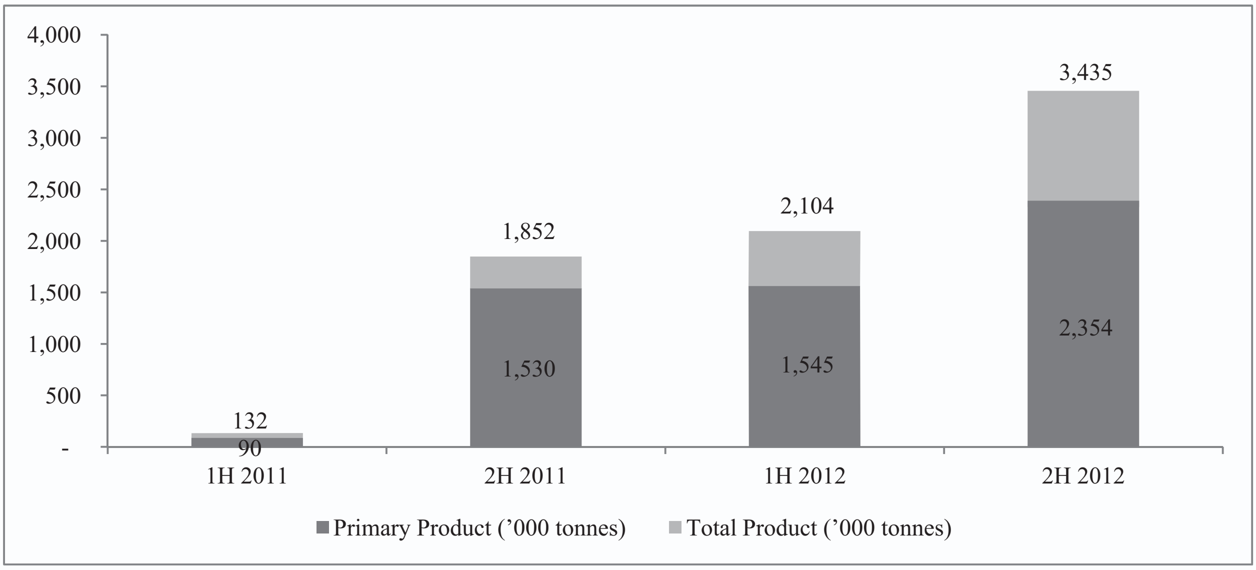
Combined ROM production targets for 2012 were strategically reduced in response to the slowed demand and reduced sales prices experienced in the second half of 2012. Mining capacity was directed to continue with overburden removal, allowing exposure of inventory in situ once ROM stockpiles had reached suitable levels, avoiding undue costs of re-handling and positioning inventories to enable response to market improvements.

In line with the Group's development objectives, the total annual processing capacity was increased to 10.0 Mt by the successful commissioning of the CHPP second module and as such, significantly increased the processed coal output in 2012. Under its synergic development strategy, the Group's CHPP based at UHG site with all necessary utility infrastructure facilities will be processing ROM coal from both operating mines.

In 2012, the Group's total processed ROM coal volume reached approximately 7.4 Mt, representing an increase of around 196.0% year-on-year, and produced 5.5 Mt of marketable product, representing a total of 74.5% combined processing yield (Figure 4).

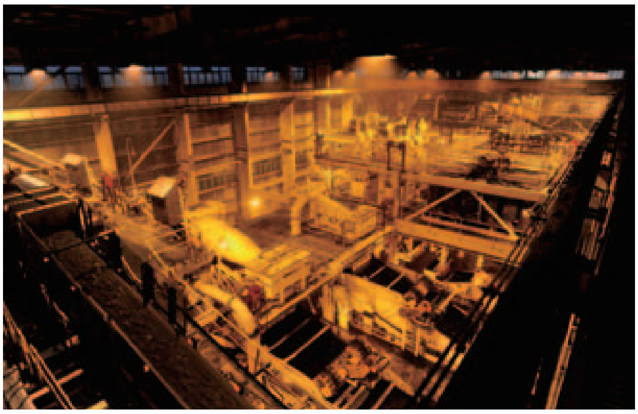
CHPP washed around 7.0 Mt of UHG ROM coal to produce around 3.7 Mt of HCC with 51.9% primary product yield and 1.6 Mt of middlings with 22.9% secondary product yield; washed around 0.4 Mt of BN ROM coal to produce around 0.2 Mt of SSCC with 62.5% primary product yield.

Figure 4. Historical semi-annual total and primary processed coal production volumes (in thousand tonnes)



The Group continued with the planned expansion of its coal processing capacity with construction of the third CHPP module. The construction of the third module was virtually completed by the end of 2012 and the commissioning is expected to take place in the first half of 2013. Once complete, this will expand the Group's total annual coal processing capacity to 15.0 Mt starting from the second half of 2013.

Exterior view - 3 modules of CHPP



Interior view of CHPP

Transportation and logistics

After continuous improvements to the Group's transportation infrastructure over the last couple of years, the Group was able to conduct full year-round operations of its 245-km paved road and 300 units of double-trailer trucks in 2012, which resulted in the increased availability and utilisation of the Group's own truck fleet as well as the improved safety and efficiency of the transport operations of the Group.

In 2012, the Group built and maintained a full capacity to handle and transport about 12 Mt per annum of coal which was sufficient to handle and move products from the UHG and BN mines to the Ganqimaodu ("**GM**") border port in China via its coal handling, custom bonded stockpile facility at Tsagaan Khad ("**TKH**") on the Mongolian side of the border.

In 2012, with the aim of maximising asset utilisation under its own direct control, the Group put a primary focus on maximising the utilisation of its own 300 double-trailer heavy haul trucking fleet for coal transportation from the UHG mine to TKH. As a result, the Group's own fleet has transported a total of 4.1 Mt of coal or 70.7% of total cargo on its main long-haul section between UHG and TKH, representing a more than threefold increase compared to 1.2 Mt of coal or 22.6% in 2011. With this achievement, the Group has significantly reduced its dependency on third party contractors, greatly improved the operational efficiency of its own fleet and effectively maintained cost control on its main long-haul operations between UHG-TKH. At the same time, the Group maintained a third party contracted fleet of trucks to deliver the remaining amount of coal, which accounted for a minor portion and had less impact on capacity and the reliability of transport operations.

However, for cross-border transportation from TKH to GM in 2012, the Group continued to utilise a third party contractors fleet, and as such the Group's own fleet has transported approximately 0.4 Mt of coal or 7.3% of total cargo on the short-haul section between TKH and GM in 2012, maintaining a comparable level compared to 0.4 Mt or 8.3% in 2011. Furthermore, to strengthen its trucking operations, in October 2012, the Group successfully completed a 4,300 m^2 new truck maintenance and repair workshop with the capacity to service 5 trucks per day which is dedicated to supporting its own double-trailer truck fleet.

Truck maintenance and repair workshop built in October 2012

In 2012, the 245-km paved road between UHG and GS border checkpoint in Mongolia served as the primary infrastructure for the Group relating to the transport and delivery of its products. The road supported the Group in achieving significant improvement in transportation reliability and efficiency, and the Group also let a number of third party coal and other freight movements on the road via a toll fee arrangement, set under the Build-Operate-Transfer Agreement for 10 years. The operations, maintenance and amortisation costs of the paved road are partially offset by toll fee revenue generated from third party cargo on commercial terms in accordance with conditions stipulated in the Build-Operate-Transfer Agreement entered into between the GoM and the Group in May 2010. Moreover, the Group completed construction of a 32-km paved road between the BN and UHG mines ("**BN-UHG Road**") in October 2012 which has full capacity to support the interconnected operations of its two mines. The BN-UHG Road will serve as a reliable connection for transporting coal from the BN mine to the coal processing facilities at the UHG mine.

BN-UHG paved road

Border checkpoint expansion

The Group jointly co-funded and executed the expansion of the GS border checkpoints with Erdenes MGL LLC, commissioned in January 2012. This investment has increased the annual border-crossing capacity at GS to an estimated 25-30 Mt. This provides sufficient capacity to eliminate bottlenecks on the Mongolian side of the border and support the Group's growth objectives.

Coal inventories

The Group maintains coal inventories in connection with its coal mining, processing, and transportation operations.

The raw coal extracted from the UHG mine is either directly fed to the CHPP for processing, or stockpiled for appropriate CHPP feed blend scheduling at a later date or loaded out for raw coal sale pending coal quality. The raw coal extracted from the BN mine is stockpiled at ROM stockpile at the BN site, and later loaded-out for raw coal sales or transported from the BN mine to UHG site and stockpiled as CHPP feed ahead of processing (Table 4).

Table 4. Opening and closing surveyed ROM coal inventories at the UHG and BN

	As at December 31		
	2012	2011	Change
	'000 tonnes	'000 tonnes	%
ROM coal at the UHG site	**2,142**	1,246	71.9%
ROM coal at the BN site	**321**	–	NA
ROM coal inventory total	**2,463**	1,246	97.7%

The coal products produced by CHPP are stockpiled at product stockpile at the UHG site and simultaneously loaded-out for transportation. Therefore, the coal product inventory levels at the UHG site are kept at very low level and as of 31 December 2012 it had only accumulated around 43 thousand tonnes of HCC.

The vast majority of the Group's coal products are transported to and stockpiled at the coal handling facility in the TKH until they are loaded-out and cleared through customs control in Mongolia for the export shipments directly to the delivery point at GM, China (Table 5).

Table 5. Opening and closing surveyed coal product inventories at TKH

	As at December 31		
	2012	2011	Change
	'000 tonnes	'000 tonnes	%
ROM coal	**104**	334	-68.9%
HCC	**116**	45	157.8%
SSCC	**–**	–	NA
Middlings	**293**	87	236.8%
TKH coal inventory total	**513**	466	10.1%

Survey of coal quantity is a measurement of volume, and as for every bulk commodity the conversion to tonnage requires the application of density assumption, which involves natural variance. Subsequently, the measurement of stockpile quantities is an estimation in which errors are inherent. Therefore, the variations within 5% are tolerated, and any tonnages above/below this limit are recorded as stockpile gain/loss. The management expects that by maintaining lower levels of inventory and improving overall inventory management, the Company will be in a position to reduce potential inventory losses in the future.

For coal products being transported from one stockpile to another destination, the transportation gain/loss is recorded as a positive/negative discrepancy between tonnages shipped-out as recorded by the weigh-bridge at the departure point and tonnages shipped-in as recorded by the weigh-bridge at the delivery point. The transportation losses are a result of natural loss during transportation, and also to some extent, to variations in moisture content.

Occupational health and safety

In 2012, the Group continued to recognise and implement the most stringent of safety policies for the protection of its personnel and equipment. The Group has conducted a total of 97,259 man hours of safety training involving the Group's personnel, contractors and visitors in 2012.

As a result, the Lost Time Injury Frequency Rate ("**LTIFR**"), an injury frequency rate expressed as the number of injuries per million hours worked was 0.71 for 8,380,412 man hours recorded within the Group's coal mining, processing and transportation operations for the whole year of 2012. In comparison, the Queensland Government publicly reported that the average LTIFR at surface coal mining operations in Queensland, Australia was 2.7 for the period from 1 July 2010 to 30 June 2011.

Regretfully, an unfortunate fatal traffic accident occurred in October 2012. It was related to the Group's transportation operations and was caused by a collision with a third party transportation vehicle. The Group's emergency response unit responded/acted immediately, and the case was further investigated by traffic police authorities. The Company representatives have fully collaborated with relevant authorities during the investigation. Currently, the case is under review by the provincial prosecutor's office. Based on the outcomes of the investigation, no charges or payment claims were raised against the Company in connection with the case. The Company provided financial assistance equal to 36 months average wage to the victim's family. The Group's occupational health and safety ("**OHS**") department, jointly with the traffic police, are committed to and make every effort to prevent accidents and minimise risks associated with increased traffic by providing safety training, conducting preventive safety checks and monitoring activities not only for the Group's own transportation operations and its contractors, but also for third party vehicles utilising its paved road on a toll fee basis.

Marketing and sales

As part of the Group's strategic objective to supply quality products to end-users, the Group continued to strengthen its existing relations with its customers in China as well as outreaching to new customers in order to further diversify its revenue sources.

The Group sold approximately 5.6 Mt of coal products in 2012, representing an increase of around 16.7% over the 4.8 Mt of coal products sold in 2011.

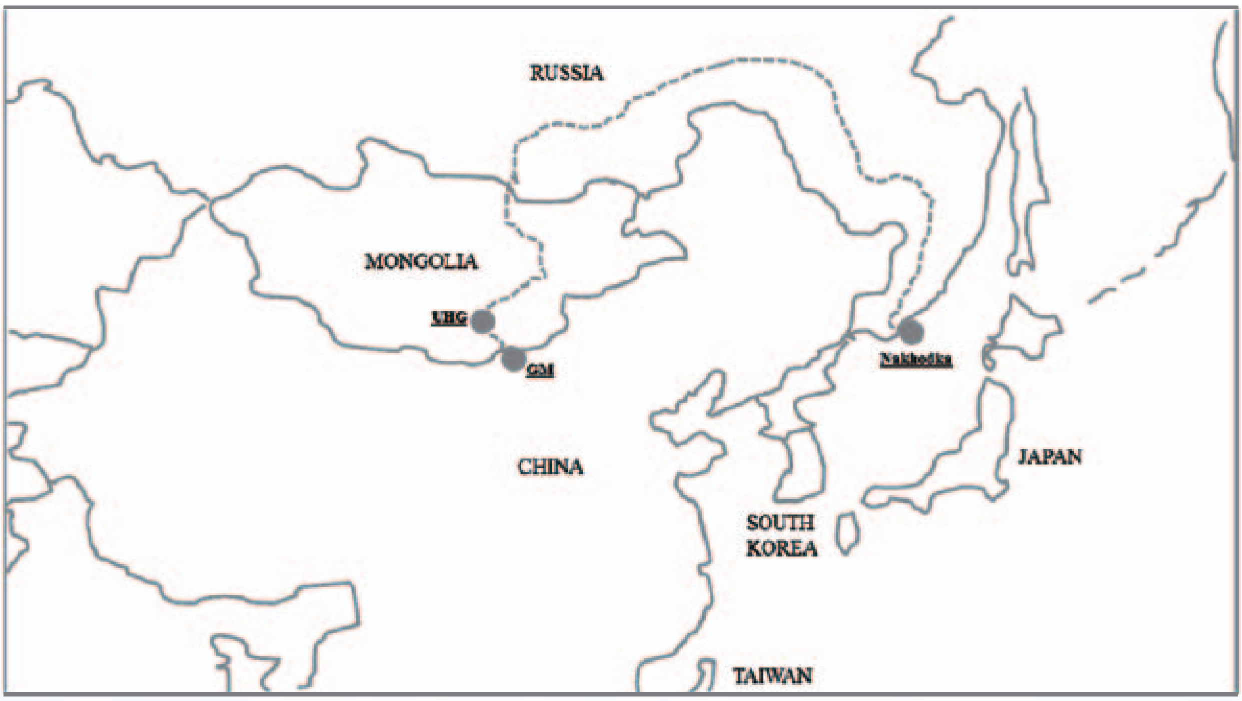
As the Group drastically shifted towards washed coal products, it strengthened already built relationship with its end-user customers. In 2012, the Group exported in total 3.6 Mt of washed coking coal, 1.6 Mt of middlings and 0.4 Mt of raw coal (2011: 1.5 Mt; 0.0 Mt and 3.3 Mt, respectively).

MMC signs long-term cooperation agreement with Jigang Group - Nov 14, 2012

In 2012, the Group sold 99.0% of total export sales volume to its China-based customers primarily under delivery at place ("**DAP**") GM terms and 1.0% to seaborne market customers under free-on-board ("**FOB**") Nakhodka terms.

The Group entered into a long-term cooperation agreement with Jigang Group, in November 2012 to supply HCC to the Jigang Group each year for a period of five years. Also, the Group entered into a long-term cooperation agreement for its middlings with China Datang Overseas Investment Co. Ltd., one of China's largest energy producers, and a sales and purchase agreement with China Panjin Oil Field Taicheng Industrial LLC.

Figure 5. Seaborne sales route



Coal shipment at Nakhodka port

In 2012, the Group has also successfully launched pilot shipments of HCC to seaborne market customers via Far-East Russian port (Figure 5). The Group exported under FOB Nakhodka terms approximately 19.1 thousand tonnes of HCC to the Japanese market in partnership with Sumitomo Corporation in February 2012. Subsequently, in March 2012, the Group delivered under the same terms around 16.4 thousand tonnes of HCC to Mesco Steel Limited. In May 2012, a third shipment from Nakhodka delivered 17.8 thousand tonnes of HCC to China Steel Corporation, one of the Taiwanese steel mills. Furthermore, the Group has continued to investigate the possibility of delivering its coking coal products to its end-user customers in the seaborne market via Chinese ports located at Bohai Economic Rim.

UHG-GS Railway

On 31 May 2012, the Group entered into a Build-Operate-Transfer Concession Agreement with the GoM. This allowed the Group to initiate the construction of the railway infrastructure between UHG mine and GS.

The GoM recognising the socio-economic importance of the first and second stage railway base infrastructure construction projects, and as a measure to accelerate the implementation of the railway network development, as defined by the State Policy on Railway Transportation approved by Resolution 32 of the Parliament in June 2010, on 3 November 2012 resolved to consolidate them into a unified railway project to be funded, managed and implemented under the government authority with the participation of domestic and foreign investors.

Moreover, in order to keep uninterrupted continuation of current construction works, the GoM decided that the previous concessionaires (including the Group) will have options to participate further in the implementation of the Project, with all costs incurred to date to be considered as a part of their investment in the unified railway project.

The consolidated railway project is expected to enhance the competitiveness of the Mongolian mining industry by creating multiple access points to the target markets.

OUTLOOK AND BUSINESS STRATEGIES IN 2013

In 2013, the Group will continue to strengthen its position as a reliable supplier of consistently high quality coking coal products to its end-user customer base. Coking coal prices fell sharply in the third quarter of 2012. However, after reaching its lowest point in September, prices have gradually recovered in subsequent months. As the Group enters 2013, the Company's management believes that this gradual recovery in coking coal prices will continue. With the vast majority of development projects related capital expenditures completed, and by virtue of its robust production profile, the Company is well positioned to grow by pursuing its strategic objectives in 2013.

The Company intends to pursue the following key strategies in order to maintain and enhance its position as a leading Asian washed coking coal producer: (i) increasing its mined coal production; (ii) expanding its coal handling and processing capacity; (iii) improving its transportation infrastructure and capability; (iv) continuing to develop and diversify its long-term customer base combined with the promotion of its own brand; (v) exploring opportunities for expanding and diversifying its business operations through potential acquisitions, strategic investments and joint ventures; and (vi) continuing its strong commitment to safety, the environment and socially responsible operations.

In 2013, the Group will continue to ramp up coal production, and is targeting an output of 12.0 Mt of ROM coal. The third module of the CHPP is expected to be commissioned in the first half of 2013, and as such the Group's total coal processing capacity is targeted to reach 15.0 Mt per annum starting from the second half of 2013. Therefore, the Group is targeting to process 12.0 Mt of ROM coal, drawing additional feed from the current site stocks, to produce 6.0-6.5 Mt of HCC.

Further improvements to operational safety, efficiency and productivity are expected by (i) adjusting workforce rosters and supporting employee resettlement to South Gobi, (ii) refining the alignment of mining contractor performance incentives with overall Company performance, (iii) identifying specific mining targets including cheaper explosive products, reduced coal re-handling, and regularly scheduled in-pit inventory for optimal and efficient blending of ROM feed to CHPP. The completion of the belt filter press facility installation for treating CHPP tailings is expected to improve water recycling rates, further reducing water extraction and environmental footprint, with cost benefit. Connection to the Mongolian Central Energy System is expected to allow the UHG Power Plant to run at full coal-fired capacity by enabling energy supply to third party customers, providing an opportunity to reduce unit costs related to power generation.

Regarding transportation and logistics, the Company's operations management will target further increases to the proportion of coal transported by own truck fleet between UHG and TKH in 2013. There is potential for further reductions in the cost of cross-border transportation between TKH and GM, with continued dialogue in progress between Mongolian and Chinese authorities to smoothen the process, allowing cost saving through improved efficiency.

Also, the Company's management will focus on reducing operational expenditures and boosting productivity by amalgamating site-based support functions, sharing available resources, increasing efficiency and minimising indirect costs.

The Company will continue to strengthen existing and create new long-term relations with its end-user customers. Additionally, the Company will actively look at strategic long-term partnerships to expand its relations and presence in China.

The specific social infrastructure development initiatives will not only benefit communities the Group operates in, but also its employees and their families. It will further strengthen the Group's competitive position as a reliable and responsible employer, allowing for the continuous build up of internal capabilities by attracting and maintaining a talented and skilled workforce.

FINANCIAL REVIEW

Revenue

The Group's sales volume of coal products reached approximately 5.6 Mt in 2012, representing an increase of around 0.8 Mt, or 16.7%, compared to 4.8 Mt of coal products sold in 2011.

The most significant sales volume growth at around 140.0% was achieved for washed coking coal products. In 2012, the Group exported 3.4 Mt of HCC and 0.2 Mt of SSCC (2011: 1.5 Mt and nil, respectively). In contrast to the increase in sales of HCC, the sales volume of raw coal declined by about 87.9%. As such, the Group exported 0.4 Mt of raw coal in 2012 (2011: 3.3 Mt), the majority of which was sold in the first half of the year.

In addition, the Group initiated export sales of its high calorific value thermal coal, a by-product in the process of washing raw coal, selling 1.6 Mt of middlings to its customers in China in 2012 (2011: nil).

The breakdown of sales volume and revenue by individual coal product type and ASP for individual coal product types for the periods are indicated in Table 6.

Table 6. Sales volume, revenue and ASP

	Year ended December 31		
	2012	2011	Change
Sales volume (Mt)	**5.6**	4.8	16.7%
HCC	**3.4**	1.5	126.7%
SSCC	**0.2**	–	NA
Middlings	**1.6**	0.0	NA
ROM coal	**0.4**	3.3	-87.9%
Revenue ('000 USD)	**474,480**	542,568	-12.5%
HCC	**371,160**	235,220	57.8%
SSCC	**17,234**	–	NA
Middlings	**57,341**	663	8,548.7%
ROM coal	**28,745**	306,685	-90.6%
ASP (USD/tonne)	**84.8**	113.9	-25.5%
HCC	**108.4**	155.6	-30.3%
SSCC	**78.1**	–	NA
Middlings	**36.9**	34.0	8.5%
ROM coal	**72.9**	95.0	-23.3%

As disclosed above, the Group recorded total revenue of USD474.5 million for the year ended 31 December 2012, representing a change of 12.5% as compared with USD542.6 million in 2011. Notably, revenue of USD371.2 million was generated from HCC sales, representing more than 78.2% of total revenue in 2012 (2011: USD235.2 million and 43.4%, respectively). The Group derived 97.3% and 2.7% of total coal export sales revenue in 2012 from its Chinese customers and seaborne market customers, respectively.

In 2012, the Group's pricing for its washed coking coal products followed the negative trend in the global market prices of coking coal products. As a result, the ASP of the Group's HCC was approximately USD108.4 per tonne in 2012, which is around 30.3% lower compared to USD155.6 per tonne in 2011.

The pricing of HCC decreased moderately in the first half of the year. ASP of HCC in the first half of 2012 was USD138.7 per tonne. In the second half of the year, pricing faced greater pressure and reached the lowest point in the third quarter, but gradually recovered in the fourth quarter of 2012. In comparison, the pricing of middlings supplied by the Group remained relatively stable during the course of the whole year. ASP of middlings was USD37.6 per tonne in the first half of 2012, and USD36.1 per tonne in the second half of 2012.

For the year ended 31 December 2012, the Group derived more than 10.0% of its annual revenue from three customers, with purchase amounts of USD168.3 million, USD115.6 million and USD59.8 million, respectively. In 2011, the Group had also derived more than 10.0% of its annual revenue from three customers, with purchase amounts of USD185.0 million, USD148.6 million and USD73.6 million, respectively.

Cost of Revenue

The Group's cost of revenue primarily consists of mining costs, processing and handling costs, transportation and logistics costs, and costs related to site administration, stockpiles and transportation losses, and governmental royalties and fees.

The increase in the Group's mining, processing, transportation and sales volumes resulted in increased cost of revenue from USD336.4 million in 2011 to approximately USD420.4 million in 2012.

Mining costs consist of costs associated with overburden and topsoil removal and ROM coal extraction, including the costs related to mining staff and equipment together with base and performance fees paid to the mining contractor, drill and blasting contractor fees, and costs paid to fuel suppliers. In 2012, the Group's total mining costs were USD123.5 million (2011: USD120.5 million). UHG mine unit mining cost was USD16.3 per ROM tonne in 2012, compared to USD19.8 in 2011, representing a 17.7% decrease. BN mine unit mining cost was USD23.9 per ROM tonne in 2012 (2011: nil).

The reduction in unit mining cost is attributable to the economy of scales, and also the shift to sales of washed coal products. According to the relevant regulatory provisions, only exporters of washed coal are entitled to VAT rebates, and as such the Group's mining cost related to the sales of washed coal products are excluding the 10% VAT component (Table 7).

Table 7. Total mining cost and unit mining cost per ROM tonne

	Year ended December 31			
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD/ ROM tonne**	USD/ ROM tonne
Total mining costs	**123,541**	120,468	**16.8**	21.6
VAT component	**1,056**	9,785	**0.1**	1.8
UHG mining cost	**114,057**	110,683	**16.3**	19.8
BN mining cost	**8,428**	–	**23.9**	–

Besides, the mining costs in the income statement, capitalised costs of pre-stripped overburden are reflected in the balance sheet. Pre-stripped overburden is associated with the coal to be mined, processed, transported and sold in the future.

Processing costs primarily included the costs associated with the operations of the CHPP, including power and water costs. In 2012, the Group's processing costs were USD51.0 million (2011: USD21.4 million), of which USD16.8 million was related to the depreciation and amortisation. Also, processing costs included the power generation and distribution costs of USD8.4 million incurred in the UHG Power Plant and the water extraction and distribution costs of USD2.9 million incurred in the UHG Water Supply Facility related to the washed coal sold in 2012.

Unit processing cost calculated per ROM coal in-feed tonne decreased by USD1.8 or 19.8% from USD9.1 per ROM tonne in 2011 to USD7.3 per ROM tonne in 2012 (Table 8).

Table 8. Total processing cost and unit processing cost per ROM tonne

	Year ended December 31			
	2012 USD'000	2011 USD'000	**2012 USD/ ROM tonne**	2011 USD/ ROM tonne
Total processing costs	**51,031**	21,433	**7.3**	9.1
Consumables	**2,993**	777	**0.4**	0.3
Maintenance and spares	**4,810**	1,468	**0.7**	0.6
Power	**8,368**	6,050	**1.2**	2.6
Water	**2,903**	1,223	**0.4**	0.5
Staff	**3,446**	1,340	**0.5**	0.6
Contractor fee	**8,251**	2,583	**1.2**	1.1
Ancillary and support	**3,477**	1,165	**0.5**	0.5
Depreciation and amortisation	**16,783**	6,827	**2.4**	2.9

Handling costs are related to feeding ROM coal from ROM coal stockpiles to the CHPP and also the removals of course reject (primarily rock and sediment separated from coal) after coal processing. In 2012, the Group's handling cost was USD13.2 million (2011: USD5.2 million). The management intends to increase the proportion of in-feed ROM coal being directly dumped to the CHPP feed, which will continue to lower the handling costs related to feeding ROM coal from ROM coal stockpiles to the CHPP going forward.

Transportation costs are derived primarily from costs related to the transportation of ROM coal from the BN mine to the CHPP located at the UHG mine, the transportation of coal products from UHG to TKH, and the transportation of coal products to the selling point destinations as stipulated under sales contracts, including fees paid to third party transportation contractors.

In 2012, the Group's transportation costs were USD130.9 million (2011: USD107.3 million), of which USD1.0 million is related to the transportation of ROM coal from BN mine to CHPP, USD66.0 million was related to long-haul (UHG-TKH) transportation; USD55.0 million to short-haul (TKH-GM) cross-border transportation for coal products sold to China-based customers under DAP GM terms, which includes costs of transportation and logistics associated with the direct delivery of products from UHG to GM; and USD8.9 million for coal products sold to seaborne market customers under FOB Nakhodka terms, which includes transportation and logistics costs incurred to deliver coal products from UHG to Nakhodka and to load the products on the customers' designated sea transportation vessels.

In 2012, the management focused on maximising the utilisation of the Company's own transportation assets and improving efficiency in its main long-haul transport (UHG-TKH) section. As a result, the transportation cost using its own fleet in the long-haul (UHG-TKH) section has been reduced from USD19.1 per tonne in 2011 to USD9.4 per tonne in 2012, which represents USD9.7 or 50.8% decrease per tonne year-on-year. Meantime, the transportation cost by third party contractors in the long-haul (UHG-TKH) section has been increased from USD16.6 per tonne in 2011 to USD18.1 per tonne in 2012, which represents USD1.5 or 9.0% increase per tonne year-on-year. In 2012, the Group's own transport fleet carried the majority (70.7%) of its total coal products while the rest (29.3%) was transported by third party contractors, bringing the combined cost of transport to USD11.9 per tonne in 2012, down by USD5.3 per tonne compared to USD17.2 per tonne in 2011. For the short-haul (TKH-GM) section, where the Group utilised a contracted fleet for the majority of its transportation, the Group's transportation costs were USD10.0 per tonne in 2012, compared to USD6.2 per tonne recorded in 2011, primarily due to competitive pressure from new entrants in this particular section. The Group maintained its overall transportation costs in the UHG-GM section at USD21.9 per tonne in 2012, which is around USD1.5 per tonne lower compared to USD23.4 per tonne recorded in the previous year.

For the years indicated, the Group's total and individual costs of revenue in terms of amount as well as unit costs of revenue were calculated on a per total product sold basis in Table 9.

Table 9. Total and individual costs of revenue and unit costs of revenue

	Year ended December 31			
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD/tonne**	USD/tonne
Cost of revenue	**420,400**	336,368	**75.1**	70.6
Mining costs	**123,541**	120,467	**22.1**	25.3
Variable costs	**70,398**	70,273	**12.6**	14.7
Fixed costs	**49,921**	49,443	**8.9**	10.4
Depreciation and amortisation	**3,222**	751	**0.6**	0.2
Processing costs	**51,031**	21,433	**9.1**	4.5
Variable costs	**19,074**	9,518	**3.4**	2.0
Fixed costs	**15,174**	5,088	**2.7**	1.1
Depreciation and amortisation	**16,783**	6,827	**3.0**	1.4
Handling costs	**13,164**	5,195	**2.4**	1.1
Transportation costs	**130,871**	107,263	**23.3**	22.5
Logistics costs	**23,252**	13,537	**4.2**	2.9
Variable costs	**6,700**	2,777	**1.2**	0.6
Fixed costs	**9,802**	7,490	**1.8**	1.6
Depreciation and amortisation	**6,750**	3,270	**1.2**	0.7
Site administration costs	**10,938**	8,605	**2.0**	1.8
Transportation and stockpile losses	**19,478**	1,002	**3.4**	0.2
Royalties and fees	**48,125**	58,866	**8.6**	12.3
Royalties	**34,756**	48,232	**6.2**	10.1
Air pollution fees	**6,033**	4,362	**1.1**	0.9
Custom fees	**7,336**	6,272	**1.3**	1.3

Logistics costs are mainly related to costs for paved road operations, maintenance and amortisation costs and also costs associated with operating product stockpiles at UHG and TKH. In 2012, the Group's logistics costs were USD23.3 million (2011: USD13.5 million), of which USD6.3 million was related to the amortisation of the UHG-GS paved road.

Site administration costs are primarily related to site support facilities such as airstrip operations, as well as the overall supervision and joint management of the Group's mining, processing, transportation and logistics operations at the UHG and BN mines, both located in South Gobi province. In 2012, the Group's site administration costs were USD10.9 million (2011: USD8.6 million).

For 2012, the Group recorded transportation and stockpile net loss of USD19.5 million compared to net loss of USD1.0 million recorded for 2011, which were included in the mining, processing, transportation and other costs in the amount of USD0.1 million gain, USD0.3 million loss, USD0.6 million loss and USD0.2 million loss respectively (Table 10).

Table 10. Transportation and stockpile losses by amounts and volumes

	Year ended December 31			
	2012	2011	**2012**	2011
	USD'000	USD'000	**tonne'000**	tonne'000
Transportation and stockpile losses	**19,478**	1,002	**754.5**	41.2
Transportation loss UHG-TKH	**1,389**	850	**38.4**	21.1
Washed coal	**1,373**	733	**37.4**	15.3
Raw coal	**16**	117	**1.0**	5.8
Transportation loss TKH-GM	**2,393**	774	**42.3**	13.3
Washed coal	**2,345**	619	**40.8**	9.2
Raw coal	**48**	155	**1.5**	4.1
Stockpile loss/(gain) at UHG	**9,030**	(2,032)	**558.8**	(22.2)
Washed coal	**(168)**	(814)	**(10.4)**	39.1
Raw coal	**9,198**	(1,218)	**569.2**	(61.3)
Stockpile loss at TKH	**6,666**	1,410	**115.0**	29.0
Washed coal	**6,851**	957	**120.9**	18.1
Raw coal	**(185)**	453	**(5.9)**	10.9

In 2012, total transportation loss was around USD3.8 million, of which USD1.4 million incurred for transportation of coal products at UHG-TKH section and USD 2.4 million for TKH-GM section. In comparison, for 2011 the Group recorded total transportation loss of USD1.7 million, with USD0.9 million for UHG-TKH section and USD0.8 million for TKH-GM section, respectively. The increase observed for transportation loss in 2012 is primarily related to increased transportation and sales volume and due to the increased transportation and sales volume of higher value washed coal products. Also, to some extent, the increase is related to moisture loss due to the increase in the proportion of washed coal product sales and also moisture losses.

The inventory losses are assessed based on periodic survey measurements of the Group's ROM coal inventories of ROM coal stockpiles at the UHG and BN mines, and also coal products inventories of product stockpiles at UHG and TKH. For 2012, the Group recorded unrealised inventory loss of USD9.0 million for ROM coal stockpile at UHG compared to unrealised gain of USD2.0 million recorded for the previous year. The stockpile loss at TKH was USD6.7 million in 2012, compared to USD1.4 million in 2011.

Governmental royalties and fees are related to royalties, air pollution fees and custom fees paid according to the applicable laws and regulations in Mongolia. The progressive royalty rate, in the range of 5-8% for processed coal products and 5-10% for raw coal, was based on the monthly reference price determined by the Ministry of Mineral Resources and Energy of Mongolia at the time. However, on 6 October 2012, the GoM issued Resolution No.74, temporarily suspending the use of the monthly reference price system and setting contracted prices used for calculating the royalty rates for the period from 1 October 2012 through 1 April 2013. In the meantime, it will find a fair market based system to determine the reference prices used to calculate royalty rates in consultation with industry representatives. The Group's effective royalty rate for 2012 was around 7.3% (2011: 8.9%).

Gross Profit and Gross Profit Margin

The Group's gross profit for the year ended 31 December 2012 was approximately USD54.1 million, representing a decrease of USD152.1 million, or 73.8 %, from gross profit of USD206.2 million recorded for the year ended 31 December 2011. In 2012, gross profit margin was 11.4%, compared with 38.0% in 2011.

The decrease in gross profit and gross profit margin was mainly driven by (i) a decrease in the ASP of coking coal products supplied by the Group due to challenging market conditions in China as demand from steel mills and coke plants was affected by global economic conditions and (ii) costs related to coal transportation and stockpile loss totaling USD19.5 million, which was one-off recording at the end of the year.

General and Administrative Expenses

The Group's general and administrative expenses relate primarily to staff costs, share option expenses, consultancy and professional fees, depreciation and amortisation of office equipment and other expenses.

In 2012, the Group's administrative expenses decreased by approximately USD12.1 million, or 20.1%, from USD60.3 million in 2011 to USD48.2 million in 2012 (Table 11). The percentage of general and administrative expenses to total revenue decreased from 11.1% in 2011 to 10.2% in 2012.

The decrease in administrative expenses was mainly due to (i) no management fees charged under provisions of the management agreement with MCS Holding LLC as this agreement expired on 1 January 2012; (ii) no acquisition-related one-off expenses incurred; and (iii) less expenses related to geological exploration works and consultancy services.

Allowance for doubtful debts is related to the accounting treatment of the Group's trade receivables proportion according to the internal credit policy guidelines and management will continue to pursue full or partial recovery.

Table 11. General and administrative expenses

	Year ended 31 December			
	2012		2011	
	USD'000	**%**	USD'000	%
Management fee	**–**	**–**	10,406	17.2
Staff costs	**10,451**	**21.7**	8,980	14.9
Consultancy and professional fees	**5,585**	**11.6**	17,413	28.9
Depreciation and amortisation	**4,327**	**9.0**	3,427	5.7
Allowance for doubtful debts	**5,928**	**12.3**	4,145	6.9
Share option	**6,620**	**13.7**	1,646	2.7
Others (Note)	**15,272**	**31.7**	14,286	23.7
Total	**48,183**	**100.0**	60,303	100.0

Note: Others include costs incurred in relation to the social responsibility and community support expenses, insurance cost, travelling expenses, rental fees and other expenses.

Net Finance Cost/(Income)

Net finance cost for the year ended 31 December 2012 was approximately USD11.4 million (2011: net finance income of USD8.5 million). Net finance cost for the year ended 31 December 2012 was primarily due to interest expenses related to the Senior Notes and other credit facilities.

Income Tax Expenses

The Group's income tax expenses decreased from approximately USD35.7 million in 2011 to USD3.2 million in 2012. The income tax expenses were incurred on taxable income generated at individual operating subsidiaries of the Group and interest income on time deposits subject to special tax rate of 10% on gross interest income.

Loss/Profit for the Year

As a result of the costs listed above, losses attributable to equity shareholders of the Company for the year ended 31 December 2012 amounted to approximately USD2.5 million. As at 31 December 2011, the Company recorded USD119.1 million profit for the year. The major contributing factors of the Group's net loss position are (i) a decrease in the ASP of coking coal products, (ii) costs related to coal transportation and stockpile losses totaling USD19.5 million, which was one-off recording at the end of the year, and (iii) an increase in the Group's finance costs due to the issue of the Senior Notes and other facilities, bringing total net finance cost to USD11.4 million.

Liquidity and Capital Resources

For the year ended 31 December 2012, the Company's cash needs were primarily related to costs associated with mining and infrastructure development, which includes construction of modules 2 and 3 of the CHPP, additional water facilities, construction of the BN-UHG Road and railway construction.

The Company's cash resources were funded by (i) the successful issuance of the Senior Notes, (ii) a facility agreement with Standard Bank of South Africa Ltd as the original lender, and Standard Bank Plc as the lead arranger (the "**Standard Bank Facility**") for up to USD300 million, and (iii) cash generated from operating activities.

The gearing ratio (calculated as total bank and other borrowings divided by total assets) of the Company as at 31 December 2012 was 46.3% (2011: 34.5%). All borrowings are denominated in USD. Cash and cash equivalents are held in MNT, USD, RMB, Euros and Hong Kong Dollars ("**HKD**"). It is Company policy to regularly monitor current and expected liquidity requirements and compliance with debt covenants to ensure that the Company maintains sufficient reserves of cash to meet its liquidity requirements in the short and long term.

Indebtedness

As of 31 December 2012, the Company had USD1,008.8 million in outstanding short-term and long-term borrowings, including indebtedness incurred under (i) the Senior Notes, (ii) a Standard Bank Facility of up to USD300 million, (iii) USD180 million facility agreements with the European Bank for Reconstruction and Development, FMO – Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V. and DEG – Deutsche Investitions-und Entwicklungsgesellschaft mbH (the "**EBRD, FMO and DEG Loan Agreements**"), and (iv) USD85 million convertible bonds.

The Senior Notes, rated B1 by Moody's Investors Service, Inc. and B+ by Standard and Poor's Ratings Services, bear a fixed interest rate of 8.875% per annum payable semi-annually. The Senior Notes will mature in March 2017, unless earlier redeemed. As of 31 December 2012, the outstanding principal amount was USD600 million. Upon the sale, transfer, conveyance or other disposition (other than by way of merger or consolidation) in one or a series of related transactions of all or substantially all of the properties or assets of the Company to any person other than one or more of the beneficial owners of less than 30% of the total voting power of the Company, the Company must make an offer to repurchase all outstanding Senior Notes at a purchase price equal to 101% of their principal amount plus accrued and unpaid interest, if any, to (but not including) the date of repurchase.

A Standard Bank Facility was drawn down in the amount of USD200 million in March 2012, and the remaining available facility of USD100 million was cancelled by the Company. The loan bears an interest rate of LIBOR plus 5.25% per annum, and is repayable in 10 quarterly installments starting from December 2012 and ending in March 2015. As of 31 December 2012, the outstanding principal amount was USD190 million. Under the Standard Bank Facility, it will be event of default if, among others, MCS Holding LLC or a holding company which beneficially and directly holds 100% cent of issued share capital of MCS Holding LLC ceases to beneficially hold (directly or indirectly) at least 30% of the issued share capital of the Company from time to time without the prior written consent of all lenders under the Facilities Agreement.

The EBRD, FMO and DEG Loan Agreements bear interest on a semi-annual basis at the rate of six-month LIBOR plus 3.25%-3.75% per annum. Pursuant to the Amendment and Consent Agreement dated 5 March 2012, the margin per annum was reduced from 4.75%-6.85% to 3.25%-3.75% and UHG mining license and share pledges were released from the security package. The USD120 million principal amount of the loan is repayable in 11 semi-annual installments ending on 15 May 2016, and the USD60 million principal amount of the loan is repayable in two equal installments on 15 May 2015 and 15 May 2016, respectively.

As at 31 December 2012, the outstanding principal amount was USD147.3 million. Under the EBRD, FMO and DEG Loan Agreements, the controlling shareholder of the Company may not cease at any time to own directly or indirectly more shares of the Company than any other shareholder, or at least 30% plus one share of the issued and outstanding shares of the Company, or the Company may not cease to be directly majority owned by entities domiciled in Mongolia.

The original maturity date of the USD85 million convertible bonds, subject to certain conditions, was on 1 December 2012. The maturity date was extended to 1 March 2013 on 27 November 2012, and further extended to 22 April 2013 on 19 February 2013. The convertible bonds can be converted into shares at the bondholder's request in the four days prior to the maturity date at a conversion rate of HKD10.92 per share.

Credit Risk

The Group closely monitors its credit exposure. Credit risk is primarily attributable to trade and other receivables.

For the year ended 31 December 2012, the Group had approximately USD35.8 million in trade receivables, USD178.0 million in other receivables and USD5.9 million for allowance of doubtful debts. For the year ended 31 December 2011, the Group had USD41.4 million in trade receivables and USD72.0 million in other receivables, as well as USD4.1 million for allowance of doubtful debts. The Company holds monthly Credit Committee meetings to review, assess and evaluate Company's overall credit quality and the recoverable amount of each individual trade credit. As of 31 December 2012, in accordance with the Credit Policy, all bad debts aged over one year were written off against the provision which was made in the previous year. Based on the Company's continuous efforts and the implementation of the credit policy, credit risk has been significantly reduced. Nevertheless, the management continues to monitor, on an ongoing basis, the exposure, including but not limited to the current ability to pay, and takes into account information specific to the customer and pertaining to the economic environment in which the customer operates.

With regard to other receivables of USD178.0 million, this amount is mainly related to VAT and other tax receivables, deposits and prepayments. The VAT and other tax receivables amounted to USD83.1 million and other receivables amounted to USD94.9 million. For the VAT receivables, the tax authorities audited and approved the Group's VAT tax refund, and the Group has started to offset the VAT refund with its other tax payments. The remaining amounts are deposits, advances, prepayments and other receivables in the ordinary course of business. The management believes that there is no issue in the collectability of such receivables.

Foreign Exchange Risk

During the two years ended 31 December 2012, 100% of the Company's revenue and 27.0% and 35.5% of the purchases in each respective year were denominated in currencies other than MNT, the functional currency of the Group's Mongolian entities.

Cash and cash equivalents denominated in the currency other than the functional currency of the entity to which they relate as at 31 December 2011 and 2012 amounted to USD119.9 million and USD282.4 million, respectively. Total borrowings denominated in the currency other than the functional currency of the entity to which they relate as at 31 December 2011 and 2012 amounted to USD179.5 million and USD147.3 million, respectively.

For the two years ended 31 December 2012, 66.6% and 75.6% of the respective revenues were denominated in USD, with the remaining revenue denominated in RMB.

For the year ended 31 December 2011, 85.4%, 26.5% and 23.4% of the finance cost, operating expenditures and capital expenditures, respectively, were denominated in USD, with the remainder denominated in MNT. For the year ended 31 December 2012, 91.3%, 31.7% and 14.0% of the finance cost, operating expenditures and capital expenditures, respectively, were denominated in USD; while 0.7%, 13.5% and 1.2% of the finance cost, operating expenditures and capital expenditures, respectively, were denominated in RMB; 0.5% and 1.1% of the operating expenditures and capital expenditures, respectively were denominated in other currencies than the USD, RMB and MNT; and the remainder was denominated in MNT.

Although the majority of the Group's assets and operating expenses are denominated in MNT, a large portion of expenses, including fuel and capital expenditures, are import costs and are thus linked to USD and RMB prices. Also, the majority of the Group's finance costs are denominated in USD. Therefore, the Group believes that there is a natural hedge that partially offsets foreign exchange risk.

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

Contingent Liabilities

a) As at 31 December 2012, the Company has contingent liability in respect of the consideration adjustments for the Acquisition pursuant to the Share Purchase Agreement, which may arise from the royalty provision. Under the royalty provision, an additional life of mine payment of USD6 per tonne may be payable 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 the 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.

Under the royalty provisions for excessive coal production at the BN mine pursuant to the Share Purchase Agreement and the Settlement Agreement, the specified semi-annual ROM coal production must exceed 5.0 Mt. Therefore, the probability of royalty provision is considered to be very low.

b) On 14 February 2013, Enrestechnology LLC, wholly-owned subsidiary of the Company, has brought a claim to the Capital Administrative Court of Mongolia against two decisions No.101/12 and 102/12 both dated 26 December 2012, of the custom officers of General Customs Office of Mongolia.

These disputing decisions were made as a result of custom post-clearance audit, of which scope of inspection was 'importing activities due course of CHPP module I and II Construction Project' of the Company. Specifically, these decisions were made in relation to costs incurred in accordance with four interconnected contracts within a scope of engineering, procurement and construction management ("**EPCM**") services contracts signed with EPCM contractor.

In particular, in terms of cost type, these disputing decisions were made upon custom officers' assumption that "procurement management service payments" stated in EPCM contracts where "brokerage service fees" as well as "design and engineering management service payments" where addable costs to the declared values of the particular imported goods in the CHPP construction period, pursuant to Article 10.3 of the Law on Custom Tariff and Tax of Mongolia.

The total amount of these decisions were MNT7,984,088,870, which includes custom and VAT with relevant penalty. The amount claimed against Enrestechnology LLC under the custom officer's first disputing decision is MNT4,630,328,449 and the amount claimed under the second disputing decision is MNT3,353,760,421.

As of the date of this disclosure, since the Company and its subsidiary Enrestechnology LLC disagree with the custom officer's decisions and this matter did not reach the final decision, no payment was made by the Company or Enrestechnology LLC in accordance with these disputing two decisions.

On 26 February 2013, the Capital Administrative Court has instituted the administrative legal proceeding on this case, which started litigation process of the first instance court hearing. The first instance court decision is expected to be made within 60 days thereafter. If, the Company or Enrestechnology LLC disagree with the first instance court decision, the Company or the defendant may appeal via the Court of Appeal up to the Supreme Court. The Company is determined to work until final decisions is made on this matter.

The court's decisions are anticipated to be available in mid-2013 and it is premature to conclude the likely outcome at this stage. In the opinion of the Directors, based on legal advices, although the Company would provide all reasonable arguments in order to have issued rulings of the court in favor of the Group, it is difficult to estimate probability of the court decision at this early stage of the litigation. If Enrestechnology LLC was found to be liable to the claim, the under-paid customs duties and VAT would result in an increase in the cost of the Group's property, plant and equipment and the penalty would be charged to the Group's profit or loss.

Reserve adjustment

Pursuant to the Share Purchase Agreement, the Group agreed with the Seller that, 18 months to 21 months from the date of the Share Purchase Agreement, an additional payment would be payable to the Seller or a clawback might be payable by the Seller in the amount of USD3.00 per tonne to the extent that the Total Reserves exceeded 150 Mt or were less than the Reserve Adjustment. The maximum amount payable to the Seller will be USD105 million, and the maximum amount payable by the Seller will be USD90 million. According to the Share Purchase Agreement, the Company conducted geological and technical work to verify the estimations of the total reserves. In November 2012, independent technical review work confirmed the final total reserve as defined in the Share Purchase Agreement. Therefore, on 27 November 2012, the Company entered into the Settlement Agreement with the Seller to establish settlement arrangements for Reserves Adjustment Payment. Pursuant to the Settlement Agreement, Reserves Adjustment Payment will be settled by the issuance of two Adjustment Promissory Notes by the Company to QGX Holdings Ltd., each in the amount of USD52.5 million (each, an "**Adjustment Promissory Note**"), with each Adjustment Promissory Note bearing interest at a per annum rate equals to 3.0% commencing on the issue date and through to the maturity date. The Company shall pay the amount under each Adjustment Promissory Note to QGX Holdings Ltd. on a maturity date which is 360 calendar days from the issue date. Given the nature of coal reserves, whose existence is unaffected by the passage of recent time, Reserve Adjustment Payment is considered as consideration for the purchase of additional coal reserves; therefore, the payment is recognised in the consolidated balance sheet on a basis consistent with the right to mine the 150 Mt covered by the initial consideration under the Share Purchase Agreement. The amount of USD105 million is therefore recognised as an addition to the acquired mining rights.

Financial Instruments

The USD85 million convertible bonds have 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 USD10.3 million, and the attributable costs of USD0.1 million were charged to the profit and loss for the year ended 31 December 2011. The liability component was initially recognised at amortised cost of USD79.1 million after taking into account USD0.9 million attributable costs.

The Company has a share option scheme, adopted on 17 September 2010 ("**Share Option Scheme**"), in which the Board is authorised, at its discretion, to grant to eligible participants options to subscribe for shares subject to the terms and conditions stipulated therein ("**Share Options**") as incentives or rewards for their contributions to the Company. Under the Share Option Scheme, the Company granted two batches of Share Options to its directors and employees. On 12 October 2011, the Company granted 3,000,000 and 32,200,000 Share Options to directors and employees, respectively, at the exercise price of HKD6.66. On 28 November 2012, the Company granted 5,000,000 and 17,750,000 Share Options to directors and employees, respectively, at the exercise price of HKD3.92. The fair value of services received in return for Share Options granted is measured with reference to the fair value of Share Options granted. For the year ended 31 December 2012, USD6.6 million was recognised in administrative expenses and capital reserves in relation to the equity-settled share-based transactions.

The Senior Notes have 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 USD4.9 million, and the attributable transactions costs of USD0.11 million were charged to the profit or loss for the year ended 31 December 2012. The fair value of the derivative component as at 31 December 2012 was USD12.4 million, and was presented as a derivative financial instrument. The liability component was initially recognised at an amortised cost of USD591.7 million after taking into account USD13.2 million as attributable costs.

Capital Commitments and Capital Expenditures

As at 31 December 2012, the capital commitments outstanding on the respective dates on the balance sheet were as follows:

Table 12. Capital commitments

	As at 31 December	
	2012	2011
	USD'000	USD'000
Contracted for	**35,409**	14,827
Authorised but not contracted for	**69,427**	80,075
Total	**104,836**	94,902

Operating Lease Commitments

As at 31 December 2012, the Company had contracted obligations consisting of operating leases which totaled approximately USD4.4 million with USD2.8 million due within one year and USD1.6 million due between two and five years. Lease terms range from 1 to 5 years, with fixed rents.

Significant investments held

As at 31 December 2012, the Company did not hold any significant investments.

Material acquisitions and disposals of subsidiaries and associated companies

For the year ended 31 December 2012, the Company did not have any material acquisitions and disposals of subsidiaries and associated companies.

Dividend

The Board does not recommend the payment of a dividend for the year ended 31 December 2012 (dividend for the year ended 31 December 2011: nil).

Employees

As at 31 December 2012, the number of the Group's employees reached 2,568 compared to 2,177 employees as at 31 December 2011.

The Group's employees are remunerated with reference to their individual performance, experience, qualifications and the prevailing salary trends in the local market, which is subject to periodic review. With reference to the Group's financial and operational performance, employees may also be rewarded other benefits such as discretionary bonuses and Share Options pursuant to the Company's Share Option Scheme.

CONNECTED TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS

The Company has entered into the following connected transactions in the ordinary course of its business with certain of its connected persons for the year ended 31 December 2012. Set out below is a summary of the connected transactions entered by the Company in compliance with the Rules Governing the Listing of Securities on the Stock Exchange (the "**Listing Rules**"), as inclusive of related party transactions fall under the definition of "connected transaction" and "continuing connected transactions".

Non-exempt connected transactions

The following non-exempt connected transactions were recorded for the year ended 31 December 2012:

(1) Apartment Sale and Purchase Agreement

Principal terms

On 17 August 2012, Energy Resources LLC, an indirect wholly-owned subsidiary of the Company, entered into an agreement with MCS Property LLC, a subsidiary of MCS Holding LLC, to purchase four sets of apartments with total area of 12,703.36 m^2 constructed by MCS Property LLC in Tsogttsetsii soum of Umnugobi province, Mongolia.

Connected Person

MCS Property LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS Property LLC is a connected person of the Company.

Consideration

The total consideration payable by Energy Resources LLC is MNT22,803,479,766 (equivalent to approximately USD16,737,113) and payments for set A and C apartments will be made in two installments: advance payment of MNT5,595,708,483 (equivalent to approximately USD4,107,093) within 10 business days and remaining 50% payment of MNT5,595,708,483 (equivalent to approximately USD4,107,093) within 20 business days of signing of the agreement.

Table 13. Payment schedule for set B and D apartments

	Date	Payments (MNT)	Percentages
Deposit	after signing the Agreement	3,483,618,840	30%
Installment 1	by 15 September 2012	3,483,618,840	30%
Installment 2	by 15 October 2012	3,483,618,840	30%
Installment 3	after handing over the keys	1,161,206,280	10%
Total		**11,612,062,800**	**100%**

The consideration was determined at the market rate of MNT1,755,000 (equivalent to approximately USD1,288) per m^2 for set A, set B, set D apartments and MNT1,930,667 (equivalent to approximately USD1,417) per m^2 for set C apartment.

A payment of MNT17,796,507,479 (equivalent to approximately USD13,096,934) was made by Energy Resources LLC under this agreement for the year ended 31 December 2012.

(2) EPCM Service Agreement for New School, Kindergarten and Dormitory Complex

Principal terms

On 3 April 2012, Energy Resources LLC, an indirect wholly-owned subsidiary of the Company, entered into an agreement with MCS Property LLC, a subsidiary of MCS Holding LLC, whereby MCS Property LLC agreed to provide Energy Resources LLC EPCM services for new school, kindergarten and dormitory complex in Tsogttsetsii soum of Umnugobi province, Mongolia for a period commencing from 3 April 2012 to 31 December 2012.

Connected Person

MCS Property LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS Property LLC is a connected person of the Company.

Consideration

The total consideration payable by Energy Resources LLC under this agreement is MNT3,166,735,887 (equivalent to approximately USD2,405,676) and was determined by tender proposal submitted by MCS Property LLC for EPCM services for new school, kindergarten and dormitory complex.

Energy Resources LLC will make advance payment of 10% of the total contract amount within 30 calendar days from signing the agreement. Interim payments will be made on monthly basis within first 10 working days of next month based on actual work completion percentage indicated in the monthly progress report issued by MCS Property LLC. 10% retention will be withheld from each interim payment and the retention will be returned to the contractor upon completion of the EPCM service and state commissioning of the construction.

A payment of MNT2,590,965,726 (equivalent to approximately USD1,906,762) was made by Energy Resources LLC under this agreement for the year ended 31 December 2012.

(3) EPCM Service Agreement for mining equipment workshop II

Principal terms

On 3 April 2012, Energy Resources Mining LLC, an indirect wholly-owned subsidiary of the Company, entered into an agreement with MCS Property LLC, a subsidiary of MCS Holding LLC, whereby MCS Property LLC agreed to provide Energy Resources Mining LLC with EPCM services for construction of mining equipment workshop II at the UHG mine for a period commencing from 3 April 2012 to 1 September 2012.

Connected Person

MCS Property LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS Property LLC is a connected person of the Company.

Consideration

The total consideration payable by Energy Resources Mining LLC under this agreement is MNT7,345,947,105 (equivalent to approximately USD5,580,500) and was determined by tender proposal submitted by MCS Property LLC for EPCM service for the mining equipment workshop II.

Energy Resources Mining LLC will make advance payment of 40% of the total contract amount within 30 calendar days from signing the agreement. Interim payments will be made on monthly basis within first 10 working days of next month based on actual work completion percentage indicated in the monthly progress report issued by MCS Property LLC. 5% retention will be withheld from each interim payment and the retention will be returned to the contractor upon completion of the EPCM service and state commissioning of the construction.

A payment of MNT6,678,133,732 (equivalent to approximately USD4,914,620) was made by Energy Resources Mining LLC under this agreement for the year ended 31 December 2012.

(4) Bitumen Supply Agreement

Principal terms

On 3 April 2012, Gobi Road LLC, an indirect wholly-owned subsidiary of the Company, entered into an agreement with Shunkhlai LLC, whereby Shunkhlai LLC agreed to supply Gobi Road LLC with 4,500 tonnes of bitumen for construction of the BN-UHG Road for a period commencing from 3 April 2012 to 30 June 2012.

Connected Person

Shunkhlai LLC is an associate of Mr. Batsaikhan Purev, a non-executive Director of the Company. As such, Shunkhlai LLC is a connected person of the Company.

Consideration

The total consideration payable by Gobi Road LLC under this agreement is MNT7,218,283,486 (equivalent to approximately USD5,483,518). The parties agreed and fixed the unit price for 3,400 tonnes of bitumen at MNT1,453,725 (equivalent to approximately USD1,104) and the unit price for the remaining 1,100 tonnes of bitumen will be determined by reference to market rate.

The payment will be made by Gobi Road LLC within 7-10 working days after receipt of an invoice issued by Shunkhlai LLC in two installments: advance payment equal to 70% of the total consideration after execution of the agreement and the remaining 30% of the total consideration after the completion date of supply. Shunkhlai LLC will submit bank guarantee, in undisputable, irrevocable and unconditional form equal to 10% of the total consideration to Gobi Road LLC within 5 working days after the contract signing. If bank guarantee is not received by the specified period, the parties agreed to deduct the amount from the payment.

A payment of MNT6,501,332,761 (equivalent to approximately USD4,784,508) was made by Gobi Road LLC under this agreement for the year ended 31 December 2012.

(5) Naimdai Electrical Power Supply System Agreement

Principal terms

On 3 April 2012, Ukhaa Khudag Water Supply LLC, an indirect wholly-owned subsidiary of the Company, entered into an agreement with MCS International LLC, a subsidiary of MCS Holding LLC, whereby MCS International LLC agreed to provide services including (i) 38.5 km of 35 kilo volts ("**kV**") double circuit overhead power line; (ii) 40.2 km of 10kV overhead power line; (iii) 1 set of 10kV substation with 2x630 kilo volt-amperes ("**kVA**") step up transformer; (iv) 4 sets of 10kV substation with 1x630 kVA transformer; (v) 1 set of 100kVA 10/0.4kV substation; (vi) 18 sets of 63 kVA 10/0.4kV complete substation; and (vii) 1,000 metres of 10kV power cable, to Ukhaa Khudag Water Supply LLC for a period commencing from 3 April 2012 to 31 March 2013.

Connected Person

MCS International LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS International LLC is a connected person of the Company.

Consideration

The total consideration payable by Ukhaa Khudag Water Supply LLC under this agreement is MNT8,381,584,566 (equivalent to approximately USD6,367,243) and was determined by tender proposal submitted by MCS International LLC for Naimdai electrical power supply system services.

Ukhaa Khudag Water Supply LLC will make payment in the following installments: 20% of the total consideration upon acceptance of the agreement; 40% of the total consideration on main equipment delivery at the site; 35% of the total consideration on mechanical completion and 5% of the total consideration on completion of whole of the works and issue of taking over certificate and completion of outstanding work.

A payment of MNT4,571,773,400 (equivalent to approximately USD3,364,493) was made by Ukhaa Khudag Water Supply LLC under this agreement for the year ended 31 December 2012.

(6) Engineering Procurement Agreement for High Voltage Substation

Principal terms

On 3 April 2012, United Power LLC, an indirect wholly-owned subsidiary of the Company, entered into an agreement with MCS International LLC, a subsidiary of MCS Holding LLC, whereby MCS International LLC agreed to provide services including high voltage 110/35/10kV main substation expansion services to United Power LLC for a period commencing from 3 April 2012 to 15 September 2012.

Connected Person

MCS International LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS International LLC is a connected person of the Company.

Consideration

The total consideration payable by United Power LLC under this agreement is MNT2,461,013,000 (equivalent to approximately USD1,869,559) and was determined by tender proposal submitted by MCS International LLC for engineering and procurement services for the construction of high voltage substation.

United Power LLC will make payment in the following installments: 20% of the total consideration upon acceptance of the agreement; 40% of the total consideration on main equipment delivery at the site; 35% of the total consideration on mechanical completion and 5% of the total consideration on completion of whole of the works and issue of taking over certificate and completion of outstanding work.

A payment of MNT1,566,099,182 (equivalent to approximately USD1,152,535) was made by United Power LLC under this agreement for the year ended 31 December 2012.

Continuing connected transactions

The following continuing connected transactions (the "**CCTs**") were recorded for the year ended 31 December 2012:

(1) Rental of equipment from MCS Electronics LLC

Table 14. Contracts breakdown

No.	Company	Contractor	Effective date	Expiration date
1.	Energy Resources LLC	MCS Electronics LLC	2009.05.01	2012.04.30
2.	Energy Resources Rail LLC	MCS Electronics LLC	2009.07.01	2012.07.01
3.	Energy Resources Rail LLC	MCS Electronics LLC	2009.05.01	2012.04.30
4.	Transgobi LLC	MCS Electronics LLC	2009.07.01	2012.07.01
5.	Enrestechnology LLC	MCS Electronics LLC	2009.07.01	2012.07.01
6.	Ukhaa Khudag Water Supply LLC	MCS Electronics LLC	2009.07.01	2012.07.01
7.	Energy Resources LLC	MCS Electronics LLC	2009.07.01	2012.07.01
8.	Transgobi LLC	MCS Electronics LLC	2009.04.30	2012.07.01
9.	Energy Resources Mining LLC	MCS Electronics LLC	2009.05.06	2012.05.06
10.	Energy Resources Mining LLC	MCS Electronics LLC	2009.07.01	2012.07.01
11.	Energy Resources LLC	MCS Electronics LLC	2010.04.22	2013.04.22

Principal terms

Prior to the Company's initial public offering ("**IPO**"), various subsidiaries of the Company have entered into rental agreements with MCS Electronics LLC, a subsidiary of MCS Holding LLC, to rent office equipment, such as computers, printers, monitors, fax apparatus, duplicating machines, scanners, and various other office equipment from MCS Electronics LLC. The rental agreements commenced at different intervals with the last one ending on 22 April 2013, as mentioned above. Each of the agreements is subsisting for no more than three years following the listing of the Company's shares on the main board of the SEHK.

Connected Person

MCS Electronics LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS Electronics LLC is a connected person of the Company.

Consideration

The rental of office equipment is charged at a monthly rate on a per unit basis to be paid on a monthly basis. Estimated annual cap for the agreements is USD503,189 for the year ended 31 December 2012.

Actual payment of USD236,582 has been made by the Group for the year ended 31 December 2012 under the agreements.

(2) Supply of goods and services by the MCS Group

Principal terms

Prior to IPO, Energy Resources LLC, an indirect wholly-owned subsidiary of the Company, has entered into an agreement in relation to the information technology services with MCS Electronics LLC, a subsidiary of MCS Holding LLC pursuant to which MCS Electronics LLC agreed to provide Energy Resources LLC job executing and equipment renting services for a period commencing from 7 December 2009 to 7 December 2012.

Connected Person

MCS Electronics LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS Electronics LLC is a connected person of the Company.

Consideration

The fees for the services payable by Energy Resources LLC under this agreement were determined by reference to market rate and will be paid on a monthly basis.

Estimated annual cap for this agreement is USD19,627 for the year ended 31 December 2012. Actual payment of USD12,612 has been made by Energy Resources LLC for the year ended 31 December 2012 under this agreement.

(3) Construction supporting and ancillary supporting services

Principal terms

Prior to IPO, Energy Resources LLC, an indirect wholly-owned subsidiary of the Company, has entered into an agreement with MCS Property LLC, a subsidiary of MCS Holding LLC, pursuant to which MCS Property LLC agreed to supply rubble for UHG coal mining construction. The agreement commenced on 31 May 2010 and has ended on 31 May 2012.

Connected Person

MCS Property LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS Property LLC is a connected person of the Company.

Consideration

The fees payable by Energy Resources LLC under this agreement were determined by reference to the market rate of rubble. Estimated annual cap for this agreement is USD222,080 for the year ended 31 December 2012. Actual payment of USD4,415 was made by Energy Resources LLC for the year ended 31 December 2012 under this agreement.

(4) Master Agreement for ICT Services and Supply

Principal terms

On 3 April 2012, the Company entered into an agreement with MCS Electronics LLC, a subsidiary of MCS Holding LLC, whereby MCS Electronics LLC agreed to provide services including (i) internet connection services (ii) intranet services (iii) iridium and satellite internet service for Ulaanbaatar headquarter office and camp sites located at the UHG and BN mines and TKH; (iv) IT equipment and server rent services; (v) fiber optic line rent and maintenance services; (vi) IP line rent services; (vii) services for the maintenance of sure clock system for registration of attendance of employees; (viii) services for the maintenance of reliable operations of a computer program in relation to finance and accounting; (ix) services for maintenance of GPS system installed with coal hauling trucks; (x) supply of laptops, computers, printers, copiers, projectors, UPS, monitors, flash discs, external HDD, cameras (Digital Video/Photo), CCTV, Kenwood radio (Hand device), tetra radio, servers storage, RFID (Reader for weigh bridges), video conference sets and other IT hardware; and (xi) fiber optic network installation in the areas between UHG mine to BN mine, UHG camp to Tavan Tolgoi Airport, inside of UHG mine site including CHPP, water supply facilities, power plant and Transgobi office, and 50 km far away boreholes in Naimdain Khundii and any additional site/area to the Group for a period commencing from 3 April 2012 to 31 December 2014.

Connected Person

MCS Electronics LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS Electronics LLC is a connected person of the Company.

Consideration

The fees payable by the Group to MCS Electronics LLC under this agreement were determined on an arm's length basis between the Group and MCS Electronics LLC and will be paid on a monthly basis. Estimated annual cap for this agreement is MNT4,948,050,068 (equivalent to approximately USD3,758,888) for the year ended 31 December 2012.

Actual payment of MNT3,580,933,691 (equivalent to approximately USD2,635,307) has been made by the Group for the year ended 31 December 2012 under this agreement.

(5) *Office and camp supporting services*

On 22 July 2011, the Group entered into a service agreement with Uniservice Solution LLC, a subsidiary of MCS Holding LLC, pursuant to which Uniservice Solution LLC conditionally agreed to provide office and camp supporting services to the Group for a period commencing from 31 August 2011 to 31 December 2013.

Connected Person

Uniservice Solution LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, Uniservice Solution LLC is a connected person of the Company.

Consideration

Estimated annual cap for this agreement is USD29,172,640 for the year ended 31 December 2012 and is payable on a monthly basis.

Actual payment of MNT16,159,073,542 (equivalent to approximately USD11,891,902) was made by the Group for the year ended 31 December 2012 under this agreement.

The consideration payable to Uniservice Solution LLC was determined on an arm's length basis based on bid submitted by Uniservice Solution LLC and based on the size of the location where services are to be provided and the number of employees utilising the camp site and the temporary ger camp located at the UHG mine, BN mine and TKH.

(6) *Power and heat generation, distribution and management agreement*

Principal terms

On 9 May 2011, Energy Resources LLC, an indirect wholly-owned subsidiary of the Company, entered into an agreement with MCS International LLC, a subsidiary of MCS Holding LLC, whereby MCS International LLC agreed to provide services including operating management of the UHG Power Plant, electricity distribution services, and heat distribution services to the Group for an initial period of 18 months commencing from 9 May 2011. On 3 April 2012, the parties entered into an amendment agreement whereby the parties agreed to extend the contract period of the agreement until 31 December 2014.

Connected Person

MCS International LLC is a subsidiary of MCS Holding LLC which is in turn wholly-owned and controlled by MCS (Mongolia) Limited which directly owns a 100% shareholding interest in MCS Mining Group Limited, a controlling shareholder of the Company. As such, MCS International LLC is a connected person of the Company.

Consideration

Estimated annual cap for this agreement is MNT16,809,119,750 (equivalent to approximately USD12,769,394) for the year ended 31 December 2012 and will be paid on a monthly basis.

Actual payment of MNT14,608,492,088 (equivalent to approximately USD10,750,787) was made by the Company for the year ended 31 December 2012.

The consideration was determined on an arm's length basis between Energy Resources LLC and MCS International LLC.

(7) Fuel Supply Agreement

Principal terms

On 22 July 2011, the Group entered into a fuel supply agreement with NIC LLC, a wholly-owned subsidiary of Petrovis LLC, pursuant to which NIC LLC conditionally agreed to supply fuel products including diesel fuel and other types of fuel to the Group. It was also agreed that NIC LLC may sub-contract its obligations under the agreement to Shunkhlai Co. Ltd and Gobi Oil LLC to supply fuel products to the Group in compliance with the terms and conditions of the agreement until 31 December 2013.

Connected Person

NIC LLC is an associate of each of Petrovis Resources Inc., a substantial shareholder of the Company, and Dr. Oyungerel Janchiv, a non-executive Director. Shunkhlai Co. Ltd, a sub-contractor of NIC LLC, is an associate of Mr. Batsaikhan Purev, a non-executive Director. As such, each of NIC LLC and Shunkhlai Co. Ltd is a connected person of the Company. Gobi Oil LLC, a sub-contractor of NIC LLC, is no longer a connected person of the Company from 21 June 2011.

Consideration

Estimated annual cap for this agreement is USD218,595,000 for the year ended 31 December 2012 and is payable to NIC LLC on a monthly basis.

Actual payment of USD108,451,913 was made by the Company for the year ended 31 December 2012 under the agreement.

The consideration was determined by tendering proposal submitted by NIC LLC which is based on market rate of fuel products.

The independent non-executive Directors reviewed the CCTs of the Group pursuant to Rule 14A.37 of the Listing Rules.

In the opinion of the independent non-executive Directors, the CCTs were entered into by the Group:

(i) in the ordinary and usual course of business of the Company;

(ii) on normal commercial terms or on terms no less favourable than those available to or from independent third parties; and

(iii) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The Board has received a letter from the auditor of the Company stating that in respect of disclosed CCTs:

(a) nothing has come to the attention of the auditor that causes them to believe that the disclosed CCTs have not been approved by the Board;

(b) for the transactions involving the provision of goods and services by the Group, nothing has come to the attention of the auditor that causes them to believe that the transactions were not, in all material respects, in accordance with the pricing policies of the Group;

(c) nothing has come to the attention of the auditor that causes them to believe that the transactions were not entered into, in all respects, in accordance with the relevant agreements governing such transactions; and

(d) with respect to the aggregate amount of each of the CCTs set out in items (1) to (7), nothing has come to the attention of the auditor that causes them to believe that the disclosed CCTs have exceeded the maximum aggregate annual value disclosed in the announcements made by the Company in respect of each of the disclosed CCTs.

In respect of the CCTs, the Company has complied with the disclosure requirements under the Listing Rules.

OUR APPROACH TO SUSTAINABLE DEVELOPMENT

For the Company, sustainable development is about creating value in society and ensuring that we are accountable for the social, economic and environmental impacts of our mining activity, and that we continue to grow while making lasting contributions to the development of the country.

MMC has adopted two major policies with regard to responsible mining operations, namely the Sustainable Development Policy and the Corporate Social Responsibility ("**CSR**") Policy. Together, these two define our approach and strong commitment towards sustainability and our responsibility towards diverse stakeholder groups.

Our drive to develop sustainably is best summarised by the four principles by which we stand: first, the benefits of economic activity must appropriately account for their respective social and environmental consequences; second, in utilising resources, the needs and expectations of future generations must be adequately considered; third, the government, our business and other relevant segments of society must act cohesively to balance these needs; and fourth, continuing to employ sound corporate governance is essential for us to successfully meet both our business and sustainable development objectives.

In practice, this means the following:

- Establishing a transparent and accountable governance framework;
- Caring for the health and well-being of our employees;
- Understanding stakeholders expectations and proactively engaging them;
- Aiming to achieve and maintain the highest standards of Health, Safety and Environmental ("**HSE**") performance;
- Seeking to mitigate any adverse impacts of our operation on local community and their ways of life;
- Forming partnerships with local community for mutual benefit and making community investments that support sustainable development;
- Publicly reporting our activities and performances; and
- Aligning our activities with international best practices.

The Company's CSR policy is based on the international ISO 26000 Standard – an international voluntary standard that provides guidelines for social responsibility. By adopting a multi-stakeholder view, MMC's CSR approach emphasises our responsibility towards diverse stakeholder groups. Actively engaging with and listening to our stakeholders' interests and expectations throughout the project cycle forms the foundation of our CSR strategies and the framework of our operations.

Meaningful, ongoing dialogue with communities and other stakeholders helps to ensure support for our activities and generates important feedback that goes into our planning processes. Our wide and diverse range of stakeholders includes our employees, local community, suppliers, customers, investors, shareholders, regulatory bodies, non-governmental organisations ("**NGOs**"), government authorities and the wider community. Stakeholder identification and mapping was conducted early in the project phase to better understand their concerns and to formulate suitable engagement methods.

Through active engagement with its stakeholders, MMC has identified the following five key areas of focus for its CSR efforts:

- Fair operating practices;
- Human rights;
- Environmental stewardship;
- Labour practices; and
- Community engagement and development.

We have management plans, individual programs, and initiatives in place addressing our areas of focus. Moreover, our long and short-term objectives and key performance indicators are reviewed annually to set more realistic and deliverable targets across these five areas.

BUSINESS CONDUCT AND ETHICS

Code of Conduct

To ensure that our business performs and behaves in a consistently legal and ethical manner, all Company employees and executives are required to abide by our business Code of Conduct which provides guidance and sets employee expectations with respect to matters such, among others, as the prevention of harassment, discrimination, conflicts of interest, bribery and corruption. The Code of Conduct is a living document that is updated periodically to ensure that it addresses relevant issues and provides clear statement of our ethical expectations. Moreover, the Company provides a mandatory induction on its Code of Conduct for all newly hired and reassigned employees.

Human rights

As the concept and scope of human rights continue to evolve to include matters such as the right to water, the right to education and the right to participate in cultural life, the Company is firmly committed to improving its ability to integrate these evolving global human rights standards and frameworks into its business practices.

The United Nations endorsed the Guiding Principles for Business and Human Rights (the "**Guiding Principles**") in 2011. These principles help ensure that companies do not violate human rights in the course of their operations, and that they provide remedy when infringement occurs. The Company supports the Guiding Principles as a comprehensive, practical framework that sets out the responsibilities of governments and corporations in protecting human rights.

The primary human rights issues relevant to our operations are as follows:

- *Labour*: The rights of our employees and contractors to fair remuneration, equal pay for equal work, freedom of association, a safe and healthy workplace, non-discrimination and protection of their legal rights;
- *Security*: The provision of private security personnel to protect our operations at certain specific locations where there may be a threat to our people and/or our assets; and
- *Communities*: The impact of our operations may have on communities, including disputes relating to use of land and mineral assets, displacement of communities, impacts to culturally sensitive resources, access to resources and economic benefits.

MMC promotes human rights within its sphere of influence in the following ways:

- For employees, we endeavor to maintain a work environment that promotes professional and personal growth and in which the rights of other stakeholders are treated with respect. We aim to ensure that equal opportunity is afforded to all our employees, irrespective of race, nationality, religion, age, gender, sexual orientation, disability, political opinion or any other basis. Hence, we are committed to upholding the United Nations Universal Declaration of Human Rights and the International Labour Organisation ("**ILO**") Declaration on Fundamental Principles and Rights at Work. Our employees are free to exercise freedom of association and freedom of speech. We operate feedback boxes at the mine site to allow the employees to express their opinions and report any breach of ethical conduct and behaviour, including employment rights;
- We provide human rights training for the relevant managers and Human Resources ("**HR**") staff on a continual basis;
- We maintain close and active engagement with our local community based on dialogue and mutual respect, supporting initiatives that contribute to the socioeconomic and environmental development of the region in which we operate throughout the life cycle of our activities. In doing so, we abide by the commitments in the International Council on Mining and Metals' position statement on Mining and Indigenous Peoples;
- We also maintain constructive dialogue platforms with various statutory bodies and NGOs and cooperate with them closely to ensure that no human rights abuses occur in our operations and the communities in which we operate;
- We have established a dedicated Human Rights Task Force to oversee the implementation of our corporate sustainability policy in the area of human rights. Based on the results of the Human Rights Risk Assessment conducted in 2010, the Task Force developed the Human Rights Program to address human rights issues; and
- We provide customised training on Voluntary Principles on Security and Human Rights to ensure that our security measures are responsible and do not violate human rights. The security staff is trained to deal with anti-harassment and equal opportunity issues, on the proper use of force and special ammunition, as well as on how to carry out personal searches, while implementing their duties.

No human rights abuses were reported or identified at any of our operations in 2012. In addition, there were no strikes or lockouts at our operations. In general, we believe that our exemplary human rights practices help us to minimise the potential for any strike or slowdowns, as well as any other sort of industrial activity that may cause production delays, increase costs or negatively affect our ability to deliver production targets.

Forced labour & child labour

The Company does not engage in any type of forced or compulsory labour as defined by the International Finance Corporation ("**IFC**") as "all work or service, not voluntarily performed, which is extracted from an individual under threat of force or penalty." Moreover, MMC does not knowingly employ a person who is under the legal age of employment, or where that employment would contravene the generally accepted definition of child labour. To the best of our knowledge and in line with our recruitment policy, we employ people aged 18 or older.

In essence, MMC's Sustainable Development Policy upholds the elimination of all forms of forced or compulsory labour and prohibits any form of child labour. A system is in place during the recruitment, deployment and termination of employment to ensure that no child is employed and that no forced labour is ever used. No cases of underage or forced labour among our employees were reported in 2012, and none of our managed operations have been found to have significant risks for incidents of forced or compulsory labour.

Transparency

At MMC, we seek to ensure maximum transparency that is commercially viable. To this end, we publicly report our financial statements, operational and sustainable development performance regularly and in accordance with all relevant legislation and with the requirements of our lenders and shareholders. In addition, we support the Extractive Industry Transparency Initiative to increase transparency regarding company payments and government revenue in the extractive sector.

As part of its commitment to transparency and fair dealing with the government, the Company has been disclosing its payments to the government since the start of its operations in 2009. By disclosing payments made to different government organisations and the state budget, we are contributing to our stakeholders' efforts to strengthen governance by improving transparency and accountability throughout Mongolia's extractives sector.

Fair operating practices

We have built our business on a reputation for fair and honest dealing and are committed not only to fully adhering to this standard but also to always conducting our business with the highest ethical principles in mind. Hence, we believe that bribery, corruption, intellectual property violations and other similar behaviour that violates the rule of fair play will have negative impacts on the Company's image and its current and future performance. Hence, we do not tolerate any form of bribery and fraud and will take consistent and swift action if it is discovered.

The World Economic Forum Partnering Against Corruption Initiative ("**PACI**") and the Office of the President of Mongolia held a joint roundtable on 3 March 2011 as part of the Mongolia Economic Forum. This anti-corruption meeting brought together leading players from the business community, civil society and government agencies. Following the meeting, a PACI Mongolia network was established by the leading private sector companies in the country. MMC joined this network along with 168 other pioneering companies in a combined effort involving all stakeholders to strengthen corporate governance standards and to counter corruption.

OUR PEOPLE

Attracting, retaining and developing a capable workforce are central to the continued success of our operations. Hence, our employees are our greatest asset, and we aspire to create a safe, healthy and fair working environment where individuals can realise their full potential. Our employees are guided by the Company's Code of Conduct, which provides directions on ethical working standards and compliance with internal procedures of the Company. As a responsible employer, we believe in providing equal employment opportunities and respecting the rights of our people. We recruit based on skills and experience and wherever possible, we support local employment within the framework of our community development strategy. Moreover, we seek to offer competitive compensation and benefit schemes through our short and long-term incentives programs.

Highlights of 2012

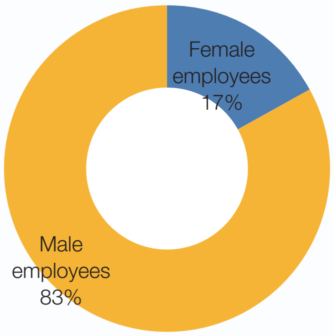
- The Annual Organisational Culture Survey was conducted among all employees;
- To enhance our competitiveness to attract highly skilled employees, the Company reviewed and updated its salary scale in March 2012;
- To improve the Company's internal HR controls and its functional operation, an HR Functional Development Assessment was conducted;
- The benefit scheme for our relocated employees was updated to include transfer of property and land ownership rights to employees based on their performance and years of employment with the Company; and
- To objectively determine the training and professional development needs of our employees, the Company introduced a new skills matrix standard.

Non-discrimination & equal opportunity

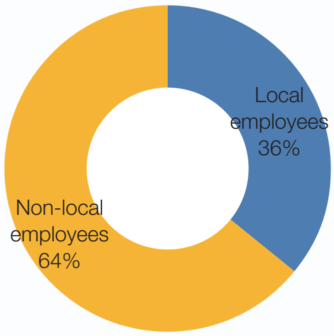
MMC stipulates that there should be no discrimination in terms of race, gender, nationality, age, religion, political views, pregnancy or disability and we also abide by the applicable national labour laws with respect to non-discrimination. MMC's policy of equal opportunity is reflected in its Code of Conduct, recruitment policy, benefits policy, training and development policy, promotions, compensation and other aspects.

As at 31 December 2012, we had a total of 2,568 employees, and all of them have signed employment contracts which detail, among other things, their duties and responsibilities, remuneration, as well as the grounds for termination of employment. Currently, over 73% of our employees are aged between 18-35 years, while the remaining 27% are over 36 years of age. Due to the labour intensive nature of the industry in which we operate, the percentage of females employed is relatively low.

Percentage of female employees (2012)

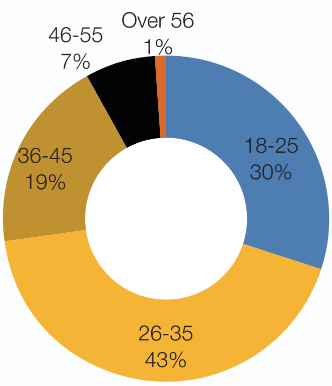


Percentage of local employees (2012)



However, our equal opportunity strategy is currently focused on increasing the number of female employees and the percentage of local community members in our workforce. As a result, the proportion of locally hired employees and the number of female employees in management have risen steadily in the last couple of years. The number of females working in management positions stands at 22 in 2012, compared to 14 in 2011.

Employee age demographic (2012)



Percentage of female employees in management positions (2012)

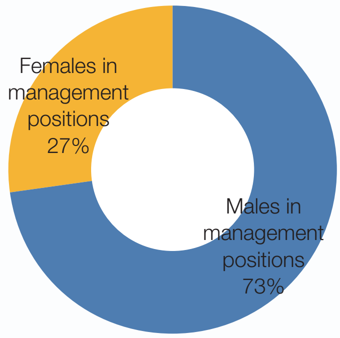


Table 15. HR statistics

		2011/12/31	2012/12/31
1.	Total no. of employees	2,177	**2,568**
2.	No. of female employees	348	**449**
3.	No. of female employees in management positions	14	**22**
4.	Percentage of local employees	29.8%	**35.6%**

Employee remuneration

While complying with minimum wage requirements as required by Mongolian labour laws, MMC has established a competitive compensation system and a set of social security and welfare mechanisms for all employees. The bonus or the incentives plan for MMC employees is tied to the Company's operational performance and individual work performance.

We review our compensation scheme annually to ensure that the scheme is balanced in terms of competitiveness and cost. Subsequent to a salary survey conducted among mining companies operating in Mongolia, the Company reviewed and updated its salary scale in March 2012.

Employee turnover

We believe that attracting, retaining and motivating a skilled workforce is critical to enduring business success. In 2012, our total employee turnover remained at a level similar to that in 2011 at 24%, an increase of 2%. We conduct turnover analysis on a monthly basis to determine the cause of employee turnover and take appropriate measures to address them. The most common cause for turnover is employee violation of internal labour procedures. In order to address this issue, we have organised HR Orientation Days and additional training on the Company's Code of Conduct and internal labour procedures.

Retention & benefits scheme

To date, we have addressed the challenges we face in recruitment and retention in number of ways such as updating our salary scale, introducing a more comprehensive benefits scheme and offering Share Options to attract and retain talented employees.

All MMC employees are entitled to comprehensive medical check-ups free-of-charge every year, and are also given assistance with housing costs and access to low interest loans. Moreover, the Company offers eligible employees up to 16 weeks of paid parental leave to help them balance their work and family commitments. Parental leave can be extended to up to 2 years of unpaid leave as we commit to securing the employees' place in the Company.

The Company encourages its operational workforce to be based in Tsogttsetsii soum rather than to fly-in/fly-out. Hence, our Relocation Policy, which has been in effect since 2011, aims to incentivise our staff to relocate to the area of our operations by providing the necessary support to employees and their families to adapt to the new environment. To that end, the Company implemented a range of initiatives such as construction of the "Tsetsii" township, a new secondary school, kindergarten and dormitory complex; the establishment of "Miners" ger district and support to "Zuzaakhai" kindergarten, to name few.

Other complimentary benefits for employees include:

- Subsidies for a range of health and wellness activities;
- Paid leave;
- Allowances for food, transportation, phone use and fuel expenses;

- Provision of coal free-of-charge during winter months for site-based staff;
- Gifts for all newborn children of employees; and
- Gifts for children of all employees on the national Mother & Children's Day holiday.

MMC responds to demand for pre-school education from its employees

With the aim of relieving the burden on public services and to also respond to our employees' growing demand for pre-school education for their children, the Company established the "Zuzaakhai" kindergarten which has the capacity to provide pre-school education for 126 children. As such, the Company agreed to provide a purpose-build, rent-free, fully-furnished 559 m² office space along with the necessary supplies to operate the kindergarten.

The kindergarten is an independently operated, non-profit body for which the Company subsidizes 50% of kindergarten fees for the children of its employees. This is in line with the Company's HR policy on employee retention and the staff relocation policy approved in 2011 to ensure that the families of its employees can comfortably relocated to and settle in Tsogttsetsii soum.

Students of the "Zuzaakhai" kindergarten in the classroom

Training and development

We believe that our progress is built on improving our employees' capabilities, thereby making a sound training and development mechanism especially important to the Company. Our employees have the opportunity to further develop their skills and competencies through ongoing training and development based on the Company's business needs and job specifications.

During the year under review, we conducted 163 various kinds of training sessions, of which 125 involved professional and vocational training and the remaining 38 involved general corporate skills training.

Table 16. Training highlights

2012 TRAINING HIGHLIGHTS	
Total no. of participants in professional and vocational training sessions	646
Total no. of participants in corporate skills training sessions	647

Organisational development

The Company took the following steps to streamline its organisational structure:

- Organised an "Organisational Productivity and Efficiency Campaign" to eliminate wasteful spending in our operations;
- Reviewed the organisational structure to ensure effective leadership and to improve organisational integration and communications. Changes in organisational structure are planned for 2013;

- Various measures have been undertaken to improve integration and coordination between different functions and departments of the Company, including regular inter-function meetings and discussions and informal activities such as inter-departmental sporting competitions, staff retreats and office gatherings; and

- A variety of orientation measures such as induction sessions, compliance training and mentorship were introduced so as to instill the Company's mission and values into its newly hired employees.

MMC enables peer learning

In commemorating the 90th anniversary of establishment of the mining sector in Mongolia, the Company initiated the "Mining Experts' Knowledge Sharing Programme" which involves series of monthly lectures and focused seminars conducted by the country's most respected and experienced industry professionals for the Company staff. The purpose of this initiative is to enable sharing of years of hands-on experience and knowledge working in the industry with the younger generations of professionals and to receive any suggestions and recommendations from them with regard to the Company's mining operations.

Mining and geology experts giving talks to Company employees

Employee engagement

Our employees are encouraged to create and maintain good working relationships with their teams and the management and to establish two-way communications with each other.

We strive to take all necessary measures to ensure that our employees' well-being is looked after. During the year under review, the Company conducted the "Relocated Employees' Satisfaction Survey" and established a comprehensive database of its relocated employees and their families residing in Tsogttsetsii soum. The purpose of this survey is to define and address to possible extent the difficulties experienced by relocated employees and their levels of satisfaction regarding the quality and availability of public services. As a result, the Company was able to determine measures to improve its employees' level of satisfaction with their relocation and to ease the process of settling into a new town. In addition, a task force has been established to deal with grievances and suggestions received during the survey.

Each year, MMC conducts an Organisational Culture Survey which allows the business to identify focus areas of improvement with regard to the Company management, organisational development, employee well-being and other HR-related issues.

HEALTH, SAFETY & ENVIRONMENT

Our integrated HSE policy ensures that we are committed to causing 'Zero harm' to our people and to minimising adverse impacts on the environment. Our integrated HSE policy applies to all of MMC's subsidiaries and its contractors. In accordance with our HSE policy, we are committed to the following:

- Identifying, assessing and managing the risks to employees, contractors, communities and the environment;
- Complying with the applicable national and international legal and other requirements;
- Ensuring that the Company management at all levels are HSE role models and lead by example;
- Providing relevant HSE training for employees, contractors and our local community;
- Auditing our HSE management system and taking measures to rectify any gaps; and
- Not tolerating re-occurrence of incidents.

The policy has strengthened leadership of managers at all levels and states that each individual is responsible for and must be involved in the implementation of the HSE policy. Currently, we have 33 regulations and procedures in place to deal with environmental and OHS issues such as regulations on waste, chemicals, spill control, incidents, personal protection equipment, training, etc.

Occupational health and safety

MMC is committed to meeting the most stringent OHS standards and practices and strives to create an incident-free safe work environment at each and every stage of its operations. In complying with both international and national OHS standards, we adhere to principle of ‘Zero harm’ to our employees, contractors and relevant stakeholders.

Our mandatory OHS standards apply to all employees and contractors and are regularly audited internally and by external inspection agencies, encouraging us to strive for continued improvement in our performance.

The following are our key achievements in the area of OHS in 2012:

- The LTIFR, an injury frequency rate expressed as the number of injuries per million hours worked, was 0.71 for 8,380,412 man-hours recorded within the Company’s coal mining, processing and transportation operations for the whole year of 2012. In comparison, the Queensland Government publicly reported that the average LTIFR at surface coal mining operations in Queensland, Australia was 2.7 for the period from 1 July 2010 to 30 June 2011;
- We recorded no occupational illnesses;
- No fines were imposed;
- The Company is in the process of introducing the internationally endorsed OHSAS 18001: 2007 OHS management system at our CHPP, for which it aims to receive certification by the end of 2013. In line with the aim, over 200 business-based safety procedures, manuals and guidelines are being reviewed and updated;

- Our OHS compliance rate stood at 94% during the State Inspection Agency visit in April 2012;
- We have introduced the Australian SAI Global Cintellite program to improve OHS within the Company and its contractors;
- Site safety inspections were carried out at more than 473 workplaces, and all identified hazards were investigated in order to discover and eliminate root causes; and
- A total of 141 workplace safety risk assessments were conducted in 2012 to minimise or eliminate work-related hazards and to enhance awareness of daily safety routines among our employees.

Table 17. Safety data

Indicators	2011	2012
Total man-hours worked	9,478,601	**8,380,412**
Fatalities	0	**1**
Total recordable injury frequency	4.77	**3.94**
Lost time injury frequency rate (LTIFR)	1.67	**0.71**
Legal compliance	100%	**94%**
Incidences (total lost workdays/total hours worked)	0.000034	**0.000019**
Safety inductions (number of employees and contractors covered)	5,403	**6,783**

Regretfully, an unfortunate fatal traffic accident occurred in October 2012 involving the Company's transportation operations and was caused by a collision with a third party transportation vehicle. The Company's emergency response unit acted immediately, and the case was further investigated by traffic authorities. Based on the outcomes of the investigation, no charges or payment claims were raised against the Company in connection with the case. The Company's OHS department, together with the traffic police, are committed to and make every effort to prevent accidents and minimise risks associated with increased traffic by providing safety training, conducting preventative safety checks and monitoring activities not only for the Company's own transportation operations and its contractors, but also for third party vehicles utilising its paved road on a toll fee basis.

MMC provides free medical and occupational health examinations for its employees. In line with our Occupational Health and Disease Policy, we identify staff members who are in positions in which they are exposed to occupational hazards according to regulatory requirements and focus on preventing infectious diseases and occupational illnesses, especially among our site-based employees. In addition, we strive to build awareness and knowledge of disease and hazard prevention through training and awareness campaigns. We have a 24/7 stand-by medical team and emergency response teams working on-site to ensure that any accidents and emergencies are responded immediately.

Environmental stewardship

Maintaining responsible environmental stewardship is an essential stepping stone to our long-term success. At each and every stage of our operations, we strive to promote the efficient use of resources, the reduction and prevention of pollution and the enhancement of biodiversity protection. Taking reference from the outcome of the Company's environmental impact assessment, individual management plans are developed to minimise the environmental impacts of the Company's operations, and the following seven environmental management plans are in place to ensure that we are accountable for our actions: Dust Management Plan, Erosion and Sediment Control Plan, Waste Management Plan, Hazardous Waste Management Plan, Tailings Storage Facility Management Plan, Mining Closure and Reclamation Plan, and Monitoring Plan.

The implementation of environmental management plans is reviewed annually against various key performance indicators. Based on the outcome of the review, corrective actions are taken aiming for continuous improvement.

The following are our key achievements in the area of environmental stewardship in 2012:

- Initiated the process of qualifying our HSE management system CHPP with international ISO 14001 and OHSAS 18001 standards with the aim of gaining certification by the end of 2013;

- Improved our waste sorting mechanism, which in turn increased our proportion of recycled waste from 59% in 2011 to 70% in 2012;

- No critical environmental incidents were recorded in our operations in 2012;

- Expanded our forest belt by another 5 hectares, bringing the total size of our forest belt to 10 hectares and 13,000 trees in total; and

- Expanded our "Uram" environmental club activities to engage more employees.

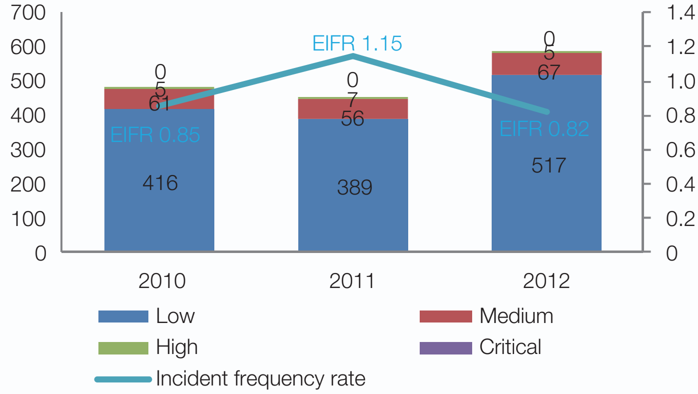
Environmental incidents

At MMC, environmental incidents are classified through a qualitative risk assessment process that evaluates the maximum reasonable consequence and likelihood of an incident occurring. The risk assessment involves four classifications: low, moderate, high and critical. A definition of each classification is given below.

Table 18. Environmental Incident Classification

Risk rating	Definition
Low	Incidents with promptly reversible environmental impact
Medium	Incidents with low environmental impact or procedural non-compliance
High	Incidents of non-compliance or incidents with moderate environmental impact
Critical	Incidents with unconfined and significant environmental impact

We recorded 589 environmental incidents in 2012, approximately 20% higher compared to 2011. This is due to our expanded operations at CHPP and increased production in 2012. However, the environmental incident frequency rate ("**EIFR**") decreased from 1.15 in 2011 to 0.82 in 2012, and we recorded fewer high ranked environmental incidents and no critical incidents in 2012.



Biodiversity and land use

With the aim of conserving biodiversity at our operation impact areas, we investigate the biodiversity elements of these regions by working together with scientists and researchers to identify the relevant areas of focus. We have been engaged in a collaborative research project with the Mongolian University of Agriculture since 2010 to identify perennial plants best suited for re-vegetation at mine sites.

To combat desertification and sand drifting, as well as to off-set our impact on biodiversity, we initiated the establishment of a wind belt area in Tsogttsetsii soum, Umnugobi aimag. In 2012, we have extended the wind belt to 10 hectares, bringing the total number of planted trees to 13,000. The livelihood rates of the planted trees are approximately 60%, which is considered relatively high compared to an average of 40%-50% livelihood rate in the Gobi region.

We have been conducting flora and fauna monitoring since 2011. A comparison of monitoring data from 2011 and 2012 shows that the number of species observed increased in 2012 due to good grassing as a result of high precipitation. In addition, habitats for rare and endangered species were identified in 2012.

With data from the monitoring results we have conducted to date, a Biodiversity Action Plan will be developed in 2013, which will further refine our approach to minimising and offsetting the impact of our operations on biodiversity.

Of our total landholding of 22,710.13 hectares, about 49.4% is used for mining, 41.1% for infrastructure, 3.0% for plants, and 6.5% for worker accommodation, respectively. We have environmental management plans in place that provide the framework for undertaking rehabilitation and other land management programs which involve reshaping and re-vegetating land that has been mined to restore the land for future use. In 2012, 30 burrow-pits were dug in connection with the construction of the BN-UHG Road. During the year under review, 22 of these 30 burrow-pits were reclaimed.

Before burrow-pits were reclaimed

After burrow-pits were reclaimed

In 2012, a total of 3 hectares of waste rock dump was rehabilitated and vegetated with local perennial plants. To prevent soil erosion from rainfall, drains were also created along the wall and covered with stones.

Re-vegetation of the waste rock dump

Waste management

Our sites operate a comprehensive non-mineral waste management system that includes the day-to-day management of all major regulated and industrial waste streams. The system focuses on correct waste handling, storage, sorting and recycling. As we continue to expand our mining operations, we seek to further improve our waste management system. In 2012, we made significant enhancements to our non-mineral waste sorting and recycling mechanism by introducing a new color coding system which increased a proportion of recycled waste from 59% in 2011 to 70% in 2012.

Table 19. Solid waste recycling

	2010	2011	2012
Solid waste, m^3	6,001	16,040	**22,602**
Proportion recycled (%)	50	59	**70**

At present, mineral waste is dumped outside the mine-pit, which is later rehabilitated by being covered with topsoil and re-vegetated. Hazardous non-mineral waste is delivered back to the supplier for refill or is burned in a special incinerator. Plastic wastes, waste metal and waste paper are sent to designated recycling facilities in other provinces in Mongolia.

Table 20. Waste data 2012

Waste classification	Waste type	Source	Storage	Waste handling and disposal	2011	2012
Solid Waste	Flat tires	Workshops, service bays	Stockpiled in designated area near the workshop	Delivered back to the supplier for recycling	1,681 pieces	1,900 pieces
	Clinical waste	First-aid unit	Sealed containers	Burned in a designated incinerator	156 kg	130 kg
	Waste oil	Workshops/service bays, fuel farms and oil/water separators, pump house	Waste oil tanks	Transported to waste oil recycling plant in Ulaanbaatar and recycled to black oil and pitch	162 tonnes	179.5 tonnes
	Food waste	Kitchen	Waste bins	Used as food for pigs by local people	30 tonnes	292 tonnes
	Paper and paper boxes	Various	Waste paper container	Transported to a recycling facility in Ulaanbaatar	N/A	30 m^3
	Waste metal	Power plant, CHPP, crushing plant	Waste metal containers	Transported to a recycling facility in Ulaanbaatar	210 tonnes	11 tonnes
	Plastic wastes	Various	Dedicated collection bins	Transported to a recycling facility in Dundgobi aimag	254 m^3	400 m^3
	Timber	Various	Dedicated timber collection bins	Used as firewood	1 tonne	2 tonnes
	Toner cartridges	Offices	Special bins	Recharged and reused	N/A	120 pieces
Hazardous Waste	Truck batteries	Workshops	Designated area near the workshop	Delivered back to the supplier for recycling	N/A	120 pieces

Waste classification	Waste type	Source	Storage	Waste handling and disposal	2011	2012
	Oily rags/oil absorbent material	Workshops, service bays	Oily rag bins	Burned in a special incinerator at a high temperature	1,570 m^3	1,609 m^3
	Oil filters	Workshops, service bays	Oily rag bins	Burned in a special incinerator at a high temperature	1,115 pieces	2,923 pieces
	Empty oil drums	Workshops	Empty drum storehouse	Reshaped to waste bins and used at the project site, or refilled	2,000 pieces	1,230 pieces

Water

Access to water is essential for the ongoing success of our operations, yet water is a finite natural resource we must use with the utmost efficiency. Therefore, we seek to minimise the volume of freshwater used in our operations through water efficient technologies and by recycling water where possible. We use water to wash coal during processing, to operate our power plant and for human consumption on site. Water is sourced from groundwater boreholes and is stored in two water reservoirs with a total storage volume of 56,000 m^3, which prevents evaporation.

In 2012, a total of 3.6 million m^3 of ground water was extracted and used for the UHG project, 95% of which was used for industrial purposes and 5% for domestic purposes at the workers' camp.

We use a combination of both fresh and recycled water on site. We have installed a tailings thickener at CHPP which decreased water content in the tailings by 30%. The slurry discharged from the thickener is disposed to the Tailings Storage Facility, where tailings sediment and the water is pumped back to CHPP for re-use. As a result, we managed to recycle 95%-97% of the water used at the CHPP in 2012, allowing us to effectively reduce ground water extraction and consumption of fresh water by 150,000 tonnes per month. Sewage is treated in a waste water treatment plant and is used for dust control on coal haulage roads.

Water monitoring is carried out regularly to control and prevent project-induced negative impacts on surface and ground water. Monitoring of herder wells around the UHG mine, Tsogttsetsii soum centre and coal transportation road are conducted on a monthly basis. Moreover, there are 10 groundwater boreholes installed in the mine licensed area for groundwater monitoring, which allows us to control contamination of groundwater resulting from our operations. In 2012, monitoring data has shown no changes in water levels and no water contamination.

Air quality and noise

The large amounts of earthwork required for our mine expansion plans generate significant amounts of dust and other emissions, which, if not properly controlled, could negatively impact the health of our employees and contractors, as well as members of the local community. Hence, managing and reducing dust is a top priority at our sites.

To reduce the generation of dust and other similar particulates, the haulage roads at our sites are regularly sprayed with water extracted from pit dewatering activities required for geotechnical control. In addition, our coal stockpile at TKH has been fenced off with a 10 metre high special wire fence that reduces wind speed and dust dispersion. Previously, the Company transported coal by truck using a gravel road, which generated excessive amounts of dust in the surrounding areas. To reduce negative environmental impacts and to improve operational efficiency, we have constructed a 245-km paved road which commenced operation in October 2011. Emission monitoring data has shown that since then, the level of dust generated on the paved road is almost negligible compared to that level generated on the gravel road. Both PM2.5 and PM10 dust levels are monitored at 30 different sites at the UHG mine site. Monitoring results show that dust levels fluctuate depending on weather conditions and wind speeds.

At our sites, the main source of noise is generated by the operation of heavy machinery and industrial equipment. Heavy machinery and industrial equipment are fitted with noise attenuation devices to keep noise generated within safe levels for employees, who are also provided with adequate hearing protection. Noise level measurements are conducted on a monthly basis at 10 points around the mine sites.

Environmental compliance and monitoring

In 2012, state and local government authorities carried out several environmental compliance inspections at the UHG mine site, which found that MMC did not breach any national laws, regulations and standards. However, a soil pollution issue was raised in connection to the operation of a workshop of Energy Resources Mining LLC, a subsidiary of the Company, during an environmental compliance inspection in April, 2012. A monetary fine of MNT2.8 million was imposed on Energy Resources Mining LLC. Necessary corrective actions were taken and all repair work outside the workshop has ceased altogether.

As a rule, we regularly monitor and measure the impacts of our activities on the environment to ensure they are within nationally-accepted levels. Our monitoring activities include biodiversity studies and the monitoring of dust emission, noise levels, air pollution, soil erosion, groundwater pollution and shallow water pollution. In addition, we seek to involve community members in our environmental monitoring activities throughout the year.

MMC involves the local community in environmental monitoring activities

We believe that transparency is a key to building successful relations with the community in which we operate. Our activities are open to local people and we encourage their participation, comments and suggestions at all times. To that end, we provide opportunities for local community to participate in environmental monitoring activities such as measurement of water levels, dust and noise levels and monitoring of wildlife in their areas of residence. Through these collaborative efforts, local residents learn more about our business and environmental protection activities. In 2012, 38 local residents, including herders, school children and local government officials took part in our environmental monitoring activities.

Local community members participating in the Company's environmental monitoring activities

Environmental awareness

The Company regularly organises training for members of local community on ecological awareness to encourage their participation in the Company's environmental protection efforts. In 2012, a total of 622 local community members received training on tree planting, household sanitation, water consumption, waste management, traditional Mongolian approaches to environmental protection and the importance of soil conservation.

In parallel, we provide environmental awareness training for our employees. During the year under review, 1,108 employees received environmental awareness training on waste sorting, hazardous waste disposal, the environmental management system of the Company, soil conservation, environmental hygiene, spills and window gardening.

In 2011, the "Uram" employee environmental club was established to provide more opportunities for our employees to take part in our environmental protection efforts. In 2012, the club expanded its activities and organised numerous events and competitions with the aim to encourage employee participation.

"Uram" environmentalist club expands activities in 2012

Within the framework of the 'Uram' environmentalist club activities, 1,268 employees of the Company planted over 640 trees in and around the Company's UHG project site and workers' camp on National Tree Planting Day. World Water Day was also celebrated to promote the sensible use of water among employees. Moreover, the club joined the worldwide effort to boost awareness and appreciation of the world's natural habitat by supporting Earth Day, with all lights at the UHG site being turned off between 8.30 pm and 9.30 pm to express the Company's support.

A 4-month "Eco-waste solution" competition in which participants created usable products from waste generated at the mine site, was organised among employees. A total of 50 products were created, including a waste bin made from an air filter, a checkers board made of gypsum, a model airplane made from a waste drum, etc. In addition, we provided environmental awareness trainings for our employees, with 1,108 employees receiving environmental awareness trainings on waste sorting, hazardous waste disposal, the environmental management system of the Company, soil conservation, environmental hygiene and growing indoor houseplants during the year under review.

Tree planting and window gardening activities of the 'Uram' environmentalists' club

OUR COMMUNITY

Broad-based community support is essential for the long-term sustainability of our business. We believe in involving community members in decisions that affect them, which in turn helps us develop more honest, two-way and mutually beneficial relationships with our host community. Hence, listening to community concerns and expectations regarding our business and engagement with them throughout the life cycle of the mine forms the foundation of our approach. As a result, the Company is able to better manage the social impacts, risks and opportunities that arise from our operations.

Prior to start of our operations and before undertaking any new projects, we conduct socio-economic baseline studies and impact and risk assessments to determine both the positive and negative impacts of our operations on the community. Based on these, we devise individual plans to mitigate any adverse impacts associated with our activities and at the same time support any positive impacts that may contribute to the development of the region. Specifically, our community directed management plans include the Public Consultation and Disclosure Plan, Resettlement Action Plan, Grievance Management Plan, Cultural Heritage Management Plan, Economic and Physical Displacement Management Plan and Community Health & Safety Management Plan.

Sustainability Report

Through our community investments, we seek to deliver long-term sustainable outcomes for the community in which we operate by empowering local people to develop independently of the Company's continued support when our mining activities cease.

Based on feedback from the relevant stakeholders, we re-evaluate the implementation of our plans and activities through various internal and external monitoring exercises and revise our plans as necessary.

Highlights of 2012

- The "Muruudul" school, kindergarten and dormitory complex was completed;
- The Company established the "Zuzaakhai" kindergarten, which has the capacity to provide pre-school education for 126 children;
- The "Gobi Future 2012-2013" scholarship program was organised for undergraduate students from Umnugobi aimag;
- In commemorating the 90th anniversary of the establishment of the mining sector in Mongolia, the Company initiated the "Mining Experts' Knowledge Sharing Programme" for its employees, which involves a series of monthly lectures and focused seminars by the country's most respected and experienced industry professionals;
- Physicians from the South Korean Ewha Clinic and Ulaanbaatar Songdo Hospital carried out health check-ups free-of-charge in Umnugobi aimag;
- The Company initiated and organised a consultative forum involving Community Relations Officers from 15 mining companies operating in the South gobi region;
- For the third consecutive year, the Company organised its annual community health awareness building training sessions and campaign;
- A "Relocated employees' satisfaction survey" was conducted among our relocated employees; and
- A site visit for 300 herders from 15 different soums of Umnugobi aimag was organised at UHG.

Community Engagement

Since its inception, MMC has strived to develop effective ways to engage its local stakeholders. There are significant challenges in being located in a rural environment largely inhabited by people with nomadic lifestyles, with limited infrastructure and facing harsh weather conditions. Nonetheless, MMC has fostered strong relationships with local community members, promoting transparency, honest two-way dialogue, and ongoing improvements to benefit local stakeholders and to support the smooth operation of the Company's activities.

The objectives of our community engagement activities are to share information about the Company's operations with the local communities and to receive feedback on our impact on the local community. This in turn enables community input in identifying appropriate mitigation and management options available to us in addressing issues of concern to them.

MMC continues to develop community programs that are effective and fit-for-purpose, and our stakeholder engagement plan is reviewed and updated as needed to respond to evolving local conditions and operational issues.

We use a range of communications and culturally appropriate dialogue mechanisms such as providing reliable factual information, establishing constructive dialogue and organising consultation events. In the reporting period, MMC conducted the following community engagement activities:

- Periodic visits to affected herder households and resettled families;
- Regular meetings with local administration;
- Initiating monthly meetings with Community Development Advisory Councils established in each impact soum to provide a better platform for dialogue between the Company and the local community;
- Annual public consultation and disclosure activities (Open ger events); and
- Operation of information centers and hotlines.

Other sources of public information disclosure to our stakeholders include our annual reports, the "Ukhaa Khudag" quarterly newspaper, monthly bulletins, brochures, and the Company's website.

Grievance Management

All of our managed operations have in place a grievance and conflict resolution process for community members. These include clear procedures for registering, evaluating and responding appropriately to all complaints and enquiries. Grievances are received via the Internet, by telephone, through face-to-face interviews and in writing, and are processed and reported quarterly and annually to the Company management and the public on their resolution. All grievances are responded to within 30 days of submission, and more quickly in urgent cases. Where requested and appropriate, the Company treats complaints in a confidential manner and in all cases grievances are addressed without prejudice. In 2012, a total of 25 grievances were received and handled. More than 44% of the grievances received were in connection to resettlement, 30% were in connection to disturbance of livestock grazing land, and the remaining 20% were claims to be compensated and requests to be included in various community development initiatives the Company undertakes. Our response actions included but were not limited to measuring water levels of herder wells, creating new wells, providing factual information and including herders in the Company's community development programs and initiatives.

Community Investment

Through community investment, we strive to create opportunities for 'shared value' – an outcome that benefits both the Company and the community. Community investment at MMC refers to how our invested financial resources (directed in the community) make positive contributions to the sustainable development of the local community in which we operate. These contributions include developing local talent and suppliers and improving local infrastructure. We strive to maximise these opportunities through our design, procurement and employment policies, the implementation of dedicated programs or partnerships with governments, NGOs and local communities. Hence, community investment at MMC encompasses both our community infrastructure investments and community development programs. In turn, the Company also gains from these activities in a multitude of ways, including access to a capable workforce and reliable supply chains. In 2012, the Company contracted approximately MNT34.9 billion on community investment and infrastructure development activities.

Table 21. Community investment in 2012

		MNT
1.	Local infrastructure development	28,403,603,804
2.	Community development programs	638,955,839
3.	Grants & Sponsorships	181,166,200
4.	Local procurement (Umnugobi aimag)	5,700,000,000
TOTAL		**34,965,575,843**

- ***Community infrastructure investments***

Prior to commencement of our UHG mining project, the Tsogttsetsii soum, an administrative unit of Umnugobi aimag, where we operate, used to be one of the least developed areas of the Gobi region, and had limited infrastructure. Since 2009, we undertook several important infrastructure development projects, including the construction of the Tsogttsetsii soum inter-road and the provision of an uninterrupted supply of filtered water and electricity to residents of Tsogttsetsii at subsidised rates.

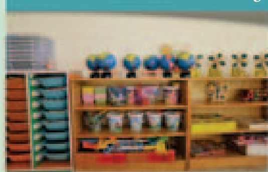
Creating opportunities through education

To ease the impact of the population influx to Tsogttsetsii soum and to enhance access to education for young people, a new school, kindergarten and dormitory complex was constructed and put into operation as part of the Company's local community investment strategy. Jointly financed by the Company and the local government, the new school and kindergarten complex is an all-modern facility which comprises a secondary school for 640 children, a kindergarten for 144 children and a dormitory for approximately 100 children.

The stakeholders of this new establishment, including the local government, the local community and the Company, have a vested interest in developing this school as a local model school offering high quality education that is competitive at both national and international standards. Hence, the Company is assisting the new school and kindergarten complex for its first 5 years of operation in order to develop its capacity to provide quality education. Orchlon School was selected through a tender as an organisation with a proven track record of implementing international secondary educational programs in Mongolia. The school complex will be owned by the local government and will serve the educational needs of both the local children as well as the children of the Company's employees. The interior and exterior of the complex are exceptionally well designed and meet all international health and safety requirements. The complex has a generous amount of green space in which students can play and undertake numerous sporting activities.

Pupils of the "Muruudul" complex

Interior of the "Muruudul" kindergarten



Exterior of the "Muruudul" complex

Health Screening and in-service professional training initiative 2012

South Korean physicians at Tsogttsetsii soum hospital

MMC is committed to improving the quality of health services as well as developing health programs to support community health. In 2012, Community Health Screening and the In-service Physician Training Program were jointly implemented by the Company, Ulaanbaatar Songdo Hospital, Ewha Medical University of South Korea and the Umnugobi aimag Department of Health. This program is in line with national efforts to control the spread of non-communicable diseases and to promote healthy living in rural Mongolia.

Within the framework of this initiative, highly sought after physicians carried out health check-ups among herders and community members living in the Company's impact area. A total of 1,214 patients benefited from gynaecology, paediatrics, cardiovascular, oncology and ultrasound examinations and received necessary treatments and medicines free-of-charge. Moreover, 8 local doctors received in-service training, and the visiting physicians from the Ewha Clinic performed operations on two patients who required urgent medical attention.

In 2012, the "Muruudul" school, kindergarten and dormitory complex, a joint investment between the Company and Umnugobi aimag administration, was commissioned and opened. The Company is also financing the establishment of "Tsetsii Town", a residential town in Tsogttsetsii soum, to cater to the demand for modern housing from our employees and members of the local community.

- ***Community development programs***

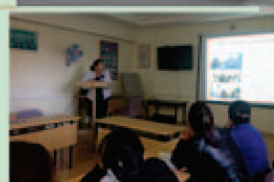
Our community development programs are designed to support the broader opportunities for development and the overall sustainability of the local communities. We implement various community development programs that focus on creating employment, improving access to health and education, promoting local business development, and preserving cultural heritage.

MMC is firmly committed to the protection and preservation of both tangible and intangible cultural heritage of the region through its Cultural Heritage Preservation Program. We conduct pre-construction archaeological surveys and have in place programs to protect the intangible aspects of the cultural heritage of the local community such as, among others, organising training and a contest involving Mongolian traditional long songs and supporting the use of our traditional 'Uigarjin' script among the younger generation.

In 2012, with the aim of promoting the use and artistry of the 'Uigarjin' script, the Company, in cooperation with a local NGO, organised an Uigarjin script beginner's class in calligraphy training for 75 pupils. Building on this initiative, an intermediate level calligraphy class for a selected 48 pupils and an exhibition showcasing the children's work was organised.

"Healthy Citizen-Future of the Region" health awareness campaign

Community members at health awareness training



In 2012, the Company organised its annual "Healthy Citizen – Future of the Region" community health awareness campaign for the third consecutive year. This initiative was jointly implemented by the Company and the Umnugobi aimag Department of Health, reaching 2,773 community members across 7 soums of the aimag.

The program aimed to build the capacities of local health professionals to deliver quality services to the public and to improve health awareness among the community members by contributing to their knowledge and experience of exercising healthy lifestyles. Training sessions and campaigns focusing on topics such as reproductive health, the hazards of smoking and alcohol consumption, the spread of HIV/STD, advice on diet & exercise, household accidents and injuries and environmental disasters were conducted among the youth, health professionals, truck operators, herders and soum center residents.

Supporting the spread of Mongolian traditional script among the younger generations:

The 'Uigarjin' Mongolian script was used as the official script of Mongolia until 1946, when it was replaced by the Cyrillic script currently in use. The traditional 'Uigarjin' script is one of the most precious forms of cultural heritage of the Mongolian people and is inextricably linked to the country's history and national identity. At the national level, numerous efforts are being made to re-popularise the script among the general population, especially among the younger generations, in learning and using the traditional script. The Company has been supporting this effort since 2011 through its Cultural Heritage Preservation program.

Children learning Mongolian traditional 'Uigarjin' script calligraphy

In addition to the two main categories of community investment described above, MMC also initiates sponsorships and donations as well as volunteer activities such as blood donations, the provision of hay and fodder to herders during winter months and extending our help to underprivileged children in orphanages.

SOCIO-ECONOMIC CONTRIBUTION

As one of the largest mining companies in Mongolia, our socio-economic commitment is extensive in the local community in which we operate and throughout the country as a whole. In addition to direct economic benefits through taxes and royalties, wages, employee benefits and payments made to suppliers, we carry out a number of community development initiatives to address fundamental social issues faced by our host communities. During the reporting period, the Company continued to invest in local infrastructure development and has maintained its position as the top private sector employer in Umnugobi aimag. Beyond the direct economic contributions, the Company's presence in the country and the region brings a number of indirect benefits ranging from new local business developments to the injection of advanced technologies into the country's mining industry.

Job creation

As of the end of 2012, MMC employed 2,568 employees, 36% of whom were locally hired. This represents an approximate 6% increase from the previous year. The majority of local employees are residents of neighboring soums of Umnugobi aimag, including Tsogttsetsii, Dalanzadgad, Manlai, Bayan-Ovoo and Tsogt-Ovoo. The Company created 395 new jobs during the reporting period and is employing more than 8,000 people directly and indirectly through its subsidiaries and contractors. We provide vocational training for local people where necessary to improve their employment prospects. Also, the Company cooperates with more than 700 local businesses within the scope of its projects and operations.

Tax contribution

MMC paid approximately MNT163 billion in taxes and fees to the state budget in 2012, representing an approximate 41% increase over the previous year. The taxes, royalties and commissions paid by MMC make a significant contribution to the socio-economic development of the country, and the Company has been widely acknowledged to be one of the top taxpayers in the country by both national and local level authorities.

Exterior view-Tsetsii miners' town

A miner's family settled in Tsetsii apartment

Infrastructure development

Besides providing reliable access to clean water, electricity and transportation for the neighboring communities, MMC has established the following facilities in support of local infrastructure development during the reporting period:

- A new school, kindergarten and dormitory complex was constructed and put into operation as part of the Company's local community investment strategy. Jointly financed by the Company and the local government, the new school and kindergarten complex is an all-modern facility which comprises a secondary school for 640 children, a kindergarten for 144 children and a dormitory for about 100 children.

- The Company is financing the establishment of "Tsetsii Town", a residential town in Tsogttsetsii soum, to cater to demand for modern housing from our employees and community members. During the year under review, 4 more blocks of 192 new apartments with a total floor space of 12,703.3 m^2 were commissioned. Three blocks of these fully furnished residential apartments are allocated to MMC employees in support of the Employee Relocation Policy approved in 2011, while the remaining block will be used as a guest house for temporary visitors. Overall, "Tsetsii Town" now provides modern comfortable housing to more than 300 households.

Given our expanding presence in Tsogttsetsii soum of Umnugobi aimag, MMC sees the new facilities as part of its growing commitment to make substantial contributions to the social well being of the local communities. While encouraging our employees to relocate and settle in Umnugobi aimag by providing them comfortable living conditions, the investment is expected to bring lasting value in the local community where existing social infrastructure is very limited.

Local procurement

The Company follows ethical business practices in its purchasing and supply management and gives priority to local procurement. In addition to providing potential domestic contractors fair and equal access to business opportunities, MMC supports local businesses through its local Small and Medium Enterprise Development Program, which in turn enables them to become reliable suppliers to the Company. During the reporting period, MMC purchased MNT5.7 billion worth of goods and services from local Umnugobi aimag businesses.

COMPANY AWARDS AND ACCOLADES

During the reporting period, MMC received numerous awards from various professional bodies as well as government agencies of Mongolia for its large scale development at the UHG and BN mines and its sizable contribution to the country's socio-economic development.

Entrepreneur 2012

The Company was selected as one of the Top 10 enterprises in Mongolia for the 4th consecutive year by the Mongolian National Chamber of Commerce and Industry. More than 200 national companies competed for the annual selection exercise, and the nominees were judged based on the level of their socio-economic contribution, environmental stewardship, local community investment and technological advancements.

Global CSR Award

MMC was named a finalist in the prestigious Global CSR Summit 2012 awards, which recognises excellence in CSR programs. Organised by Pinnacle Group International, the awards honor companies from around the world for outstanding, innovative and world-class programs that demonstrate a company's commitment to CSR. MMC was included on the list of finalists from a pool of more than 100 candidates representing a large number of multinational companies with strong backgrounds in CSR.

Mongolian Mining Journal Awards – Grand Prix

The Company received the prestigious Grand Prix Award for the second year in a row at the annual Mining Journal Awards. Organised by the Mongolian Mining Journal, the country's first independent professional publication, the Mining Journal Awards is a prestigious annual event which recognises companies and individuals that have made valuable contributions to the development of the country's mining sector. In addition to the Grand Prix Award, Mr. Odjargal Jambaljamts, the Chairman of the Board of MMC, won the "Man of the Year" award based on the results of online public voting.

Best High-Yield Bond of the Year award by IFR Asia

Best High-Yield Bond of the Year

MMC's USD600 million Senior Notes issued in March 2012, was awarded the Best High-Yield bond for 2012 by reputable international financial magazines that include IFR Global, IFR Asia and AsiaMoney. In addition to reaching out to onshore US investors by using the 144A documentation for the first time in Mongolia, the MMC bond set numerous benchmarks in the Asia-Pacific financial market. It was the biggest bond out of Mongolia, the first USD deal from the country's corporate sector, and stood out as one of the largest debut issues from Asia in its ratings bracket in the last 5 years.

Green Awards-2012 ceremony

Eco Awards 2012

The Company's water management activities for its mine operations received the Best Water Stewardship Award at the first Green Awards-2012 organised by the Mongolian Ministry of Environment and Green Development. The Green Awards-2012 recognises outstanding environmental leaders that exemplify innovation, leadership and action for the environment.

Best Development of the Year

The Company's social infrastructure facilities built at Tsogttsetsii soum of Umnugobi aimag, namely the apartment blocks and school and kindergarten complex, were named the Best Development of the Year by Morning Daily, one of the most reputable daily newspapers in Mongolia. The selection was based entirely on the results of online public voting and reflected the scale of the Company's ongoing commitment to contributing to sustainable development in the Gobi region.

Corporate Governance Report

The board of directors (the "**Directors**") of the Company is pleased to present this Corporate Governance Report in the annual report for the year ended 31 December 2012.

CORPORATE GOVERNANCE PRACTICES OF THE COMPANY

The Company is committed to achieving high standards of corporate governance to safeguard the interests of shareholders and to enhance corporate value and accountability. The Board believes that high corporate governance standards are essential in providing a framework for the development of Company.

The Company's corporate governance practices are based on the principles and code provisions as set out in the Corporate Governance Code (the "**CG Code**") contained in Appendix 14 to the Listing Rules.

In the opinion of the Directors, throughout the year under review, the Company has complied with all the code provisions as set out in the CG Code, save and except for code provision E.1.2 which states that the Chairman of the Board should attend the annual general meeting ("**AGM**") of the Company, details of which is set out under "Communication with Shareholders and Investor Relations" below.

The Company will continue to review and enhance its corporate governance practices to ensure that these continue to meet the requirements of the CG Code and the rising expectations of the shareholders and investors.

BOARD OF DIRECTORS

The Board Composition

The Board currently comprises nine members, consisting of two executive Directors, four non-executive Directors and three independent non-executive Directors:

EXECUTIVE DIRECTORS:
Mr. Odjargal Jambaljamts, *Chairman of the Board, Chairman of the Nomination Committee and member of the Remuneration Committee*
Dr. Battsengel Gotov, *Chief Executive Officer*

NON-EXECUTIVE DIRECTORS:
Dr. Oyungerel Janchiv
Mr. Batsaikhan Purev
Mr. Od Jambaljamts, *member of the Corporate Governance Committee*
Ms. Enkhtuvshin Gombo, *member of the Audit Committee*

INDEPENDENT NON-EXECUTIVE DIRECTORS:
Mr. Ochirbat Punsalmaa, *Chairman of the Remuneration Committee and member of the Audit Committee and the Nomination Committee*
Mr. Unenbat Jigjid, *Chairman of the Corporate Governance Committee and member of the Audit Committee, the Nomination Committee and the Remuneration Committee*
Mr. Chan Tze Ching, Ignatius, *Chairman of the Audit Committee and member of the Corporate Governance Committee*

Mr. Od Jambaljamts is the brother of Mr. Odjargal Jambaljamts, both being directors of MCS (Mongolia) Limited and MCS Mining Group Limited, and all being controlling shareholders of the Company. The relationship between the members of the Board and the biographical information of the Directors are set out in the section headed "Directors and Senior Management" on pages 5 to 13 of the annual report for the year ended 31 December 2012.

Chairman and Chief Executive Officer

The roles and duties of the Chairman and the Chief Executive Officer of the Company are carried out by different individuals and have been clearly defined in writing.

The Chairman of the Board is Mr. Odjargal Jambaljamts, and the Chief Executive Officer is Dr. Battsengel Gotov. With the support of the senior management, the Chairman is responsible for ensuring that the Directors receive adequate, complete and reliable information in a timely manner and appropriate briefing on issues arising at Board meetings. The Chief Executive Officer focuses on implementing objectives, policies and strategies approved and delegated by the Board and is in charge of the Company's day-to-day management and operations. The Chief Executive Officer is also responsible for developing strategic plans and formulating the organisational structure, control systems and internal procedures and processes for the Board's approval.

Independent Non-Executive Directors

During the year ended 31 December 2012, the Board at all times met the requirements of the Listing Rules relating to the appointment of at least three independent non-executive Directors representing one-third of the Board with one of whom possessing appropriate professional qualifications or accounting or related financial management expertise.

The Company has received written annual confirmation from each of the independent non-executive Directors in respect of his independence in accordance with the independence guidelines set out in Rule 3.13 of the Listing Rules. The Company is of the view that all independent non-executive Directors are independent.

Non-Executive Directors and Directors' Re-election

Code provision A.4.1 of the CG Code stipulates that non-executive directors shall be appointed for a specific term, subject to re-election, whereas code provision A.4.2 states that all directors appointed to fill a casual vacancy shall be subject to election by shareholders at the first general meeting after appointment and that every director, including those appointed for a specific term, shall be subject to retirement by rotation at least once every three years.

Each of the non-executive Directors and independent non-executive Directors (except Mr. Od Jambaljamts) is engaged on a letter of appointment with the Company for a term of 2 years commencing from 13 October 2010 (the "**Listing Date**"). The Board resolved to extend the appointment of each of the non-executive Directors and independent non-executive Directors (except Mr. Od Jambaljamts) for their respective positions and issued a new letter of appointment to each of them all effective from 12 October 2012 for a term of 2 years. Mr. Od Jambaljamts, a non-executive Director, is engaged on a letter of appointment with the Company for a term of 2 years commencing from 4 July 2012.

In accordance with the Articles of Association (the "**Articles**") of the Company, all Directors are subject to retirement by rotation at least once every three years and any new Director appointed to fill a causal vacancy or as an addition to the Board shall submit himself/herself for re-election by shareholders at the first general meeting or next AGM after appointment.

Responsibilities, Accountabilities and Contributions of the Board and Management

The Board is responsible for the overall management of the Company's business. The Board provides leadership and control of the Company and is collectively responsible for promoting the success of the Company by directing and supervising its affairs. All Directors should make decisions objectively in the interests of the Company in the attainment of the objective of creating value to shareholders.

The Board reserves for its decision all major matters of the Company, including the approval and monitoring of all policy matters, overall strategies and budgets, internal control and risk management systems, material transactions (in particular those that may involve a conflict of interest), financial information, appointment of directors and other significant financial and operational matters.

The day-to-day management, administration and operation of the Company are delegated to the Chief Executive Officer and the senior management. The delegated functions and work tasks are periodically reviewed. Approval has to be obtained from the Board prior to any significant transactions entered into by the abovementioned officers.

All Directors, including non-executive Directors and independent non-executive Directors, have brought a wide spectrum of valuable business experience, knowledge and professionalism to the Board for its efficient and effective functioning.

All Directors have full and timely access to all relevant information of the Company. Board procedures and all applicable laws and regulations are followed. Each Director is normally able to seek independent professional advice under appropriate circumstances at the Company's expense, upon making request to the Board.

Every Director carries out his/her duty in good faith and in compliance with the standards of applicable laws and regulations, and acts in the interests of the Company and its shareholders at all times.

The Directors shall disclose to the Company details of other offices held by them and the Board regularly reviews the contribution required from each director to perform his responsibilities to the Company.

Continuous Professional Development of Directors

The existing Directors are continually kept up-to-date with legal and regulatory developments, and business and market changes to facilitate the discharge of their responsibilities. The Directors received formal, comprehensive and tailored induction on the amendments of the CG Code and associated Listing Rules effective on 1 January 2012 and 1 April 2012 adopted by the Stock Exchange, so as to ensure that they are fully aware of their responsibilities and obligations under the Listing Rules and relevant regulatory requirements. Continued briefings and professional development for Directors will be arranged where necessary.

Newly appointed Director will receive comprehensive and tailored induction of his/her appointment to ensure appropriate understanding of the business and operations of the Company and full awareness of Director's responsibilities and obligations under the Listing Rules and relevant statutory requirements. Such induction shall be supplemented by visits to the Company's key plant sites and meetings with senior management of the Company.

Internally-facilitated briefings for Directors will be arranged and reading material on relevant topics will be issued to Directors where appropriate. All Directors are encouraged to attend relevant training courses at the Company's expenses.

During the year ended 31 December 2012, the Company organised a training session conducted by qualified professionals for the Directors on Corporate Governance Code and Associated Listing Rules and Price Sensitive Information, Emerging Trends in Board Effectiveness and Board Effectiveness Reviews, and Introduction to Enterprise Risk Management. Directors namely Mr. Odjargal Jambaljamts, Dr. Battsengel Gotov, Dr. Oyungerel Janchiv, Mr. Batsaikhan Purev, Mr. Od Jambaljamts, Ms. Enkhtuvshin Gombo, Mr. Ochirbat Punsalmaa and Mr. Unenbat Jigjid attended the training session. Mr. Chan Tze Ching, Ignatius, independent non-executive Director, also attended training sessions of the Corporate Governance Orientation Programme, and the Non-Executive Director Programmes on Corporate Governance and Listing, and Board Effectiveness on Factors for Long Term Strategy on the Financial Services Industry conducted by qualified professionals.

In addition, relevant reading materials including directors' manual, legal and regulatory update and seminar handouts have been provided to the Directors for their reference and studying.

BOARD COMMITTEES

The Board has established four committees, namely, the Audit Committee, Remuneration Committee, Nomination Committee and Corporate Governance Committee, for overseeing particular aspects of the Company's affairs. All Board committees of the Company are established with defined written terms of reference. The terms of reference of the Board committees are posted on the Company's website and the Stock Exchange's website and are available to shareholders upon request.

Audit Committee

The Audit Committee comprises four members, including one non-executive Director namely Ms. Enkhtuvshin Gombo, and three independent non-executive Directors namely Mr. Chan Tze Ching, Ignatius (chairman), Mr. Ochirbat Punsalmaa and Mr. Unenbat Jigjid (including one independent non-executive Director who possesses the appropriate professional qualifications or accounting or related financial management expertise). None of the members of the Audit Committee is a former partner of the Company's existing external auditor.

The principal duties of the Audit Committee include the following:

- To review the financial statements and reports and to consider any significant or unusual items raised by the staff responsible for the accounting and financial reporting function, the internal auditor or the external auditor before submission to the Board;

- To review the relationship with the external auditor by reference to the work performed by the auditor, their fees and terms of engagement, and to make recommendations to the Board on the appointment, re-appointment and removal of the external auditor;

- To review the adequacy and effectiveness of the Company's financial reporting system, internal control system and risk management system and associated procedures; and

- To review arrangements to enable employees of the Company to raise, in confidence, concerns about possible improprieties in financial reporting, internal control or other matters of the Company.

The Audit Committee provides supervision on the internal control system of the Group and reports and makes recommendations to the Board on any material issues.

During the year under review, the Audit Committee reviewed the interim and annual financial results and reports in respect of the year ended 31 December 2012 and significant issues on the financial reporting and compliance procedures, internal control and risk management systems, scope of work and appointment of external auditors and arrangements for employees to raise concerns about possible improprieties.

The Audit Committee held two meetings during the year ended 31 December 2012. Where appropriate, decisions were also taken by way of circulated resolutions. The attendance records of the Directors at the Audit Committee meetings are set out under "Attendance Records of Directors and Committee Members" on page 102 of this Corporate Governance Report.

The Audit Committee also met the external auditors twice without the presence of the executive Directors.

Nomination Committee

The Nomination Committee comprises three members, namely Mr. Odjargal Jambaljamts (chairman), executive Director, and Mr. Ochirbat Punsalmaa and Mr. Unenbat Jigjid, both independent non-executive Directors, with the majority being independent non-executive Directors.

The principal duties of the Nomination Committee include the following:

- To review the structure, size and composition of the Board and to make recommendations regarding any proposed changes;

- To develop and formulate relevant procedures for nomination and appointment of directors;

- To identify suitable candidates for appointment as Directors;

- To make recommendations to the Board on appointment or re-appointment of and the succession planning of Directors; and

- To assess the independence of independent non-executive Directors.

The Nomination Committee has adopted a set of nomination procedures for selection of candidates for directorships by making reference to the skills, experience, professional knowledge, personal integrity and time commitments of such individuals, as well as the Company's needs and other relevant statutory requirements and regulations. External recruitment agencies may be engaged to carry out the recruitment and selection process where necessary.

The Nomination Committee held three meetings during the year ended 31 December 2012 to review the structure, size and composition of the Board and the independence of the independent non-executive Directors, and to consider the qualifications of the retiring Directors standing for election at the AGM. The attendance records are set out under "Attendance Records of Directors and Committee Members" on page 102 of this Corporate Governance Report.

Remuneration Committee

The Remuneration Committee comprises three members, namely Mr. Ochirbat Punsalmaa (chairman) and Mr. Unenbat Jigjid, both independent non-executive Directors, and Mr. Odjargal Jambaljamts, executive Director, with the majority being independent non-executive Directors.

The primary objectives of the Remuneration Committee include determining the remuneration packages of individual executive Directors and senior management. The Remuneration Committee is also responsible for establishing transparent procedures for developing such remuneration policy and structure to ensure that no Director or any of his/her associates will participate in deciding his/her own remuneration. Remuneration will be determined by reference to the performance of the individual and the Company, as well as market practices and conditions.

The Remuneration Committee has reviewed the remuneration policy and structure of the Company, and approve the remuneration packages of the executive Directors and the senior management for the year under review.

The Remuneration Committee held three meetings during the year ended 31 December 2012 and the attendance records are set out under "Attendance Records of Directors and Committee Members" on page 102 of this Corporate Governance Report.

Corporate Governance Committee

The Corporate Governance Committee comprises three members, namely Mr. Unenbat Jigjid (chairman) and Mr. Chan Tze Ching, Ignatius, both independent non-executive Directors, and Mr. Od Jambaljamts, executive Director, with the majority being independent non-executive Directors.

The principal duties of the Corporate Governance Committee include the following:

- To develop and review the Company's policies and practices on corporate governance and make recommendations to the Board;

- To review and monitor the training and continuous professional development of Directors and senior management;

- To review and monitor the Company's policies and practices on compliance with legal and regulatory requirements;

- To develop, review and monitor the code of conduct and compliance manual (if any) applicable to employees and Directors; and

- To review the Company's compliance with the code and disclosure in the Corporate Governance Report.

The Corporate Governance Committee reviewed the Company's compliance with the CG Code, the corporate governance policies and practices and disclosure in the Corporate Governance Report.

The Corporate Governance Committee passed one resolution during the year ended 31 December 2012.

ATTENDANCE RECORD OF DIRECTORS AND COMMITTEE MEMBERS

During the year ended 31 December 2012, five Board meetings were held, of which four were regular Board meetings held at approximately quarterly intervals for reviewing and approving the financial and operating performance, and considering and approving the overall strategies and policies of the Company.

The attendance records of each Director at the meetings of the Board, Nomination Committee, Remuneration Committee, Audit Committee, Corporate Governance Committee and general meeting during the year ended 31 December 2012 are set out in Table 22.

Table 22. Attendance records

	Attendance/Number of Meetings					
Name of Director	Board	Nomination Committee	Remuneration Committee	Audit Committee	Corporate Governance Committee	Annual General Meeting
Odjargal Jambaljamts	4/5	3/3	3/3	N/A	N/A	0/1
Battsengel Gotov	5/5	N/A	N/A	N/A	N/A	0/1
Oyungerel Janchiv	4/5	N/A	N/A	N/A	N/A	1/1
Batsaikhan Purev	4/5	N/A	N/A	N/A	N/A	0/1
Od Jambaljamts (appointed on 4 July 2012)	2/2	N/A	N/A	N/A	0/0	N/A
Enkh-Amgalan Luvsantseren (resigned on 4 July 2012)	2/3	N/A	N/A	N/A	N/A	0/1
Philip Hubert ter Woort (resigned on 12 October 2012)	3/4	N/A	N/A	N/A	0/0	1/1
Gantumur Lingov (resigned on 12 October 2012)	4/4	N/A	N/A	N/A	N/A	0/1
Enkhtuvshin Gombo	3/5	N/A	N/A	2/2	N/A	1/1
Ochirbat Punsalmaa	4/5	3/3	3/3	2/2	N/A	1/1
Unenbat Jigjid	5/5	3/3	3/3	2/2	0/0	1/1
Chan Tze Ching, Ignatius	5/5	N/A	N/A	2/2	0/0	1/1

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "**Model Code**") as set out in Appendix 10 to the Listing Rules.

Specific enquiry has been made of all the Directors and all the Directors have confirmed that they have complied with the Model Code throughout the year ended 31 December 2012.

The Company has also established written guidelines on no less exacting terms than the Model Code (the "**Employees Written Guidelines**") for securities transactions by employees who are likely to be in possession of inside information of the Company.

No incident of non-compliance with the Employees Written Guidelines by the employees was noted by the Company.

DIRECTORS' RESPONSIBILITY IN RESPECT OF THE FINANCIAL STATEMENTS

The Directors acknowledge their responsibility for preparing the financial statements of the Company for the year ended 31 December 2012.

The Directors are not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern.

The statement of the independent auditor of the Company about their reporting responsibilities on the financial statements is set out in the Independent Auditor's Report on pages 125 to 126.

INTERNAL CONTROLS

During the year under review, the Board conducted a review of the effectiveness of the internal control system of the Company including the adequacy of resources, qualifications and experience of staff of the Company's accounting and financial reporting function, and their training programmes and budget.

AUDITOR'S REMUNERATION

The remuneration paid to the external auditor of the Company in respect of audit services and non-audit services for the year ended 31 December 2012 amounted to USD595,000 and USD464,000 respectively. Breakdown of the remuneration paid to the external auditor of the Company is set out in Table 23.

Table 23. Category of services

	Fees Paid/Payable
Audit Service	USD595,000
Non-audit Services	USD464,000
– Senior notes advisory service and Enterprise Resource Planning ("ERP") project implementation review	
Total	USD1,059,000

COMPANY SECRETARY

Ms. Ng Sin Yee, Clare of Tricor Services Limited, external service provider, has been engaged by the Company as its Company Secretary. Its primary contact persons at the Company are Dr. Battsengel Gotov, executive Director and Chief Executive Officer of the Company and Ms. Uurtsaikh Dorjgotov, Executive Vice President and Chief Legal Counsel of the Company.

COMMUNICATION WITH SHAREHOLDERS AND INVESTOR RELATIONS

The Company believes that effective communication with shareholders is essential for enhancing investor relations and investors' understanding of the Group's business performance and strategies. The Company also recognises the importance of transparency and the timely disclosure of corporate information to enable shareholders and investors to make the best investment decisions.

According to CG Code Provision E.1.2, the Chairman of the Board should attend the AGM. Due to the coincidence of the engagement to oversee Company's railway project development activities, Mr. Odjargal Jambaljamts, Chairman of the Board, appointed Mr. Chan Tze Ching, Ignatius, independent non-executive Director to attend and answer questions on his behalf at the 2012 AGM. Mr. Jambaljamts will use his best endeavours to attend all future shareholders' meetings of the Company.

All members of the Board including non-executive Directors, independent non-executive Directors, and the chairmen of all Board committees (or their delegates) will make themselves available at the AGMs to meet shareholders and answer their enquiries.

During the year under review, the Company has not made any changes to the Articles.

To promote effective communication, the Company maintains a website at www.mmc.mn, where up-to-date information and updates on the Company's business operations and developments, financial information, corporate governance practices and other information are available for public access. Investors may write directly to the Company at its principal place of business in Hong Kong or via email to investor@mmc.mn for any enquiries.

SHAREHOLDERS' RIGHTS

As one of the measures to safeguard shareholders' interests and rights, separate resolutions are proposed at shareholders' meetings on each substantially separate issue, including the election of individual directors, for shareholders' consideration and voting.

All resolutions put forward at shareholders' meetings will be voted on by poll pursuant to the Listing Rules, and the poll results will be posted on the websites of the Company and the Stock Exchange after each shareholders' meeting. Detailed procedures for conducting a poll will be explained during the proceedings of the meetings.

Convening an Extraordinary General Meeting by Shareholders of the Company

Pursuant to the Articles, extraordinary general meetings may be convened by the Board on requisition of shareholder(s). Any one or more members of the Company holding at the date of deposit of the requisition not less than one-tenth of the paid up capital of the Company carrying the right of voting at general meetings of the Company shall at all times have the right, by written requisition to the Board or the Secretary of the Company, to require an extraordinary general meeting to be called by the Board for the transaction of any business specified in such requisition; and such meeting shall be held within 2 months after the deposit of such requisition. If within 21 days of such deposit the Board does not to proceed to convene such meeting the requisitionist(s) himself (themselves) may do so in the same manner, and all reasonable expenses incurred by the requisitionist(s) shall be reimbursed to the requisitionist(s) by the Company.

Putting Forward Proposals at General Meetings

There are no provisions under the Company's Articles or the Companies Law of the Cayman Islands regarding procedures for shareholders of the Company to put forward proposals at general meetings other than a proposal of a person for election as Director. Shareholders of the Company may follow the procedures set out in the preceding paragraph to convene an extraordinary general meeting for any business specified in such written requisition.

Putting Forward Enquiries to the Board

For putting forward any enquiries to the Board, shareholders may send written enquiries to the Company.

Note: The Company will not normally deal with verbal or anonymous enquiries.

Contact Details

Shareholders may send their enquiries or requests as mentioned above to the following:

Address: Level 28, Three Pacific Place
1 Queen's Road East
Hong Kong

16th Floor, Central Tower
Sukhbaatar District
Ulaanbaatar 14200
Mongolia
(For the attention of the Board of Directors/Chief Investment Officer/Company Secretary)

Email: contact@mmc.mn

For the avoidance of doubt, shareholder(s) must deposit and send the original duly signed written requisition, notice or statement, or enquiry (as the case may be) to the above addresses, apart from the registered office of the Company, and provide their full name, contact details and identification in order to give effect thereto. Shareholders' information may be disclosed as required by law.

Directors' Report

The Directors submit herewith their annual report together with the audited consolidated financial statements of the Group for the year ended 31 December 2012.

PRINCIPAL PLACE OF BUSINESS

The Company is incorporated in the Cayman Islands with its registered office at Cricket Square, Hutchins Drive, PO Box 2681, Grand Cayman, KY1-1111, Cayman Islands, its headquarters and principal place of business in Mongolia at 16th Floor, Central Tower, Sukhbaatar District, Ulaanbaatar 14200, Mongolia, and its principal place of business in Hong Kong at Level 28, Three Pacific Place, 1 Queen's Road East, Hong Kong.

PRINCIPAL ACTIVITIES

The principal activities of the Company are mining, production, transportation and sale of coking coal products. The principal activities and other particulars of the subsidiaries and associates are set out in note 18 and note 19 to the consolidated financial statements.

The analysis of the principal activities and geographical locations of the operations of the Group during the financial year are set out in note 13 to the consolidated financial statements.

MAJOR CUSTOMERS AND SUPPLIERS

The information in respect of the Group's sales and purchases attributable to the major customers and suppliers respectively during the financial year is set out in Table 24.

Table 24. Sales and purchases attributable to the major customers and suppliers

	Percentage of the Group's total	
	Sales	**Purchases**
The largest customer	35.5%	
Five largest customers in aggregate	81.1%	
The largest supplier		18.0%
Five largest suppliers in aggregate		39.1%

Petrovis Resources Inc, a shareholder who holds more than 5% of the ordinary shares of the Company (the "Shares") and Dr. Oyungerel Janchiv, Director of the Company, hold interests in NIC LLC which is one of the five largest suppliers disclosed above. Each of MCS Mining Group Limited, the controlling shareholder of the Company and Mr. Odjargal Jambaljamts and Mr. Od Jambaljamts, Directors of the Company, has interests in MCS Property LLC which is one of the five largest suppliers disclosed above.

Save as disclosed above, to the best knowledge of the Directors, none of the Directors nor any of their associates nor any shareholder who holds more than 5% of the Shares has any interests in the customers or suppliers disclosed above.

FINANCIAL STATEMENTS

The results of the Group for the year ended 31 December 2012 and the state of the Group's affairs as at that date are set out in the consolidated financial statements on pages 127 to 204.

TRANSFER TO RESERVES

Loss attributable to shareholders, before dividend, of USD2,542,000 (2011: profit of USD119,090,000) have been transferred to reserves. Other movements in reserves are set out in the consolidated statement of changes in equity on page 131.

No dividend has been declared and paid by the Group during the year ended 31 December 2012 (2011: nil).

CHARITABLE DONATIONS

Charitable donations made by the Group during the year ended 31 December 2012 amounted to USD133,000 (2011: USD179,000).

PROPERTY, PLANT AND EQUIPMENT

During the year, the Group acquired property, plant and equipment for approximately USD67,305,000. Details of these acquisitions and other movements in the property, plant and equipment of the Group are set out in note 14 to the consolidated financial statements.

CONVERTIBLE NOTES

According to the Share Purchase Agreement, the Company issued the Convertible Bond to QGX Holdings Ltd. on 1 June 2011 for payment of some portion of the total consideration of USD464,465,000. On 27 November 2012, the Company and its subsidiary Mongolian Coal Corporation Limited entered into an amendment agreement with Kerry Mining (Mongolia) Limited and Quincunx (BVI) Ltd pursuant to which the parties thereto have agreed to extend the maturity date of the Convertible Bond until 1 March 2013. Later on 19 February 2013, the Company and QGX Holdings Limited also entered into an amendment agreement pursuant to which they agreed to extend the maturity date of the Convertible Bond until 22 April 2013 and change the interest rate to 4.0% as mentioned below.

The principal terms of the Convertible Bond are as follows:

Principal amount:	USD85,000,000
Maturity:	22 April 2013
Interest:	For the period until 28 February 2013 – 2.0% per annum payable semi-annually. If the Group's consolidated leverage ratio exceeds 5.5:1, the interest rate of the Convertible Bond will increase to 4.0% per annum. For the period from 1 March 2013 until and including the Maturity Date – 4.0% per annum.
Transferability:	A holder of the Convertible Bond may assign or transfer the Convertible Bond in its name without consent from the Company, to (a) any of its wholly-owned subsidiaries, (b) any other entity in respect of which the relative beneficial ownership of Kerry Mining (Mongolia) Limited and MCS Minerals LLC is substantially the same as their respective beneficial ownership of the holder of the Convertible Bond immediately prior to such assignment or transfer and (c) in the event the holder of the Convertible Bond becomes a wholly owned subsidiary of Kerry Mining (Mongolia) Limited, any of its Affiliates (as defined in the announcement of the Company dated 1 June 2011) or any member of the Kuok Group (as defined in the announcement of the Company dated 1 June 2011), provided that an assignment or transfer of the Convertible Bond shall be limited to assignments or transfers in wholly only, and not in part
Conversion right:	The Convertible Bond will only be convertible at maturity at the election of the holder of the Convertible Bond
Conversion price:	HKD10.92 per Conversion Share (as defined in the announcement of the Company dated 1 June 2011)
Redemption and purchase:	Unless converted, the Company will redeem all the Convertible Bond at the principal amount on maturity
Ranking of Conversion Shares:	Conversion Shares (as defined in the announcement of the Company dated 1 June 2011) will rank pari passu in all respect with the Shares in issue on the relevant date of registration of holders of such Shares on the register of members of the Company
Voting rights:	The holder of the Convertible Bond will not be entitled to vote at any general meeting of the Company by reason only of it being the holder of the Convertible Bond

Save as disclosed above, the Company has not issued any convertible notes for the period ended 31 December 2012.

SHARE CAPITAL

Details of the movements in share capital of the Company during the year are set out in note 31 to the consolidated financial statements.

BANK LOANS AND OTHER BORROWINGS

Particulars of bank loans and other borrowings of the Group as at 31 December 2012 are set out in note 24 to the consolidated financial statements. The borrowing amount totals USD330.9 million and all of it is in USD. All borrowings are at variable rate (with a fixed margin over LIBOR).

FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 205.

DIRECTORS

The Directors during the financial year and up to the date of this annual report are:

Executive Directors

Mr. Odjargal Jambaljamts (Chairman of the Board)
Dr. Battsengel Gotov (Chief Executive Officer)

Non-executive Directors

Dr. Oyungerel Janchiv
Mr. Batsaikhan Purev
Mr. Philip Hubert ter Woort (resigned on 12 October 2012)
Mr. Enkh-Amgalan Luvsantseren (resigned on 4 July 2012)
Mr. Gantumur Lingov (resigned on 12 October 2012)
Mr. Od Jambaljamts (appointed on 4 July 2012)
Ms. Enkhtuvshin Gombo

Independent non-executive Directors

Mr. Ochirbat Punsalmaa
Mr. Unenbat Jigjid
Mr. Chan Tze Ching, Ignatius

In accordance with Articles 83(3) and 84(1) of the Articles, Mr. Odjargal Jambaljamts and Dr. Battsengel Gotov, being executive Directors, and Mr. Od Jambaljamts and Ms. Enkhtuvshin Gombo, being non-executive Directors, will retire from directorship at the forthcoming AGM and, being eligible, offer themselves for re-election. Biographical details of the Directors are set out in the section headed "Directors and Senior Management" on pages 5 to 13.

The Company has received from each of the independent non-executive Directors an annual confirmation of independence pursuant to Rule 3.13 of the Listing Rules and considers all the independent non-executive Directors to be independent in accordance with the guidelines set out under the Listing Rules.

DIRECTORS' SERVICE CONTRACTS

Each of the executive Directors has entered into a service agreement with the Company for an initial fixed period of three years commencing from the Listing Date.

Each of the non-executive Directors and independent non-executive Directors (except Mr. Od Jambaljamts) is engaged on a letter of appointment with the Company for a term of 2 years commencing from 13 October 2010, the Listing Date. The Board resolved to extend the appointment of each of the non-executive Directors and independent non-executive Directors (except Mr. Od Jambaljamts) for their respective positions and issued a new letter of appointment to each of them all effective from 12 October 2012 for a term of 2 years. Mr. Od Jambaljamts, a non-executive Director, is engaged on a letter of appointment with the Company for a term of 2 years commencing from 4 July 2012.

None of the Directors proposed for re-election at the forthcoming AGM has entered into any service agreement with the Company which is not determinable by the Group within one year without payment of compensation (other than statutory compensation).

DIRECTORS' INTERESTS IN CONTRACTS

Saved as disclosed under the section headed "Connected transactions and continuing connected transactions" in this directors' report and "Material Related Party Transactions" in note 34 to the consolidated financial statements, no contract of significance, to which the Company or its subsidiary or its shareholder was a party and in which a Director had a material interest, subsisted at the end of the year or at any time during the year.

MANAGEMENT CONTRACTS

Other than the service contracts of the Directors, the Company has not entered into any contract with any individual, firm or body corporate to manage or administer the whole or any substantial part of any business of the Company during the year.

DIRECTORS' INTERESTS IN COMPETING BUSINESS

None of the Directors or their associates had any interest in a business that competes or may compete with the business of the Group.

NON-COMPETITION UNDERTAKING

Pursuant to a deed of non-competition dated 20 September 2010, and as amended on 3 April 2012 and 4 July 2012 (the "**Deed of Non-competition**") executed by Mr. Odjargal Jambaljamts, Mr. Od Jambaljamts, MCS Holding LLC, MCS Mining Group Limited and MCS Group Limited (in the case of MCS Holding LLC and MCS Group Limited, up to 15 February 2012 only, being the date on which MCS Holding LLC ceased to be a shareholder of MCS Group Limited and MCS Group Limited was liquidated) (collectively the "**Controlling Shareholders**") in favour of the Company (for itself and on behalf of the Group), the Controlling Shareholders undertake, among other things, that at any time which the shares of the Company are listed on the SEHK and for so long as the Controlling Shareholders and its associates together hold, whether individually or taken together, 30% or more of the issued share capital or are otherwise regarded as a controlling shareholder of the Company under the Listing Rules, the Controlling Shareholders will not, and will procure that its associates (excluding the Group) will not, directly or indirectly, either on its own account or with each other or in conjunction with or on behalf of any person, firm or company, except through a member of the Group, among other things, carry on, participate or be interested or engaged in, acquire or hold (in each case whether as a shareholder, partner, agent, employee or otherwise) any business (except for their aggregate 10% interest in Quincunx (BVI) Ltd) which is or may be in competition with the Restricted Mining Business (as defined in the prospectus of the Company dated 28 September 2010) of any member of the Group from time to time. In the event that a business opportunity in relation to the Restricted Mining Business (as defined in the prospectus of the Company dated 28 September 2010) is made available to the Controlling Shareholders and/or any of their associates, the Controlling Shareholders shall promptly notify the Company in writing and refer such business opportunity for the Company's consideration and the Controlling Shareholders shall not and procure his/their associates shall not, invest or participate in any project or business opportunity unless such project or business opportunity has been rejected by the Company and the principal terms on which the Controlling Shareholders or his/their associates invest or participate are no more favourable than those made available to the Company. Each of the Controlling Shareholders has reviewed (except for MCS Holding LLC and MCS Group Limited which was for the period from 1 January 2012 to 15 February 2012 only, being the date on which MCS Group Limited was liquidated) his/their respective business (excluding the business of the Group) and advised that during the year ended 31 December 2012, his/their respective business did not compete with the Group and there was no opportunity made available to the Controlling Shareholders to invest or participate in any such project or business opportunity that is governed by the Deed of Non-competition.

Each of the Controlling Shareholders has given a written confirmation to the Company that it has fully complied with the terms of the Deed of Non-competition. The independent non-executive Directors have also reviewed the confirmations by each of the Controlling Shareholders and concluded that each of the Controlling Shareholders has been in compliance with the Deed of Non-competition during the year ended 31 December 2012.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY OR ITS ASSOCIATED CORPORATIONS

As at 31 December 2012, the interest and short positions of the Directors and chief executive of the Company in the shares and underlying shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO (Cap. 571 of the Laws of Hong Kong) as recorded in the register required to be kept pursuant to section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code were as follows:

Table 25. Interests in Shares

	Ordinary shares of USD0.01 each		
Name of Director	**Nature of interest**	**Total number of Shares held**	**Approximate percentage of total issued share capital**
Mr. Odjargal Jambaljamts (Note 1)	Interest of controlled corporation	1,424,118,061 (L) 849,179,681 (S)	38.44% 22.92%
Mr. Od Jambaljamts (Note 2)	Interest of controlled corporation	1,345,763,949 (L) 836,679,681 (S)	36.32% 22.58%
Dr. Oyungerel Janchiv (Note 3)	Interest of controlled corporation	338,500,000 (L)	9.14%
Mr. Batsaikhan Purev (Note 4)	Interest of controlled corporation	119,923,500 (L)	3.24%

(L) – long position *(S) – short position*

Notes:

1. *Mr. Odjargal Jambaljamts through Novel Holdings Group Limited which is 100% owned by him, is interested in 49.84% of MCS (Mongolia) Limited. MCS (Mongolia) Limited holds the entire interest of MCS Mining Group Limited which in turn holds 1,239,459,042 shares in MMC. Novel Holdings Group Limited also directly holds 184,659,019 shares in MMC in its name.*

2. *Mr. Od Jambaljamts through Trimunkh Limited which is 100% owned by him, is interested in 28.69% of MCS (Mongolia) Limited which holds the entire interest of MCS Mining Group Limited which in turn holds 1,239,459,042 shares in MMC. Trimunkh Limited also directly holds 106,304,907 shares in MMC in its name.*

3. *The shares were registered in the name of Petrovis Resources Inc. Dr. Oyungerel Janchiv through Lotus Amsa Limited which is 100% owned by her, is interested in 33.39% of Petrovis Resources Inc.*

4. *The shares were registered in the name of Shunkhlai Mining. Mr. Batsaikhan Purev is interested in 50% of Shunkhlai Group LLC, which holds the entire interest of Shunkhlai Mining LLC, which in turn holds the entire interest of Shunkhlai Mining.*

Table 26. Interest in underlying Shares

		Ordinary shares of USD0.01 each	
Name of Director	Nature of interest	Total number of underlying Shares held pursuant to Share Options under the Share Option Scheme	Approximate percentage of total issued share capital
Dr. Battsengel Gotov	Beneficial owner	8,000,000 (L)	0.22%

Save as disclosed above, as at 31 December 2012, so far as was known to any Director or chief executive of the Company, neither the Directors nor the chief executive had any interests or short positions in any Shares, underlying Shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of SFO).

SHARE OPTION SCHEME

The Share Option Scheme was adopted by the Company on 17 September 2010, which became effective on the Listing Date (the "**Adoption Date**"). Share Options could be granted within a period of 10 years from the Adoption Date. Therefore, as at 31 December 2012, the remaining life of the Share Option Scheme was approximately 7 years and 9 months. The purpose of the Share Option Scheme is to provide an opportunity for employees of the Group to acquire an equity participation in the Company and to encourage them to work towards enhancing the value of the Company for the benefit of the Company and its shareholders as a whole.

Eligibility

The Directors may invite any person belonging to any of the following classes of participants to take up options to subscribe for Shares:

(a) any employee or proposed employee (whether full time or part-time and including any executive Director), consultants or advisers of or to the Company, any of its subsidiaries or any entity ("**Invested Entity**") in which the Group holds an equity interest;

(b) any non-executive directors (including independent non-executive directors) of the Company, any of its subsidiaries or any Invested Entity;

(c) any supplier of goods or services to any member of the Group or any Invested Entity;

(d) any customer of the Group or any Invested Entity;

(e) any person or entity that provides research, development or other technological support to the Group or any Invested Entity; and

(f) any shareholder of any member of the Group or any Invested Entity or any holder of any securities issued by any member of the Group or any Invested Entity.

The basis of eligibility of any of the classes of participants to the grant of any options shall be determined by the Directors from time to time on the basis of the participants' contribution to the development and growth of the Company.

Grant of options

Unless terminated by a resolution adopted at general meeting, the Directors shall be entitled at any time within a period of 10 years commencing on the Adoption Date to make an offer to such participant as the Directors may select to subscribe for such number of Shares at the subscription price as the Directors shall determine.

The option period of an option within which the Shares must be taken up may not end later than 10 years from the date of offer ("**Offer Date**"), while the Directors may fix any minimum period for which an option must be held, any performance targets that must be achieved and any other conditions that must be fulfilled before the option can be exercised upon the grant of an option to participant. HKD1.00 is payable on acceptance of the option within 28 days from the Offer Date.

Subscription price

The subscription price in respect of any option must be at least the highest of:

(a) the closing price of the Shares as stated in the SEHK's daily quotations sheet on the Offer Date;

(b) the average closing price of the Shares as stated in the SEHK's daily quotations sheet for the five business days immediately preceding the Offer Date; and

(c) the nominal value of the Shares.

Directors' Report

Exercise of options

An option shall be exercisable in whole or in part by giving notice in writing to the Company accompanied by a payment for the full amount of the subscription price for the shares. An option shall be personal to the grantee and shall not be transferable or assignable.

Maximum number of shares available for subscription

The total number of Shares which may be issued upon exercise of all options to be granted under the Share Option Scheme and any other share option schemes of the Group must not in aggregate exceed 10% of the total number of Shares in issue on the Listing Date which amounts to 359,712,250 Shares, representing 9.71% of the issued share capital of the Company as at the date of this annual report.

The maximum number of Shares to be issued upon exercise of all outstanding options granted and yet to be exercised under the Share Option Scheme and any other share option schemes of the Company must not in aggregate exceed 30% of the issued share capital from time to time. No option may be granted under any schemes of the Company (or the subsidiary of the Company) if such grant will result in the maximum number being exceeded. The total number of Shares issued and to be issued upon exercise of all options granted to each Participant in any 12-month period shall not exceed 1% of the Shares of the Company then in issue.

Details of the movements in Share Options of the Company during the year ended 31 December 2012 are as follows:

Table 27. Director

					Number of Share Options				
Name of Director	Date of grant	Exercise period	Exercise price per share	Balance as at 1 January 2012	Granted during the year ended 31 December 2012	Lapsed during the year ended 31 December 2012	Cancelled during the year ended 31 December 2012	Exercised during the year ended 31 December 2012	Balance as at 31 December 2012
Dr. Battsengel Gotov	12 October 2011	(Note 1)	HKD6.66	3,000,000	–	–	–	–	3,000,000
	28 November 2012	(Note 2)	HKD3.92	–	5,000,000	–	–	–	5,000,000

Table 28. Employees of the Group other than the Directors

			Number of Share Options					
Date of grant	Exercise period	Exercise price per share	Balance as at 1 January 2012	Granted during the year ended 31 December 2012	Lapsed during the year ended 31 December 2012	Cancelled during the year ended 31 December 2012	Exercised during the year ended 31 December 2012	Balance as at 31 December 2012
12 October 2011	(Note 1)	HKD6.66	31,900,000	–	1,000,000	–	–	30,900,000
28 November 2012	(Note 2)	HKD3.92	–	17,750,000	–	–	–	17,750,000

Notes:

1. *The Share Options are subject to vesting scale in four tranches of 25% each. The exercise periods are as follows:*

    (1) first 25% of the Share Options granted – 12 October 2012 to 12 October 2019
    (2) second 25% of the Share Options granted – 12 October 2013 to 12 October 2019
    (3) third 25% of the Share Options granted – 12 October 2014 to 12 October 2019
    (4) fourth 25% of the Share Options granted – 12 October 2015 to 12 October 2019

2. *The Share Options are subject to vesting scale in three tranches. The exercise periods are as follows:*

    (1) first 25% of the Share Options granted – 28 November 2013 to 28 November 2020
    (2) second 25% of the Share Options granted – 28 November 2014 to 28 November 2020
    (3) third 50% of the Share Options granted – 28 November 2015 to 28 November 2020

The closing price of the Shares immediately before the grant on 28 November 2012 was HKD3.92 per Share. Further details of the Share Option Scheme are set out in note 29 to the consolidated financial statements.

RIGHTS TO PURCHASE SHARES OR DEBENTURES OF DIRECTORS AND CHIEF EXECUTIVE

Save as disclosed under the section headed "**Share Option Scheme**" above, at no time during the year ended 31 December 2012 had the Company or any of its subsidiaries, holding companies or any fellow subsidiaries entered into any arrangement which enables the Directors or chief executive to have the right to acquire benefits by means of acquisition of shares or debentures in the Company or any associated corporations.

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31 December 2012, so far as was known to any Director or chief executive of the Company, shareholders (other than a Director or chief executive of the Company) who had an interest or short position in the shares or underlying shares of the Company as recorded in the register required to be kept pursuant to section 336 of the SFO were as follows:

Table 29. Interest in the Shares and underlying Shares

	Ordinary shares of USD0.01 each		
Name of substantial shareholder	**Nature of interest**	**Total number of Shares held**	**Approximate percentage of total issued share capital**
MCS Mining Group Limited (Note 1)	Beneficial owner	1,239,459,042 (L) 836,679,681 (S)	33.45% 22.58%
MCS (Mongolia) Limited (Note 1)	Interest of controlled corporation	1,239,459,042 (L) 836,679,681 (S)	33.45% 22.58%
Novel Holdings Group Limited (Note 1)	Interest of controlled corporation/ Beneficial owner	1,424,118,061 (L) 849,179,681 (S)	38.44% 22.92%
Trimunkh Limited (Note 1)	Interest of controlled corporation/ Beneficial owner	1,345,763,949 (L) 836,679,681 (S)	36.32% 22.58%
Ms. Batmunkh Dashdeleg (Note 1)	Interest of spouse	1,424,118,061 (L) 849,179,681 (S)	38.44% 22.92%
Ms. Munkhsuren Surenkhuu (Note 1)	Interest of spouse	1,345,763,949 (L) 836,679,681 (S)	36.32% 22.58%

		Ordinary shares of USD0.01 each	
Name of substantial shareholder	Nature of interest	Total number of Shares held	Approximate percentage of total issued share capital
Petrovis Resources Inc. (Note 2)	Beneficial owner	338,500,000 (L)	9.14%
Lotus Amsa Limited (Note 2)	Interest of controlled corporation	338,500,000 (L)	9.14%
Botgo Limited (Note 2)	Interest of controlled corporation	338,500,000 (L)	9.14%
Mr. Batbold Batochir (Note 2)	Interest of spouse	338,500,000 (L)	9.14%
Ms. Tuya Danzandarjaa (Note 2)	Interest of controlled corporation	338,500,000 (L)	9.14%
Kerry Mining (UHG) Limited (Note 3)	Beneficial owner	300,000,000 (L)	8.10%
Kerry Mining (Mongolia) Limited (Note 3)	Interest of controlled corporation	300,000,000 (L) 60,714,285 (L) (Note 4)	9.74%
Fexos Limited (Note 3)	Interest of controlled corporation	302,102,171 (L) 60,714,285 (L) (Note 4)	9.79%
Kerry Holdings Limited (Note 3)	Interest of controlled corporation	302,102,171 (L) 60,714,285 (L) (Note 4)	9.79%
Kerry Group Limited (Note 3)	Interest of controlled corporation	383,946,990 (L) (Note 5) 60,714,285 (L) (Note 4)	12.00%
Genesis Asset Managers, LLP	Investment manager	222,167,638 (L)	6.00%

(L) – Long position *(S) – Short position*

Notes:

(1) The entire issued share capital of MCS Mining Group Limited is wholly-owned by MCS (Mongolia) Limited. MCS (Mongolia) Limited is owned as to approximately 49.84% by Novel Holdings Group Limited which in turn is wholly-owned by Mr. Odjargal Jambaljamts and 28.69% by Trimunkh Limited which in turn is wholly-owned by Mr. Od Jambaljamts. MCS Mining Group Limited holds 1,234,459,042 shares in MMC. Novel Holdings Group Limited and Trimunkh Limited each also directly holds 184,659,019 shares and 106,304,907 shares, respectively, in MMC in their names. Ms. Batmunkh Dashdeleg is the spouse of Mr. Odjargal Jambaljamts and Ms. Munkhsuren Surenkhuu is the spouse of Mr. Od Jambaljamts.

(2) The entire issued share capital of Petrovis Resources Inc. is owned as to approximately 33.39% by Lotus Amsa Limited which in turn is wholly-owned by Dr. Oyungerel Janchiv and 33.31% by Botgo Limited which in turn is wholly-owned by Ms. Tuya Danzandarjaa. Mr. Batbold Batochir is the spouse of Dr. Oyungerel Janchiv.

*(3) Kerry Mining (UHG) Limited ("**KMUHG**") is a direct wholly-owned subsidiary of Kerry Mining (Mongolia) Limited ("**KMM**") which in turn is owned as to approximately 49.38% by Fexos Limited ("**Fexos**"). Fexos is a direct wholly-owned subsidiary of Kerry Holdings Limited ("**KHL**") which in turn is a direct wholly-owned subsidiary of Kerry Group Limited ("**KGL**"). The Shares in which KMUHG are shown to be interested are also included in the Shares in which KMM, Fexos, KHL and KGL are shown to be interested.*

(4) Each of KMM, Fexos, KHL and KGL was deemed to be interested in 60,714,285 underlying Shares held by a subsidiary of KMM. Such underlying Shares represent the number of Shares that may be issued upon exercise of the conversion rights attaching to the convertible bonds issued by the Company to KMM's subsidiary. Please refer to the announcement of the Company dated 1 June 2011 for further details.

(5) Out of KGL's corporate interest in 383,946,990 shares of the Company, 81,844,819 shares of the Company were held through its wholly-owned subsidiaries (other than KHL), 302,102,171 shares of the Company were held through companies in which KGL, through KHL, controls more than one-third of the voting power (other than those wholly-owned subsidiaries as aforementioned).

Save as disclosed above, as at 31 December 2012, the Company has not been notified by any person (other than the Directors or chief executive of the Company) who had interests or short position in the shares or underlying shares of the Company.

CONNECTED TRANSACTIONS AND CONTINUING CONNECTED TRANSACTIONS

For the year ended 31 December 2012, the non-exempted connected transactions of the Group were USD29,219,852 and the CCTs were USD133,983,518.

The details of non-exempt connected transactions and CCTs for the year ended 31 December 2012 are set out on pages 57 to 67 of this annual report.

PLEDGE OF ASSETS OF THE GROUP

As at 31 December 2012, the Company pledged Energy Resources LLC's current accounts held with Trade and Development Bank of Mongolia, Khan Bank of Mongolia, Golomt Bank of Mongolia, its Debt Reserve Account with Standard Bank Plc for loan repayment, coal sales contract with Inner Mongolia Qinghua Group of China, coal mining agreement with Leighton LLC; EPCM contract for the CHPP constructed at the UHG site with Sedgman LLC; CHPP modules 1 and 2; UHG Power Plant; water facilities for the EBRD, FMO and DEG Loan Agreements.

The Company pledged its Collection and Cash Collateral accounts with Standard Bank Plc, coal sales contracts with Inner Mongolia Fuji Energy Co., Ltd, Winsway Resources Holdings Private Limited and Shenhua Bayannaoer Energy Co., Ltd, coal stockpile of Energy Resources LLC for a Standard Bank Facility.

Share pledges of Mongolian Coal Corporation Limited and Mongolian Coal Corporation S.a.r.l. are shared among a Standard Bank Facility and the Senior Notes.

The total amount of indebtedness covered with the above pledges is USD923.8 million.

EMOLUMENT POLICY

The emolument policy of the Group is set to (1) recruit, retain and motivate qualified and experienced staff, including directors and senior management, (2) apply a responsible and sustainable remuneration practice, that is determined by reference to the performance of the individual, and the operational and financial results of the Group and is in line with the market practice and conditions, (3) ensure that no individual participates in deciding his/her own remuneration, and (4) ensure that the base salary levels and annual incentives are competitive in the market and comparable to the similar jobs in the peer companies.

The emolument of directors and senior management of the Group is determined by the remuneration committee of the board of directors and the emolument of staff is determined by the group management.

In addition to a base salary, the emolument of staff and directors and senior management is structured to include bonuses (such as a discretionary bonus), and benefits.

The Company has a Share Option Scheme to provide a long-term incentive and an opportunity for employees of the Group to acquire an equity participation in the Company. On 28 November 2012, the Company has granted a total of 22,750,000 Share Options subject to acceptance to its Chief Executive Officer and certain employees under the Share Option Scheme adopted by the Company and all the Share Options granted were accepted by the grantees.

The required competencies, skills and performance of the individual concerned and the specific role and responsibilities of the relevant position are considered in determining the emolument of an individual director or member of senior management.

RETIREMENT SCHEME

The Group participates in retirement benefit schemes pursuant to the relevant labour rules and regulations of Mongolia, the country of operation, whereby the Group is required to make contributions to the retirement schemes at a rate of 7% of the eligible employees' salaries.

The Group has no other retirement schemes beyond the retirement contributions described above. Particulars of the retirement scheme are set out in note 6 to the consolidated financial statements.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Articles or relevant laws of the Cayman Islands where the Company is incorporated which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

CHARGE OF SHARES BY CONTROLLING SHAREHOLDER

On 9 June 2011, MCS Mining Group Limited, the controlling shareholder of the Company, entered into a share charge over the Shares with Standard Bank Plc ("**SB Charged Shares**") and on 27 November 2012 entered into further share charge in respect of the SB Charged Shares, whereby MCS Mining Group Limited granted security over the SB Charged Shares in favour of Standard Bank Plc. On 18 November 2011, MCS Mining Group Limited entered into a share charge over the Shares with IFC ("**IFC Charged Shares**") and on 28 December 2011 entered into further share charge in respect of the IFC Charged Shares, whereby MCS Mining Group Limited granted security over the IFC Charged Shares in favour of IFC.

ISSUE OF EQUITY SECURITIES

No additional shares were issued during the year ended 31 December 2012.

PURCHASE, SALE OF REDEMPTION OF THE COMPANY'S LISTED SECURITIES

For the year ended 31 December 2012, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the listed securities of the Company.

RELATED PARTY TRANSACTIONS

Details of the related party transactions undertaken in the normal course of business are set out in note 34 to the consolidated financial statements. In respect of those related party transactions that constituted connected transactions under the Listing Rules, they have complied with applicable requirements in accordance with the Listing Rules.

SUFFICIENCY OF PUBLIC FLOAT

Rules 8.08(1)(a) and (b) of the Listing Rules require there to be an open market in the securities for which listing is sought and for a sufficient public float of an issuer's listed securities to be maintained. This normally means that (i) at least 25% of the issuer's total issued share capital must at all times be held by the public; and (ii) where an issuer has more than one class of securities apart from the class of securities for which listing is sought, the total securities of the issuer held by the public (on all regulated market(s) including the SEHK) at the time of listing must be at least 25% of the issuer's total issued share capital. However, the class of securities for which listing is sought must not be less than 15% of the issuer's total issued share capital, and must have an expected market capitalisation at the time of listing of not less than HKD50 million.

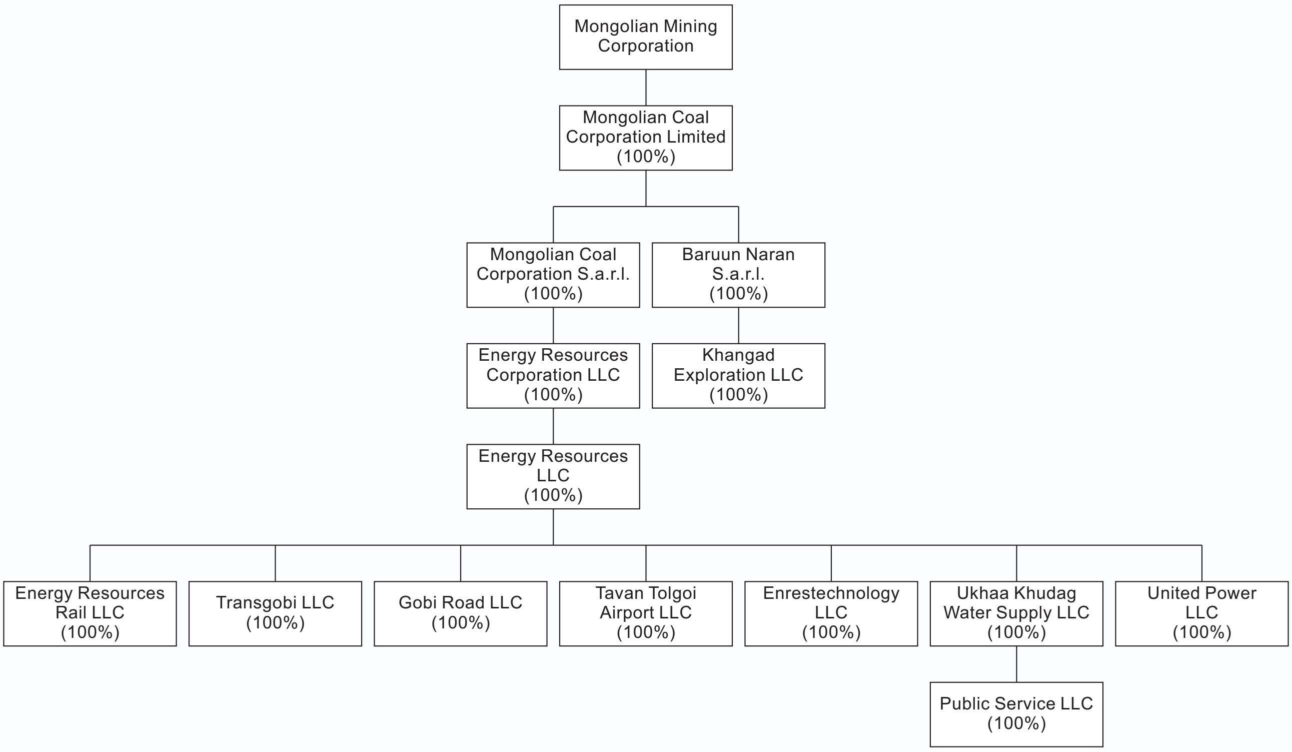
Based on the information that is publicly available to the Company and within the knowledge of the Directors as at the date of this annual report, the Directors confirm that the Company has maintained the amount of public float as required under the Listing Rules during the year ended 31 December 2012.

POST BALANCE SHEET EVENTS

The Company has resolved to undergo an internal restructuring of the Group in order to reduce extra accounting work and to centralise the core mining business of the Group in Energy Resources LLC, an indirect wholly-owned subsidiary of the Company (the "**Reorganisation**"). The Reorganisation involved merger, liquidation and asset transfer of some members of the Group into Energy Resources LLC from 1 January 2013. Energy Resources Mining LLC and Energy Resources Road LLC (the "**Dissolving Entities**"), indirect wholly-owned subsidiaries of the Company, were merged into Energy Resources LLC and all their rights, obligations, liabilities, business and assets were transferred to Energy Resources LLC. Members of the Group which hold special permits, such as land use rights, mining license, road construction license/agreement, power generation permit and water extraction permit will remain as a member of the Group.

Ukhaa Khudag Water Supply LLC, Enrestechnology LLC, United Power LLC and Gobi Road LLC, indirect wholly-owned subsidiaries of the Company, was wholly-owned subsidiaries of the Dissolving Entities and upon decision for the Reorganisation, they became wholly-owned subsidiaries of Energy Resources LLC.

Set out below is the Group structure subsequent to the Reorganisation:



Save as disclosed above, there have been no post balance sheet events subsequent to 31 December 2012 which require adjustment to or disclosure in the annual report.

AUDITOR

Messrs. KPMG was engaged as auditor of the Company for the year ended 31 December 2012. Messrs. KPMG has audited the accompanying financial statements which were prepared in accordance with International Financial Reporting Standards.

The Company has retained Messrs. KPMG since the date of listing. Messrs. KPMG was re-appointed as auditor of the Company at the AGM held on 24 May 2012.

Messrs. KPMG will retire and, being eligible, offer itself for re-appointment. A resolution for the re-appointment of Messrs. KPMG as auditor of the Company is to be proposed at the forthcoming AGM.

On behalf of the board

Odjargal Jambaljamts
Chairman

Hong Kong, 11 March 2013

Independent Auditor's Report

Independent auditor's report
to the shareholders 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 127 to 204, which comprise the consolidated and Company balance sheets as at 31 December 2012, and the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, 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 as issued by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance, 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 2012 and of the Group's loss and cash flows for the year then ended in accordance with the International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

KPMG
Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

11 March 2013

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2012

	Note	2012 USD'000	2011 USD'000
Revenue	4	**474,480**	542,568
Cost of revenue	5	**(420,400)**	(336,368)
Gross profit		**54,080**	206,200
Other revenue		**1,121**	435
Other net income		**5,418**	76
Administrative expenses		**(48,183)**	(60,303)
Profit from operations		**12,436**	146,408
Finance income	6(a)	**39,561**	22,236
Finance costs	6(a)	**(50,994)**	(13,785)
Net finance (costs)/income	6(a)	**(11,433)**	8,451
Share of losses of associates		**(362)**	(119)
Profit before taxation	6	**641**	154,740
Income tax	7	**(3,183)**	(35,650)
(Loss)/profit for the year		**(2,542)**	119,090
Other comprehensive income for the year	12		
Exchange differences on re-translation		**(20,929)**	(79,153)
Total comprehensive income for the year		**(23,471)**	39,937
(Loss)/profit attributable to the equity shareholders of the Company		**(2,542)**	119,090
Total comprehensive income attributable to the equity shareholders of the Company		**(23,471)**	39,937
Basic (loss)/earnings per share	8	**(0.07) cents**	3.21 cents
Diluted (loss)/earnings per share	8	**(0.07) cents**	3.07 cents

The notes on pages 134 to 204 form part of these financial statements.

Consolidated Balance Sheet

at 31 December 2012

	Note	2012 USD'000	2011 USD'000
Non-current assets			
Property, plant and equipment, net	14	**527,358**	347,109
Construction in progress	15	**242,838**	183,229
Lease prepayments	16	**103**	105
Intangible assets	17	**774,773**	681,352
Interest in associates	19	**3,808**	4,278
Other non-current assets	20	**26,727**	7,423
Deferred tax assets	26(b)	**19,144**	9,698
Total non-current assets		**1,594,751**	1,233,194
Current assets			
Inventories	21	**90,290**	57,734
Trade and other receivables	22	**207,914**	109,322
Cash at bank and in hand	23	**284,322**	227,765
Total current assets		**582,526**	394,821
Current liabilities			
Short-term borrowings and current portion of long-term borrowings	24(b)	**81,818**	333,568
Trade and other payables	25	**247,057**	118,680
Current taxation	26(a)	**3,950**	17,508
Convertible bond	27	**85,000**	83,508
Obligations under finance leases		**210**	247
Total current liabilities		**418,035**	553,511
Net current assets/(liabilities)		**164,491**	(158,690)
Total assets less current liabilities		**1,759,242**	1,074,504

The notes on pages 134 to 204 form part of these financial statements.

Consolidated Balance Sheet
at 31 December 2012

	Note	2012 USD'000	2011 USD'000
Non-current liabilities			
Interest-bearing borrowings, less current portion	24(a)	**249,113**	144,661
Senior notes	28	**592,891**	–
Provisions	30	**15,538**	11,110
Deferred tax liabilities	26(b)	**149,574**	149,656
Obligations under finance leases		**113**	213
Total non-current liabilities		**1,007,229**	305,640
NET ASSETS		**752,013**	768,864
CAPITAL AND RESERVES			
Share capital	31(c)	**37,050**	37,050
Reserves		**714,963**	731,814
TOTAL EQUITY		**752,013**	768,864

Approved and authorised for issue by the board of directors on 11 March 2013.

Odjargal Jambaljamts
Chairman

Battsengel Gotov
Chief Executive Officer

The notes on pages 134 to 204 form part of these financial statements.

Balance Sheet

at 31 December 2012

	Note	2012 USD'000	2011 USD'000
Non-current assets			
Interests in subsidiaries	18	**1,548,203**	1,007,581
Total non-current assets		**1,548,203**	1,007,581
Current assets			
Trade and other receivables	22	**12,420**	5
Cash at bank and in hand	23	**707**	7,776
Total current assets		**13,127**	7,781
Current liabilities			
Short term borrowings and current portion of long-term borrowings	24(b)	**60,000**	298,750
Trade and other payables	25	**119,938**	577
Convertible bond	27	**85,000**	83,508
Total current liabilities		**264,938**	382,835
Net current liabilities		**(251,811)**	(375,054)
Total assets less current liabilities		**1,296,392**	632,527
Non-current liabilities			
Senior notes	28	**592,891**	–
Long-term borrowings	24(a)	**125,768**	–
Total non-current liabilities		**718,659**	–
NET ASSETS		**577,733**	632,527
CAPITAL AND RESERVES	31(a)		
Share capital		**37,050**	37,050
Reserves		**540,683**	595,477
TOTAL EQUITY		**577,733**	632,527

Approved and authorised for issue by the board of directors on 11 March 2013.

Odjargal Jambaljamts
Chairman

Battsengel Gotov
Chief Executive Officer

The notes on pages 134 to 204 form part of these financial statements.

Consolidated Statement of Changes in Equity

for the year ended 31 December 2012

	Note	Share capital USD'000 (Note 31(c))	Share premium USD'000 (Note 31(d)(i))	Other reserve USD'000 (Note 31(d)(ii))	Exchange reserve USD'000 (Note 31(d)(iii))	Retained earnings USD'000	Total equity USD'000
At 1 January 2011		37,050	608,650	14,569	6,125	60,887	727,281
Changes in equity for 2011:							
Profit for the year		–	–	–	–	119,090	119,090
Other comprehensive income		–	–	–	(79,153)	–	(79,153)
		–	–	–	(79,153)	119,090	39,937
Equity-settled share-based transactions	29	–	–	1,646	–	–	1,646
At 31 December 2011		37,050	608,650	16,215	(73,028)	179,977	768,864
At 1 January 2012		**37,050**	**608,650**	**16,215**	**(73,028)**	**179,977**	**768,864**
Changes in equity for 2012:							
Loss for the year		**–**	**–**	**–**	**–**	**(2,542)**	**(2,542)**
Other comprehensive income		**–**	**–**	**–**	**(20,929)**	**–**	**(20,929)**
		–	**–**	**–**	**(20,929)**	**(2,542)**	**(23,471)**
Equity-settled share-based transactions	29	**–**	**–**	**6,620**	**–**	**–**	**6,620**
At 31 December 2012		**37,050**	**608,650**	**22,835**	**(93,957)**	**177,435**	**752,013**

The notes on pages 134 to 204 form part of these financial statements.

Consolidated Cash Flow Statement

for the year ended 31 December 2012

	Note	2012 USD'000	2011 USD'000
Cash flows from operating activities			
Profit before taxation		**641**	154,740
Adjustments for:			
Depreciation and amortisation	6(c)	**47,619**	19,370
Allowance for doubtful debts	6(c)	**5,929**	4,145
Share of losses of associates		**362**	119
Loss on disposal of an associate		**133**	–
Loss on disposal of property, plant and equipment	6(c)	**900**	438
Net finance costs/(income)	6(a)	**11,433**	(8,451)
Equity-settled share-based payment expenses	6(b)	**6,620**	1,646
Transaction costs in relation to acquisition		**–**	4,299
Changes in working capital:			
Increase in inventories		**(31,019)**	(55,879)
Increase in trade and other receivables		**(96,444)**	(88,441)
Increase in trade and other payables		**13,630**	14,997
Cash (used in)/generated from operations		**(40,196)**	46,983
Income tax paid	26(a)	**(21,527)**	(25,998)
Net cash (used in)/generated from operating activities		**(61,723)**	20,985
Investing activities			
Payments for acquisition of property, plant and equipment and construction in progress		**(284,432)**	(292,294)
Proceeds from disposal of property, plant and equipment		**–**	3,069
Payment for acquisition of subsidiaries, net		**–**	(103,494)
Payment for acquisition of associates		**–**	(4,820)
Time deposits		**(53,241)**	159,886
Interest received		**17,251**	22,236
Net cash used in investing activities		**(320,422)**	(215,417)

The notes on pages 134 to 204 form part of these financial statements.

	Note	2012 USD'000	2011 USD'000
Financing activities			
Proceeds from issue of senior notes		**589,679**	–
Proceeds from borrowings		**194,246**	143,864
Repayment of borrowings		**(344,818)**	(201,713)
Interest paid		**(50,398)**	(19,634)
Payment of transaction costs on issue of senior notes		**(2,999)**	–
Other borrowing costs paid		**–**	(2,388)
Net cash generated from/(used in) financing activities		**385,710**	(79,871)
Net increase/(decrease) in cash and cash equivalents		**3,565**	(274,303)
Cash and cash equivalents at beginning of the year		**41,006**	328,262
Effect of foreign exchange rate changes		**(249)**	(12,953)
Cash and cash equivalents at end of the year	23	**44,322**	41,006

The notes on pages 134 to 204 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, processing, 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.

The Group (as defined below) 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 (the "Acquisition"). Baruun Naran Limited 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. In order to change the Seller's structure which was not cost effective for the Group, Mongolian Coal Corporation Limited owned by the Company (in its capacity as sole shareholder) made a decision to wind up Baruun Naran Limited voluntarily on 21 June 2012. Accordingly, Baruun Naran Limited (Gibraltar registered company) has been liquidated and its all assets were transferred to Mongolian Coal Corporation Limited on 16 July 2012.

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 for the current accounting period of the Group and the Company.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Basis of preparation of the financial statements

The consolidated financial statements for the year ended 31 December 2012 comprise the Company and its subsidiaries (together referred to as the "Group") and its interest in associates.

The measurement basis used in the preparation of the financial statements is the historical cost basis except that derivative financial instruments are stated at their fair value (see Note 2(f)).

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) Changes in accounting policies

The IASB has issued several amendments to IFRSs that are first effective for the current accounting period of the Group and the Company. Of these, the amendments to IFRS 7, *Financial instruments: Disclosures – Transfers of financial assets*, is relevant to the Group's financial statements. The amendments to IFRS 7 require certain disclosures to be included in the financial statements in respect of all transferred financial assets that are not derecognised in their entirety and for any continuing involvement in transferred financial assets that are derecognised in their entirety, irrespective of when the related transfer transaction occurred. However, an entity needs not provide the disclosures for the comparative period in the first year of adoption. The Group did not have any significant transfers of financial assets in previous periods or the current period which require disclosure in the current accounting period under the amendments.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see Note 37).

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) 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 consolidated 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 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Subsidiaries and non-controlling interests (continued)

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(e)).

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).

(e) 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, adjusted for any excess of the Group's share of the acquisition-date fair values of investee's identifiable net assets over the cost of the investment (if any). Thereafter, the investment is adjusted 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)). Any acquisition-date excess over cost, 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 other 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Associates (continued)

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(e)).

(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, stripping costs incurred to develop coal mines are capitalised as part of the cost of the mining structures. 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.

All other expenditures, including the cost of repairs and maintenance and major overhaul, are expensed as they are incurred.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Property, plant and equipment (continued)

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:

	Depreciable life
– 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Leased assets (continued)

(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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(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(e)), 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(j) Impairment of assets (continued)

(i) Impairment of interests in subsidiaries, interest in associate and trade and other receivables (continued)

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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(j) Impairment of assets (continued)

(ii) Impairment of other assets (continued)

– 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)).

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(r) Income tax (continued)

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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(r) Income tax (continued)

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

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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(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 members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

(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.

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. In addition to those disclosed in Note 29 about equity-settled share-based payment transactions and in Note 33(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.

3 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

(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 cash flow 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.

3 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

(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 net profit in the future years.

(f) Derivative financial instruments

In determining the fair value of the derivative financial instruments, considerable judgement 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.

3 SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

(i) Taxations

The Group is subject to various taxes and levies in the jurisdictions where it has operations. The Group makes payments and determines the provision for tax and levy liabilities primarily based on the computations as prepared by the Group. Nevertheless, judgement is required in determining the provision for taxes and levies as there are many transactions and calculations for which the ultimate determination is uncertain during the ordinary course of business, there are possible cases of disagreements with the relevant authorities on treatment of certain items included in the computations and certain non-routine transactions. The Group uses its best judgement to determine the probability although it is typically very difficult to determine the timing and ultimate outcome of each case. If the Group considers it probable that these judgement will result in different positions, the most likely amounts of the outcome will be estimated and adjustments to the liabilities will be made in the period in which such determination is made. Due to the inherent uncertainties related to the eventual outcome of each case, it is probable that certain matters may be resolved for amounts materially different from any estimated provisions or previous disclosures.

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:

	2012 **USD’000**	2011 USD’000
Washed hard-coking coal (“**HCC**”)	**371,160**	235,220
Washed semi-soft coking coal (“**SSCC**”)	**17,234**	–
Washed thermal coal (“**middlings**”)	**57,341**	663
Raw coal (“**ROM coal**”)	**28,745**	306,685
	474,480	542,568

During the year ended 31 December 2012, the Group had three customers that individually exceeded 10% of the Group’s turnover, being USD168,300,000 USD115,601,000, and USD59,778,000, 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 32(b).

5 COST OF REVENUE

	2012 USD'000	2011 USD'000
Mining costs	**123,541**	120,326
Processing costs	**51,031**	21,738
Transportation costs	**130,871**	107,928
Others#	**114,957**	86,376
	420,400	336,368

Others include USD34,756,000 (2011: USD48,232,000) relating to the royalty tax on the coals sold.

6 PROFIT BEFORE TAXATION

Profit before taxation is arrived at after charging/(crediting):

(a) Net finance income:

	2012 USD'000	2011 USD'000
Interest income	**(20,345)**	(22,236)
Net change in fair value of derivative component of senior notes (Notes 22 and 28)	**(7,500)**	–
Foreign exchange gain, net	**(11,716)**	–
Finance income	**(39,561)**	(22,236)
Interest on bank and other borrowings	**20,300**	18,403
Net change in fair value of derivative component of convertible bond (Note 27)	**(2,429)**	(7,863)
Interest on liability component of convertible bond (Note 27)	**6,766**	3,371
Interest on liability component of senior notes (Note 28)	**41,417**	–
Transaction costs	**3,822**	6,495
Unwinding interest on		
– Obligations under finance lease	**94**	168
– Accrued reclamation obligations (Note 30)	**1,070**	567
Less: Interest expense capitalised	**(20,046)**	(9,229)
Net interest expense	**50,994**	11,912
Foreign exchange loss, net	**–**	1,873
Finance costs	**50,994**	13,785
Net finance costs/(income)	**11,433**	(8,451)

* *Borrowing costs have been capitalised at a rate of 8.5% and 5.2% per annum for the years ended 31 December 2012 and 2011, respectively.*

6 PROFIT BEFORE TAXATION (continued)

(b) Staff costs:

	2012 USD'000	2011 USD'000
Salaries, wages, bonuses and benefits	**34,718**	17,584
Retirement scheme contributions	**2,602**	2,201
Equity-settled share-based payment expenses (Note 29)	**6,620**	1,646
	43,940	21,431

Pursuant to the relevant labour 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% of the eligible employees' salaries. Contributions to the Schemes vest immediately.

The Group has no other material obligation for the payment of pension benefits beyond the annual contributions described above.

(c) Other items:

	2012 USD'000	2011 USD'000
Depreciation and amortisation	**47,619**	19,370
Provision for impairment losses on trade and other receivables (Note 22)	**5,929**	4,145
Operating lease charges:		
minimum lease payments		
– hire of plant and machinery	**6,046**	1,049
– hire of other assets (including property rentals)	**1,317**	1,107
	7,363	2,156
Net losses on disposal of property, plant and equipment	**900**	438
Auditors' remuneration		
– audit services	**595**	780
– tax and other services	**464**	154
	1,059	934
Cost of inventories # (Note)	**420,400**	336,368

\# *Cost of inventories includes USD76,208,000 (2011: USD29,961,000), relating to personnel expenses, depreciation and amortisation and operating lease charges which are also included in the respective amounts disclosed separately above for each of these types of expenses.*

Note: Cost of inventories includes USD19,478,000 (2011: USD1,002,000) relating to transportation and stockpile losses.

7 INCOME TAX

(a) Income tax in the consolidated statement of comprehensive income represents:

	2012 USD'000	2011 USD'000
Current tax		
Provision for the year		
– Mongolian Enterprise Income Tax (Note 26(a))	**12,870**	49,367
Deferred tax		
Origination and reversal of temporary difference (Note 26(b))	**(9,687)**	(13,717)
	3,183	35,650

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2012 USD'000	2011 USD'000
Profit before income tax	**641**	154,740
Notional tax on profit before taxation	**(5,170)**	35,725
Tax effect of non-deductible items (Note (iii))	**2,207**	1,508
Tax effect of non-taxable items (Note (iv))	**(1,035)**	(2,588)
Tax losses not recognised	**7,181**	1,005
Actual tax expenses	**3,183**	35,650

Note:

(i) *Pursuant to the prevailing income tax rules and regulations of Mongolia, the Group is liable to Mongolian Enterprise Income Tax at a rate of 10% of first MNT3 billion taxable income and 25% of the remaining taxable income for the years ended 31 December 2012 and 2011.*

(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 years ended 31 December 2012 and 2011.*

(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 years ended 31 December 2012 and 2011.*

(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 years ended 31 December 2012 and 2011.*

8 (LOSS)/EARNINGS PER SHARE

(a) Basic (loss)/earnings per share

For the year ended 31 December 2012, the calculation of basic loss per share is based on the loss attributable to equity shareholders of the Company of USD2,542,000 (2011: profit attributable to equity shareholder of the Company of USD119,090,000) and the weighted average of 3,705,036,500 ordinary shares (2011: 3,705,036,500 ordinary shares).

(b) Diluted (loss)/earnings per share

For the year ended 31 December 2012, basic and diluted loss per share are the same as the effect of the potential ordinary shares outstanding is anti-dilutive. For the year ended 31 December 2011, the diluted earnings per share was based on the profit attributable to equity shareholders of the Company of USD114,716,000 and the weighted average of 3,740,633,369 shares in issue during the year ended 31 December 2011.

The convertible bond and equity-settled share-based payment transactions (see Note 29) are anti-dilutive and therefore not included in calculating diluted loss per share for the year ended 31 December 2012. The equity-settled share-based payment transactions (see Note 29) is anti-dilutive and therefore not included in calculating diluted earnings per share for the year ended 31 December 2011.

9 DIRECTORS' REMUNERATION

Details of the directors' remuneration disclosed are as follows:

	Year ended 31 December 2012					
	Directors' fee USD'000	Salaries, allowances and benefits in kind USD'000	Discretionary bonuses USD'000	Retirement scheme contributions USD'000	Equity-settled share-based payment expenses USD'000	Total USD'000
Executive directors						
Odjargal Jambaljamts *(Chairman)*	–	146	114	18	–	278
Battsengel Gotov	–	98	110	14	623	845
Non-executive directors						
Gantumur Lingov (resigned on 12 October 2012)	14	–	–	–	–	14
Enkhtuvshin Gombo	18	–	–	–	–	18
Enkh-Amgalan Luvsantseren (resigned on 4 July 2012)	9	–	–	–	–	9
Oyungerel Janchiv	18	–	–	–	–	18
Philip Hubert ter Woort (resigned on 12 October 2012)	–	–	–	–	–	–
Batsaikhan Purev	18	–	–	–	–	18
Od Jambaljamts (appointed on 4 July 2012)	9	–	–	–	–	9
Independent non-executive directors						
Ochirbat Punsalmaa	24	–	–	–	–	24
Unenbat Jigjid	27	–	–	–	–	27
Chan Tze Ching, Ignatius	58	–	–	–	–	58
Total	195	244	224	32	623	1,317

9 DIRECTORS' REMUNERATION (continued)

	Year ended 31 December 2011					
	Directors' fee USD'000	Salaries, allowances and benefits in kind USD'000	Discretionary bonuses USD'000	Retirement scheme contributions USD'000	Equity-settled share-based payment expenses USD'000	Total USD'000
Executive directors						
Odjargal Jambaljamts *(Chairman)*	–	144	114	19	–	277
Battsengel Gotov	–	97	110	15	141	363
Badamtsetseg Dash-Ulzii	–	40	44	6	–	90
Non-executive directors						
Gantumur Lingov	18	–	–	1	–	19
Enkhtuvshin Gombo	18	–	–	1	–	19
Enkh-Amgalan Luvsantseren	18	–	–	1	–	19
Oyungerel Janchiv	18	–	–	1	–	19
Philip Hubert ter Woort	–	–	–	–	–	–
Batsaikhan Purev	18	–	–	1	–	19
Independent non-executive directors						
Ochirbat Punsalmaa	24	–	–	1	–	25
Unenbat Jigjid	26	–	–	1	–	27
Chan Tze Ching, Ignatius	58	–	–	–	–	58
Total	198	281	268	47	141	935

No emoluments have been paid to the directors as an inducement to join or upon joining the Group or as compensation for loss of office during the year ended 31 December 2012.

Philip Hubert ter Woort waived all his emoluments from 1 January 2012 to 12 October 2012 (date of resignation) and for the year ended 31 December 2011.

10 INDIVIDUALS WITH HIGHEST EMOLUMENTS

The number of directors and non-directors included in the five highest paid individuals is set forth below:

	2012	2011
Directors	**1**	1
Non-directors	**4**	4
	5	5

The emoluments of the directors are disclosed in Note 9. The aggregate of the emoluments in respect of the remaining highest paid individuals are as follows:

	2012 **USD'000**	2011 USD'000
Basic salaries, allowances and benefits in kind	**428**	551
Discretionary bonuses	**455**	455
Retirement scheme contributions	**59**	41
Equity-settled share-based payment expenses (Note)	**1,673**	311
	2,615	1,358

The emoluments of the remaining individuals with the highest emoluments are within the following band:

	2012	2011
HKD2,000,001 to HKD2,500,000	**–**	3
HKD3,500,001 to HKD4,000,000	**–**	1
HKD4,000,001 to HKD4,500,000	**1**	–
HKD5,000,001 to HKD5,500,000	**2**	–
HKD5,500,001 to HKD6,000,000	**1**	–

No emoluments have been paid to these individuals as an inducement to join or upon joining the Group or as compensation for loss of office during the year ended 31 December 2012.

Note:

These represent the estimated value of share options granted to the key management under the Group's share option scheme. The value of these share options is measured according to the Group's accounting policies for share-based payment transactions as set out in Note 1(q)(ii) and, in accordance with that policy, included adjustments to reverse amounts accrued in previous years where grants of equity instruments are for forfeited to vesting.

The details of these benefits in kind, including the principal terms and number of options granted, are disclosed under the paragraph "Share option scheme" in the directors' report and Note 29.

11 LOSS ATTRIBUTABLE TO EQUITY SHAREHOLDERS OF THE COMPANY

The consolidated loss attributable to the equity shareholders of the Company includes loss of USD61,414,000 (2011: USD9,563,000) which has been dealt with in the financial statements of the Company.

12 OTHER COMPREHENSIVE INCOME

The components of other comprehensive income do not have any significant tax effect for the years ended 31 December 2012 and 2011.

13 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.

14 PROPERTY, PLANT AND EQUIPMENT, NET

The Group

	Buildings and plants USD'000	Machinery and equipment USD'000	Motor vehicles USD'000	Office equipment USD'000	Mining structures and mining rights USD'000	Total USD'000
Cost:						
At 1 January 2011	21,131	2,931	12,594	3,401	42,124	82,181
Additions in relation to the Acquisition	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 (Note 15)	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
At 1 January 2012	117,012	109,208	50,539	5,223	84,818	366,800
Additions	1,811	1,668	10,567	2,988	50,271	67,305
Transfer from construction in progress (Note 15)	89,045	35,188	–	–	28,471	152,704
Disposals	(116)	(463)	(761)	(346)	–	(1,686)
Exchange adjustments	(1,794)	(531)	(78)	(47)	(1,614)	(4,064)
At 31 December 2012	**205,958**	**145,070**	**60,267**	**7,818**	**161,946**	**581,059**
Accumulated amortisation and depreciation:						
At 1 January 2011	798	311	3,499	565	362	5,535
Additions in relation to the Acquisition	22	7	247	35	–	311
Charge for the year	2,618	6,432	6,189	1,227	646	17,112
Written back on disposals	(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
At 1 January 2012	2,894	6,080	8,444	1,362	911	19,691
Charge for the year	8,348	13,538	11,525	1,363	791	35,565
Written back on disposals	(15)	(131)	(376)	(264)	–	(786)
Exchange adjustments	(187)	(301)	(240)	(22)	(19)	(769)
At 31 December 2012	**11,040**	**19,186**	**19,353**	**2,439**	**1,683**	**53,701**
Carrying amount:						
At 31 December 2012	**194,918**	**125,884**	**41,063**	**5,379**	**160,114**	**527,358**
At 31 December 2011	114,118	103,128	42,095	3,861	83,907	347,109

14 PROPERTY, PLANT AND EQUIPMENT, NET (continued)

(a) All the Group's property, plant and equipment are located in Mongolia.

(b) Mining structures and mining rights at 31 December 2012 include deferred stripping costs of USD106,319,000 (2011: USD60,437,000) and application fee for the mining rights of USD743,000 (2011: USD707,000) in relation to the Group's mine at the UHG deposit.

(c) The addition of mining structures and mining rights for the year ended 31 December 2012 include reclamation cost of USD3,430,000 (2011: USD4,834,000) (see Note 30).

(d) As at 31 December 2012, no short-term interest-bearing borrowing was 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 24).

(e) As at 31 December 2012, certain of the Group's borrowings were secured by the Group's coal handling and preparation plant-modules I and II, power plant and water supply infrastructure assets-phase I with a net book value of USD172,320,000, USD46,351,000 and USD5,034,000, respectively (31 December 2011: USD99,483,000, USD54,627,000 and nil, respectively) (see Note 24).

15 CONSTRUCTION IN PROGRESS

	The Group	
	2012	2011
	USD'000	USD'000
At 1 January	**183,229**	232,784
Additions in relation to the Acquisition	**–**	18,582
Additions	**214,528**	267,520
Transfer to property, plant and equipment (Note 14)	**(152,704)**	(219,605)
Transfer to intangible asset (Note 17)	**–**	(95,817)
Exchange adjustments	**(2,215)**	(20,235)
At 31 December	**242,838**	183,229

The construction in progress is mainly related to coal handling and preparation plant, railway and mining related machinery and equipment.

As at 31 December 2012, the carrying amount of railway included in construction in progress amounted to USD60,000,000 (2011: USD14,379,000).

15 CONSTRUCTION IN PROGRESS (continued)

On 31 May 2012, the Group entered into a Build-Operate-Transfer Concession Agreement (the "Agreement") with the Government of Mongolia to build and operate the railway base infrastructure between Ukhaa Khudag coking coal mine and Gashuun Sukhait border check point of Mongolia (the "UHG-GS Railway"). Under the terms of the Agreement, the Group has been granted a right to construct and then operate the UHG-GS Railway for a period up to 19 years from the date of the commissioning of the railway base infrastructure.

On 3 November 2012, the Government of Mongolia discussed at its cabinet meeting the measures to accelerate the implementation of railway network development. The Government resolved to consolidate various railway projects into a unified railway project (the "Project") to be managed and implemented under government authority and financing with the participation of domestic and foreign investors through jointly established project companies. It also resolved to instruct the Minister of the Road and Transportation to take measure to terminate the Agreement with the Group, to negotiate and agree with the Group regarding the implementation structure of the Project, amount of the investment and its term and, to negotiate regarding the granting of shares by considering the investment costs incurred for the UHG-GS Railway by the Group as an investment to the project company or as the reimbursement.

As at the date of the approval of these financial statements, the negotiation between the Government of Mongolia and the Group regarding the arrangement for the implementation of the above resolutions is still on going and therefore the Agreement has not been terminated yet. Pursuant to the Agreement, if the Agreement is early terminated by the government initiatives, in the event of default of the Government of Mongolia or expropriation by the Government, the Government of Mongolia shall reimburse the Group by the sum of value of the railway base infrastructure, costs incurred and damages caused. In this connection, the Group has estimated the reimbursable amount according to the Agreement and according to management judgment that the carrying amount of UHG-GS Railway as at 31 December 2012 amounting to USD60,000,000 is recoverable if the Agreement is terminated, no impairment loss has been provided in relation to the railway project.

16 LEASE PREPAYMENTS

	The Group	
	2012	2011
	USD'000	USD'000
Cost:		
At 1 January	**112**	124
Exchange adjustments	**–**	(12)
At 31 December	**112**	112
Accumulated amortisation:		
At 1 January	**7**	6
Charge for the year	**2**	2
Exchange adjustments	**–**	(1)
At 31 December	**9**	7
Net book value:	**103**	105

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.

17 INTANGIBLE ASSETS

The Group

	Acquired mining right (Note (i)) USD'000	Operating right paved road (Note (ii)) USD'000	Total USD'000
Cost:			
At 1 January 2011	–	–	–
Addition in relation to the Acquisition	596,557	–	596,557
Transfer from construction in progress (Note 15)	–	95,817	95,817
Exchange adjustments	–	(8,978)	(8,978)
At 31 December 2011	596,557	86,839	683,396
At 1 January 2012	596,557	86,839	683,396
Addition (Note (iii))	105,000	–	105,000
Exchange adjustments	–	266	266
At 31 December 2012	**701,557**	**87,105**	**788,662**
Accumulated amortisation:			
At 1 January 2011	–	–	–
Charge for the year	–	2,256	2,256
Exchange adjustments	–	(212)	(212)
At 31 December 2011	–	2,044	2,044
At 1 January 2012	–	2,044	2,044
Charge for the year	3,110	8,942	12,052
Exchange adjustments	–	(207)	(207)
At 31 December 2012	**3,110**	**10,779**	**13,889**
Carrying amount:			
At 31 December 2012	**698,447**	**76,326**	**774,773**
At 31 December 2011	596,557	84,795	681,352

17 INTANGIBLE ASSETS (continued)

Note:

(i) *Acquired mining right represents the mining right acquired during the acquisition of BN mine. The amortisation of acquired mining right and operating right of paved road charge for the year is included in "cost of revenue" and "other net income" in the consolidated statement of comprehensive income, respectively. As BN mine has not commenced the commercial production until February 2012, accordingly there was no amortisation related to the acquired mining right during the year ended 31 December 2011.*

(ii) *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.*

(iii) *Pursuant to the Share Purchase Agreement of the Acquisition (the "Agreement"), entered into on 31 May 2011, the Group agreed with Quincunx (BVI) Ltd. and its parent, Kerry Mining (Mongolia) Limited (collectively the "Seller") that, approximately 18 months to 21 months from the date of the Agreement, an additional payment would be payable to the Seller or a clawback might be payable by the Seller in the amount of USD3.00 per tonne to the extent that total proved and probable reserves (as defined under the Australian Code for Reporting of Mineral Resources and Ore Reserves) contained in the BN Mine (the "Total Reserves") exceeded 150,000,000 tonnes or were less than 150,000,000 tonnes, respectively (the "Reserve Adjustment"). Under the Reserve Adjustment, the maximum amount payable to the Seller would be US$105,000,000 consistent with the Seller's own estimation of Total Reserves being approximately 185,000,000 tonnes based on a report by SRK Consulting (Australasia) Pty Ltd in March 2011.*

The Group has, according to the relevant clauses in the Agreement, conducted the additional geological and technical work to verify the estimations of the Total Reserves. In November 2012, independent technical review work confirmed the final Total Reserves as defined in the Share Purchase Agreement and pursuant to the Agreement the Group shall pay to the Seller an aggregate amount of USD105,000,000 (the "Reserves Adjustment Payment").

The Reserve Adjustment Payment is highly linked to the results of the independent quantifications of the physical coal reserves by both the Seller and the Group. Given the nature of coal reserves, whose existence is unaffected by the passage of recent time, management views the Reserve Adjustment Payment as consideration for the purchase of additional coal reserves and therefore considers that the payment should be recognised in the consolidated balance sheet on a basis consistent with the right to mine the 150,000,000 tonnes covered by the initial consideration under the Agreement. The amount of USD105,000,000 is therefore recognised as an addition to the acquired mining right.

18 INTERESTS IN SUBSIDIARIES

	The Company	
	2012 **USD'000**	2011 USD'000
Unlisted shares, at cost	**–**	–
Amount due from subsidiaries	**1,548,203**	1,007,581
	1,548,203	1,007,581

Particular of subsidiaries at 31 December 2012 are as follows:

Name of company	Place of incorporation	Issued and fully paid up capital	Equity attributable to the Company Direct	Equity attributable to the Company Indirect	Principal activities
Mongolian Coal Corporation Limited	Hong Kong	HKD1	100%	–	Investment holding
Mongolian Coal Corporation S.a.r.l	Luxembourg	USD67,126,690	–	100%	Investment holding
Energy Resources Corporation LLC	Mongolia	USD103,800,000	–	100%	Investment holding
Energy Resources LLC	Mongolia	USD150,000,370	–	100%	Mining and trading of coals
Energy Resources Rail LLC	Mongolia	MNT15,300,000,000	–	100%	Railway project management
Energy Resources Mining LLC	Mongolia	USD72,001,000	–	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
Enrestechnology LLC	Mongolia	MNT118,000,000,000	–	100%	Coal plant management
Ukhaa Khudag Water Supply LLC	Mongolia	MNT31,500,000,000	–	100%	Water exploration and supply management
United Power LLC	Mongolia	MNT26,000,000,000	–	100%	Power supply project management
Gobi Road LLC	Mongolia	MNT32,300,000,000	–	100%	Construction of road
Energy Resources 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 S.a.r.l	Luxembourg	EUR24,918,394	–	100%	Investment holding

19 INTEREST IN ASSOCIATES

	The Group	
	2012	2011
	USD'000	USD'000
Share of net assets	**3,808**	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 MNT209,075,133. The principal activities of Coal Road are the provision of road maintenance service and traffic management. The shares on Coal Road was disposed of in March 2012 after the commission of paved road in October 2011.

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 MNT22,522,500,000. 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 MNT913,500,000. The principal activity of International Technical College is technical education for ensuring the long- term availability of skilled technical workforce.

20 OTHER NON-CURRENT ASSETS

	The Group	
	2012	2011
	USD'000	USD'000
Prepayments in connection with construction work, equipment purchases and others	**23,442**	7,423
Others	**3,285**	–
	26,727	7,423

21 INVENTORIES

(a) Inventories in the consolidated balance sheet comprise:

	The Group	
	2012	2011
	USD'000	USD'000
Coal	**72,150**	49,912
Materials and supplies	**18,140**	7,822
	90,290	57,734

As at 31 December 2012, certain of the Group's borrowings were secured by the Group's coal inventory of USD58,922,000 (31 December 2011: nil) (see Note 24).

22 TRADE AND OTHER RECEIVABLES

	The Group		The Company	
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD'000**	USD'000
Trade receivables (Note (a))	**35,819**	41,445	**–**	–
Other receivables (Note (c))	**178,024**	72,022	**12,420**	5
	213,843	113,467	**12,420**	5
Less: allowance for doubtful debts (Note (b))	**(5,929)**	(4,145)	**–**	–
	207,914	109,322	**12,420**	5

(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 2012 and 2011, all of the trade receivables are aged within one year.

22 TRADE AND OTHER RECEIVABLES (continued)

(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)).

The movement in the allowance for doubtful debts during the year is as follows:

	The Group	
	2012	2011
	USD'000	USD'000
At 1 January	**4,145**	–
Provision for impairment losses	**5,929**	4,145
Amounts written off	**(4,145)**	–
At 31 December	**5,929**	4,145

As at 31 December 2012, an allowance for doubtful debts amounting to USD5,929,000 (2011: USD4,145,000) 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 statement of comprehensive income.

(c) Other receivables

	The Group		The Company	
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD'000**	USD'000
Amounts due from related parties (Note (i))	**94**	455	**–**	–
Prepayments and deposits (Note (ii))	**64,598**	17,695	**–**	–
VAT and other tax receivables (Note (iii))	**83,071**	43,697	**–**	–
Derivative financial instruments (Note (iv))	**12,420**	–	**12,420**	–
Others (Note (v))	**17,841**	10,175	**–**	5
	178,024	72,022	**12,420**	5

22 TRADE AND OTHER RECEIVABLES (continued)

(c) Other receivables (continued)

Note:

(i) *Amount due from related parties are unsecured, interest-free and have no fixed repayment terms.*

(ii) *At 31 December 2012 and 2011, prepayments and deposits mainly represent the prepayments made to the Group's mining contractor and fuel supplier.*

(iii) *VAT and other tax 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 32(b).*

(iv) *It represented the embedded derivative in the senior notes (see Note 28).*

(v) *At 31 December 2012, this item mainly represents the reimbursement receivables due from Erdenes MGL LLC of USD3.5 million (2011: USD4.5 million) and Government of Mongolia of USD4.5 million (2011: USD4.5 million) for the construction costs in relation to the expansion project of the border crossing in Mongolian side at Gashuun Sukhait, which are interest-free. Based on current available information the Group anticipates full recoverability of such amounts. The remaining other receivables mainly represent the interest income receivable of USD3.1 million for the bank deposits.*

All other receivables were aged within one year and expected to be recovered or expensed off within one year.

23 CASH AT BANK AND IN HAND

	The Group		The Company	
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD'000**	USD'000
Cash in hand	**92**	77	**–**	–
Cash at bank	**284,230**	227,688	**707**	7,776
Cash at bank and in hand	**284,322**	227,765	**707**	7,776
Less: time deposits with original maturity over three months	**(240,000)**	(186,759)	**–**	(7,000)
Cash and cash equivalents in the consolidated cash flow statement	**44,322**	41,006	**707**	776

As at 31 December 2012, certain of the Group's borrowings were secured by the Group's cash at bank of USD9,690,000 (31 December 2011: USD213,884,000) (see Note 24).

24 BORROWINGS

(a) The Group's long-term interest-bearing borrowings comprise:

	The Group		The Company	
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD'000**	USD'000
Bank loan (secured)	**337,273**	169,091	**190,000**	300,000
Less: Current portion	**(81,818)**	(21,818)	**(60,000)**	(298,750)
Less: Unamortised transaction costs	**(6,342)**	(2,612)	**(4,232)**	(1,250)
	249,113	144,661	**125,768**	–

As at 31 December 2012, the Group's long-term interest-bearing borrowings from European Bank for Reconstruction and Development, Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V., and Deutsche Investitions-und Entwicklungsgesellschaft mbH of USD103,636,000 (31 December 2011: USD114,546,000), USD26,182,000 (31 December 2011: USD32,727,000) and USD17,455,000 (31 December 2011: USD21,818,000), respectively, bearing interest of 6 months LIBOR + 3.25%~3.75%, were secured by the Group's property, plant and equipment (see Note 14) and cash at bank (see Note 23).

On 8 March 2012, the Group obtained a bank facility from Standard Bank of South Africa Ltd up to USD300,000,000, and on 23 March 2012, the Group cancelled part of the facility amounting to USD100,000,000. As at 31 December 2012, the Group utilised USD200,000,000 from this facility. These long-term interest-bearing borrowings from Standard Bank of South Africa Ltd of USD200,000,000 bear interest of LIBOR + 5.25%, are secured by the Group's cash at bank (see Note 23) and inventory (see Note 21). The attributable transaction cost amounts to USD5,754,000.

The Group's long-term borrowings are repayable as follows:

	The Group		The Company	
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD'000**	USD'000
Within 1 year or on demand	**81,818**	21,818	**60,000**	–
After 1 year but within 2 years	**101,818**	21,818	**80,000**	–
After 2 years but within 5 years	**153,637**	125,455	**50,000**	–
	337,273	169,091	**190,000**	–

24 BORROWINGS *(continued)*

(b) The short-term interest-bearing borrowings comprise:

	The Group		The Company	
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD'000**	USD'000
Bank loans				
– Secured	**–**	311,750	**–**	298,750
Current portion of long-term borrowings				
– Bank loan	**81,818**	21,818	**60,000**	–
	81,818	333,568	**60,000**	298,750

As at 31 December 2011, the Group's short-term interest-bearing borrowings from Standard Bank Plc of USD300,000,000 bearing interest of LIBOR + 3.25%, were secured by the Group's cash at bank (see Note 23). The attributable transaction cost as at 31 December 2011 amounts to USD1,250,000. The original borrowings from Standard Bank Plc was USD400,000,000, part of which amounted to USD100,000,000 was early repaid in December 2011. The Group paid the remaining amount of USD300,000,000 in March 2012.

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 14).

25 TRADE AND OTHER PAYABLES

	The Group		The Company	
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD'000**	USD'000
Trade payables (Note (i))	**45,718**	18,523	**–**	–
Receipts in advance (Note (ii))	**1,745**	9,160	**–**	–
Amounts due to related parties (Note (iii))	**14,109**	9,560	**–**	–
Payables for purchase of equipment	**38,706**	36,018	**–**	–
Security deposit on construction work	**2,223**	9,259	**–**	–
Interest payable	**15,271**	2,544	**–**	–
Other taxes payables	**4,152**	21,354	**–**	–
Promissory notes (Note (iv))	**105,000**	–	**105,000**	–
Others (Note (v))	**20,133**	12,262	**14,938**	577
	247,057	118,680	**119,938**	577

25 TRADE AND OTHER PAYABLES (continued)

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 34(a)).

(iv) On 27 November 2012, the Group entered into an agreement (the "Settlement Agreement") with the Seller setting out the settlement arrangement of the Reserves Adjustment Payment (see Note 17(iii)). Pursuant to the Settlement Agreement the Reserves Adjustment Payment will be settled by the issuance of two promissory notes by the Company to QGX Holdings Ltd., each in the amount of US$52,500,000 (each, an "Adjustment Promissory Note"), and each Adjustment Promissory Note shall bear interest at a rate of 3.0% per annum commencing on the issue date to the maturity date. The Company shall pay the amount under each Adjustment Promissory Note to QGX Holdings Ltd. on a maturity date which is 360 calendar days from the issue date. Both Adjustment Promissory Notes were issued on 27 November 2012.

(v) Others represent mainly 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.

26 INCOME TAX IN THE CONSOLIDATED BALANCE SHEET

(a) Tax payable in the consolidated balance sheet represents:

	The Group	
	2012	2011
	USD'000	USD'000
At 1 January	**17,508**	5,455
Provision for the year (Note 7(a))	**12,870**	49,367
Offsetting with VAT receivable (Note 32(b))	**(5,287)**	(9,470)
Income tax paid	**(21,527)**	(25,998)
Exchange adjustments	**386**	(1,846)
At 31 December	**3,950**	17,508

26 INCOME TAX IN THE CONSOLIDATED BALANCE SHEET (continued)

(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 year are as follows:

The Group

	Tax losses	Unrealised profits on intra-group transactions	Depreciation and amortisation	Unrealised foreign exchange differences 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 2011	811	724	(482)	(4,753)	–	–	(3,700)
Addition in relation to the Acquisition	–	–	–	–	–	(149,105)	(149,105)
Credit to profit or loss (Note 7(a))	1,816	3,593	553	6,719	1,036	–	13,717
Exchange adjustments	(251)	(409)	(54)	(156)	–	–	(870)
At 31 December 2011	2,376	3,908	17	1,810	1,036	(149,105)	(139,958)
At 1 January 2012	**2,376**	**3,908**	**17**	**1,810**	**1,036**	**(149,105)**	**(139,958)**
Credit to profit or loss (Note 7(a))	**12,529**	**(3,892)**	**789**	**(471)**	**446**	**286**	**9,687**
Exchange adjustments	**(262)**	**104**	**(18)**	**17**	**–**	**–**	**(159)**
At 31 December 2012	**14,643**	**120**	**788**	**1,356**	**1,482**	**(148,819)**	**(130,430)**

	The Group	
	2012	2011
	USD'000	USD'000
Net deferred tax assets recognised on the consolidated balance sheet	**19,144**	9,698
Net deferred tax liability recognised on the consolidated balance sheet	**(149,574)**	(149,656)
	(130,430)	(139,958)

26 INCOME TAX IN THE CONSOLIDATED BALANCE SHEET (continued)

(c) Deferred tax assets not recognised

In accordance with the accounting policy set out in Note 2(r), the Group has not recognised deferred tax assets in respect of cumulative tax losses of USD116,192,000 as at 31 December 2012 (2011: USD26,973,000) 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. 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. Tax losses of other entities will expire in two years after the tax losses generated.

Expiry of unrecognised tax losses of group entities located in Mongolia:

	The Group	
	2012	2011
	USD'000	USD'000
Year of expiry		
2012	**–**	358
2013	**9,131**	9,103
2014	**3,361**	2,681
2016	**27,454**	–
	39,946	12,142

In relation to group entities located in the jurisdictions other than Mongolia, the tax losses amounting to USD76,246,000 as at 31 December 2012 do not expire under current tax legislations (31 December 2011: USD14,831,000).

(d) Deferred tax liabilities not recognised

At 31 December 2012, temporary differences relating to the undistributed profits of subsidiaries amounted to USD131,713,000 (2011: USD142,463,000). Deferred tax liabilities of USD26,343,000 (2011: USD28,493,000) have not been recognised in respect of the tax that would be payable on the distribution of these retained profits as the Company controls the dividend policy of these subsidiaries and it has been determined that it is probable that profits will not be distributed in the foreseeable future.

27 CONVERTIBLE BOND

	The Group and the Company		
	Liability component	Derivative component	Total
	USD'000	USD'000	USD'000
At 1 January 2012	81,079	2,429	83,508
Interest charged during the year (Note 6(a))	6,766	–	6,766
Interest payable	(2,845)	–	(2,845)
Fair value adjustment (Note 6(a))	–	(2,429)	(2,429)
At 31 December 2012	**85,000**	**–**	**85,000**

On 1 June 2011, the Company issued the USD85,000,000 aggregate principal amount convertible bond ("convertible bond") to QGX Holdings Ltd. ("Bondholder"), related to the acquisition of BN Limited.

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. On 27 November 2012, the maturity date of convertible bond was extended to 1 March 2013. Subsequent to 31 December 2012, the maturity date of convertible bond was further extended to 22 April 2013 on 19 February 2013.

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) 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 USD3.00 per tonne of such Reserves Shortfall, subject to a cap of USD85,000,000. In November 2012, the Total Reserves was confirmed to be above 150,000,000 tonnes and therefore the principal amount of the convertible bond is not adjusted for the Reserves Shortfall.

Pursuant to the bond conversion terms, the initial conversion price shall be HKD10.92 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.

28 SENIOR NOTES

	The Group and the Company USD'000
At 1 January 2012	–
Issuance of senior notes	604,920
Transaction costs	(13,213)
Interest charged during the period (Note 6(a))	41,417
Interest payable	(40,233)
At 31 December 2012	**592,891**

On 29 March 2012, the Company issued guaranteed senior notes in the aggregate principal amount of USD600,000,000 and listed on the Singapore Exchange Securities Trading Limited. The senior notes bear interest at 8.875% per annum, payable semi-annually in arrears, and will be due in 2017.

The senior notes may be redeemed at the option of the Company upon giving not less than 30 days or no more than 60 days notice to the holders.

The Company has agreed, for the benefit of the holders of the senior notes, to pledge all of the capital stock of Mongolian Coal Corporation Limited owned by the Company and to cause Mongolian Coal Corporation Limited to pledge all of the capital stock of Mongolian Coal Corporation S.a.r.l. owned by Mongolian Coal Corporation Limited. The senior notes are guaranteed by some of the Company's subsidiaries, namely Mongolian Coal Corporation Limited, Mongolian Coal Corporation S.a.r.l., Energy Resources Corporation LLC, Energy Resources LLC, Energy Resources Mining LLC and Transgobi LLC.

The senior notes have 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 USD4,920,000, and the attributable transaction cost of USD107,000 were charged to the profit or loss for the year ended 31 December 2012. The fair value of the derivative component as at 31 December 2012 was USD12,420,000 which was presented as derivative financial instruments (see Note 22(c)(iv)).

The liability component was initially recognised at amortised cost of USD591,707,000, after taking into account attributable transaction costs of USD13,213,000.

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 Binomial model.

29 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:

Grant Date	Number of options '000	Vesting conditions	Contractual life of options
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
28 November 2012	5,688	28 November 2012 to 28 November 2013	28 November 2012 to 28 November 2020
28 November 2012	5,688	28 November 2012 to 28 November 2014	28 November 2012 to 28 November 2020
28 November 2012	11,374	28 November 2012 to 28 November 2015	28 November 2012 to 28 November 2020
Total share options	57,950		

The number of options granted to directors and employees for the year ended 31 December 2012 are 5,000,000 and 17,750,000 respectively (2011: 3,000,000 and 32,200,000).

29 EQUITY-SETTLED SHARE-BASED PAYMENT TRANSACTIONS (continued)

(ii) The movement of the number and weighted average exercise prices of share options are as follows:

	2012		2011	
	Exercise Price HKD	Number of options '000	Exercise Price HKD	Number of options '000
Outstanding at 1 January	6.66	34,900	–	–
Granted during the year	3.92	22,750	6.66	35,200
Forfeited during the year	6.66	(1,000)	6.66	(300)
Outstanding at 31 December	5.56	56,650	6.66	34,900
Exercisable at 31 December	6.66	8,475	–	–

The options outstanding at 31 December 2012 had an exercise price of HKD6.66 or HKD3.92 (2011: HKD6.66) per share and a weighted average remaining contractual life of 7.2 years (2011: 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.

Fair value of share options and assumptions

	28 November 2012	12 October 2011
Fair value at measurement date	HKD1.8155 ~ HKD2.0303	HKD3.3793 ~ HKD3.7663
Share price	HKD3.92	HKD6.66
Exercise price	HKD3.92	HKD6.66
Expected life	4.5-5.5 years	4.5-6 years
Risk-free interest rate	0.249%~0.298%	0.755%~1.054%
Expected volatility	57.71%~59.43%	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.

29 EQUITY-SETTLED SHARE-BASED PAYMENT TRANSACTIONS (continued)

(iii) Fair value of share options and assumptions (continued)

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.

30 PROVISIONS

	The Group	
	2012	2011
	USD'000	USD'000
Accrued reclamation obligations	**15,538**	11,110
Contingent considerations	**1,500**	1,500
Less: Current portion	**1,500**	1,500
	15,538	11,110

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 2012 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 is as follows:

	The Group	
	2012	2011
	USD'000	USD'000
At 1 January	**11,110**	6,904
Addition	**3,430**	4,834
Accretion expense (Note 6(a))	**1,070**	567
Exchange adjustments	**(72)**	(1,195)
At 31 December	**15,538**	11,110

Accrued reclamation costs increased during the years ended 31 December 2012 as the result of the reclamation obligations for BN mine was accrued. Accrued reclamation costs increased during the years ended 31 December 2012 and 2011 as the result of a reduction in the discount rate.

31 CAPITAL, RESERVES AND DIVIDENDS

(a) Movements in components of equity

The reconciliation between the opening and closing balances of each component of the Group's consolidated equity is set out in the consolidated statement of changes in equity. Details of the changes in the Company's individual components of equity between the beginning and the end of the year are set out below:

	Note	Share capital USD'000 (Note 31(b))	Share premium USD'000 (Note 31(d)(i))	Other reserve USD'000 (Note 31(d)(ii))	Retained earnings USD'000	Total equity USD'000
Balance at 1 January 2011		37,050	608,650	–	(5,256)	640,444
Changes in equity for 2011						
Total comprehensive income for the year		–	–	–	(9,563)	(9,563)
Equity-settled share-based transactions	29	–	–	1,646	–	1,646
Balance at 31 December 2011		37,050	608,650	1,646	(14,819)	632,527
Balance at 1 January 2012		**37,050**	**608,650**	**1,646**	**(14,819)**	**632,527**
Changes in equity for 2012						
Total comprehensive income for the year		**–**	**–**	**–**	**(61,414)**	**(61,414)**
Equity-settled share-based transactions	29	**–**	**–**	**6,620**	**–**	**6,620**
Balance at 31 December 2012		**37,050**	**608,650**	**8,266**	**(76,233)**	**577,733**

(b) Dividends

The board of directors of the Company does not recommend the payment of a final dividend in respect of the year ended 31 December 2012.

31 CAPITAL, RESERVES AND DIVIDENDS (continued)

(c) 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 2012 and 2011 (Note 31(d)(ii)).

The Company

	2012		2011	
	No of shares ’000	**USD’000**	No of shares ’000	USD’000
Authorised:				
Ordinary shares	**6,000,000**	**60,000**	6,000,000	60,000

	At 31 December 2012		At 31 December 2011	
	No. of shares ’000	**USD’000**	No. of shares ’000	USD’000
Ordinary shares, issued and fully paid:				
Ordinary shares	**3,705,037**	**37,050**	3,705,037	37,050

31 CAPITAL, RESERVES AND DIVIDENDS (continued)

(d) Nature and purpose of reserves

(i) 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.

(ii) 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).

(iii) Exchange reserve

The exchange reserve comprises all foreign exchange adjustments arising from the translation of the MNT denominated financial statements of the Group's operations to the Group's presentation currency. The reserve is dealt with in accordance with the accounting policy set out in Note 2(v).

(e) 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 2012.

31 CAPITAL, RESERVES AND DIVIDENDS (continued)

(f) 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 2012 was 46.3% (31 December 2011: 34.5%)

32 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.

32 FINANCIAL INSTRUMENTS (continued)

(b) Credit risk (continued)

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 doubtful debts 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 71% of the total trade receivables as at 31 December 2012.

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 is 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 2012, the Group offset current income tax and royalty tax owing of USD5,287,000 and USD10,154,000, 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 2012. 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 2012 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 22.

32 FINANCIAL INSTRUMENTS (continued)

(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.

The Group

	Exposure to foreign currencies (expressed in United States Dollars)					
	2012			2011		
	Renminbi USD'000	**United States Dollars USD'000**	**Hong Kong Dollars USD'000**	Renminbi USD'000	United States Dollars USD'000	Hong Kong Dollars USD'000
Trade and other receivables	**57**	**39,457**	**–**	3,771	37,629	–
Cash and cash equivalents	**8,244**	**273,708**	**425**	2,418	117,234	235
Trade and other payables	**(4,017)**	**(7,361)**	**(59)**	(6)	(18,675)	(82)
Short-term borrowings and current portion of long-term borrowings	**–**	**(21,818)**	**–**	–	(34,818)	–
Long-term borrowings	**–**	**(125,455)**	**–**	–	(144,661)	–
Net exposure arising from recognised assets and liabilities	**4,284**	**158,531**	**366**	6,183	(43,291)	153

32 FINANCIAL INSTRUMENTS (continued)

(c) Foreign currency exchange risk (continued)

(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) loss after taxation (2011: increase/(decrease) profit after taxation) by the amount shown below. This analysis assumes that all other risk variables remained constant.

	2012	2011
	USD'000	USD'000
Loss/profit for the year		
5% increase in RMB	**461**	232
5% decrease in RMB	**(461)**	(232)
5% increase in USD	**19,606**	(979)
5% decrease in USD	**(19,606)**	979
5% increase in HKD	**24**	8
5% decrease in HKD	**(24)**	(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.

32 FINANCIAL INSTRUMENTS (continued)

(d) Interest rate risk (continued)

The following table details the profile of the Group's and the Company'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 and the Company's borrowings are disclosed in Note 24.

	The Group		The Company	
	2012	2011	**2012**	2011
	USD'000	USD'000	**USD'000**	USD'000
Net fixed rate borrowings:				
Borrowings	**–**	13,000	**–**	–
Obligations under finance lease	**323**	460	**–**	–
Convertible bond	**85,000**	83,508	**85,000**	83,508
Promissory notes	**105,000**	–	**105,000**	–
Less: Bank deposits (including pledged deposits)	**(240,000)**	(186,759)	**–**	(7,000)
	(49,677)	(89,791)	**190,000**	76,508
Net floating rate borrowings:				
Borrowings	**330,931**	465,229	**185,768**	298,750
Less: Bank deposits (including pledged deposits)	**(44,322)**	(41,006)	**(707)**	(776)
	286,609	424,223	**185,061**	297,974
Total net borrowings:	**236,932**	334,432	**375,061**	374,482

32 FINANCIAL INSTRUMENTS (continued)

(d) Interest rate risk (continued)

At 31 December 2012, 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 Group's loss after taxation and decreased/increased retained earnings by approximately USD2,606,000 (31 December 2011: decreased/increased the Groups profit after taxation and retained earnings 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 27, 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.

32 FINANCIAL INSTRUMENTS (continued)

(e) Liquidity risk (continued)

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:

The Group

	2012 Contractual undiscounted cash outflow					
	Within 1 year USD'000	After 1 year but within 2 years USD'000	After 2 years but within 5 years USD'000	After 5 years USD'000	Total contractual undiscounted cash flow USD'000	Balance sheet carrying amount USD'000
Borrowings (Note 24)	**97,099**	**112,144**	**157,935**	**–**	**367,178**	**330,931**
Trade and other payables (Note 25)	**247,057**	**–**	**–**	**–**	**247,057**	**247,057**
Convertible bond (Note 27)	**85,550**	**–**	**–**	**–**	**85,550**	**85,000**
Senior notes (Note 28)	**53,250**	**53,350**	**733,125**	**–**	**839,625**	**592,891**
	482,956	**165,394**	**891,060**	**–**	**1,539,410**	**1,255,879**

	2011 Contractual undiscounted cash outflow					
	Within 1 year USD'000	After 1 year but within 2 years USD'000	After 2 years but within 5 years USD'000	After 5 years USD'000	Total contractual undiscounted cash flow USD'000	Balance sheet carrying amount USD'000
Borrowings (Note 24)	348,132	29,997	138,088	–	516,217	478,229
Trade and other Payables (Note 25)	118,680	–	–	–	118,680	118,680
Convertible bond (Note 27)	86,565	–	–	–	86,565	83,508
	553,377	29,997	138,088	–	721,462	680,417

32 FINANCIAL INSTRUMENTS (continued)

(e) Liquidity risk (continued)

The Company

	2012 Contractual undiscounted cash outflow					
	within 1 year USD'000	After 1 year but within 2 years USD'000	After 2 years but within 5 years USD'000	After 5 years USD'000	Total contractual undiscounted cash flow USD'000	Balance sheet carrying amount USD'000
Borrowings (Note 24)	**69,713**	**85,627**	**50,517**	**–**	**205,857**	**185,768**
Trade and other payables (Note 25)	**119,938**	**–**	**–**	**–**	**119,938**	**119,938**
Convertible bond (Note 27)	**85,550**	**–**	**–**	**–**	**85,550**	**85,000**
Senior notes (Note 28)	**53,250**	**53,350**	**733,125**	**–**	**839,625**	**592,891**
	328,451	**138,877**	**783,642**	**–**	**1,250,970**	**983,597**

	2011 Contractual undiscounted cash outflow					
	within 1 year USD'000	After 1 year but within 2 years USD'000	After 2 years but within 5 years USD'000	After 5 years USD'000	Total contractual undiscounted cash flow USD'000	Balance sheet carrying amount USD'000
Borrowings (Note 24)	302,559	–	–	–	302,559	298,750
Trade and other Payables (Note 25)	577	–	–	–	577	577
Convertible bond (Note 27)	86,565	–	–	–	86,565	83,508
	389,701	–	–	–	389,701	382,835

32 FINANCIAL INSTRUMENTS (continued)

(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	
	The Group	
	2012	2011
	USD'000	USD'000
Assets		
Derivative financial instruments:		
– Redemption option embedded in senior notes	**12,420**	–
Liabilities		
Derivative financial instruments:		
– Conversion option embedded in convertible bond	**–**	2,429

32 FINANCIAL INSTRUMENTS (continued)

(f) Fair values (continued)

(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 2012. 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 2012.

33 COMMITMENTS AND CONTINGENCIES

(a) Capital commitments

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

	2012	2011
	USD'000	USD'000
Contracted for	**35,409**	14,827
Authorised but not contracted for	**69,427**	80,075
	104,836	94,902

(b) Operating lease commitments

(i) At 31 December 2012, the total future minimum lease payments under non-cancellable operating leases are payable as follows:

	2012	2011
	USD'000	USD'000
Within 1 year	**2,823**	7,136
After 1 year but within 5 years	**1,593**	2,245
	4,416	9,381

33 COMMITMENTS AND CONTINGENCIES (continued)

(b) Operating lease commitments (continued)

(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 30 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.

(d) Contingency in respect of tax dispute

The Group received two decisions (the "Decisions"), both dated 26 December 2012, made by the state customs officers of General Customs Office of Mongolia regarding the result of post-clearance audit made in relation to import activities in connection with the coal handling and preparation plant module I and II construction project. The Group was claimed for additional customs duties of USD1,423,000, VAT of USD2,989,000 and related penalty of USD1,324,000. The Group is in a position not to agree with or accept the Decisions and commenced a defence action against the Decisions in the Capital Administrative Court of Mongolia.

The court's decisions are anticipated to be available in mid-2013 and it is premature to conclude the likely outcome at this stage. In the opinion of the directors, based on legal advices, though company would provide all reasonable arguments in order to have issued rulings of the Court in the favor of the Group, it is difficult to estimate probability of the court decision at this early stage of the litigation. If the Group was found to be liable to the claim, the under-paid customs duties and VAT would result in an increase in the cost of the Group's property, plant and equipment and the penalty would be charged to the Group's profit or loss.

34 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 year, the Group entered into transactions with the following related parties.

Name of party	Relationship
MCS (Mongolia) Limited ("**MCS Mongolia**")	Shareholder
MCS Holding LLC ("**MCS**")	Subsidiary of MCS Mongolia
Uniservice Solution LLC ("**Uniservice Solution**")	Subsidiary of MCS Mongolia
MCS Property LLC ("**MCS Property**")	Subsidiary of MCS Mongolia
MCS Electronics LLC ("**MCS Electronics**")	Subsidiary of MCS Mongolia
MCS International LLC ("**MCS International**")	Subsidiary of MCS Mongolia
Erchim Suljee LLC ("**Erchim Suljee**")	Subsidiary of MCS Mongolia

Particulars of significant transactions between the Group and the above related parties during the year ended 31 December 2012 are as follows:

	2012 **USD'000**	2011 USD'000
Ancillary services (Note (i))	**24,326**	30,326
Purchases of equipment and construction work (Note (ii))	**26,006**	24,447
Sales of property, plant and equipment (Note (iii))	**96**	2,418
Lease of property, plant and equipment (Note (iv))	**1,203**	897
Finance lease of equipment (Note (v))	**223**	301

34 MATERIAL RELATED PARTY TRANSACTIONS (continued)

(a) Transactions with related parties (continued)

(i) 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, were applicable.

Included in the ancillary services for the year ended 31 December 2011, there was management fee paid/payable to MCS in relation to the management services provided to the Group. Upon the expiry of the management agreement signed between the Group and MCS, no management fee incurred during the year ended 31 December 2012 (2011: USD10,406,000)

(ii) Purchases of equipment and construction work represent expenditure relating to equipment and construction service provided by MCS Electronics, MCS and its affiliates. The purchases are carried out at comparable or prevailing market rates, where applicable.

(iii) Sales of property, plant and equipment represent sale to Uniservice Solution. The sales are carried out at comparable or prevailing market rates, where applicable.

(iv) 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.

(v) 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.

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

	2012 **USD'000**	2011 USD'000
Other receivables (Note 22(c)(i))	**94**	455
Other accruals and payables (Note 25(iii))	**(14,109)**	(9,560)

34 MATERIAL RELATED PARTY TRANSACTIONS (continued)

(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 as disclosed in Note 9, and certain of the highest paid employees as disclosed in Note 10, is as follows:

	2012 **USD'000**	2011 USD'000
Salaries and other emoluments	**1,521**	1,500
Discretionary bonus	**1,097**	1,001
Retirement scheme contributions	**133**	140
Equity-settled share-based payment expenses	**3,574**	837
	6,325	3,478

(c) Applicability of the Listing Rules relating to connected transactions

The related party transactions in respect of (a) above constitute connected transactions or continuing connected transactions as defined in Chapter 14A of the Listing Rules. The disclosures required by Chapter 14A of the Listing Rules are provided in section headed "Connected transactions and continuing connected transactions" of the Reports of the directors.

35 ULTIMATE CONTROLLING PARTY

As at 31 December 2012, the directors consider the ultimate controlling party of the Group to be MCS (Mongolia) Limited, which was incorporated in British Virgin Islands. This entity does not produce financial statements available for public use.

36 MAJOR NON-CASH TRANSACTIONS

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 2012, the Group offset the VAT receivables of USD5,287,000 (2011: USD9,470,000) and USD10,154,000 (2011: USD8,381,000) with income tax payable and royalty tax payable, respectively (see Note 26 (a)).

During the year ended 31 December 2012, the Group issued Adjustment Promissory Note (see Note 25 (iv)) to acquire additional mining right (see Note 17 (iii)).

37 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2012

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 2012 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
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 IFRS 1, First-time adoption of International Financial Reporting Standards – Government loans	1 January 2013
Annual Improvements to IFRSs 2009-2011 Cycle	1 January 2013
Amendments to IFRS 10, Consolidated financial statements, IFRS 11, Joint arrangements and IFRS 12, Disclosure of interests in other entities – Transition guidance	1 January 2013
Amendments to IFRS 10, IFRS 12 and IAS 27, Investment entities	1 January 2014
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

37 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2012 (continued)

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 the adoption of them is unlikely to have a significant impact on the Group's results of operations and financial position except for IFRIC 20. The Group has not completed its assessment of the full impact of adopting IFRIC 20 and therefore its possible impact on the Group's results and financial position has not been quantified.

Financial Summary

SUMMARY DATA OF CONDENSED CONSOLIDATED INCOME STATEMENTS

	2012 USD'000	2011 USD'000	2010 USD'000	2009 USD'000	2008 USD'000
Revenue	**474,480**	542,568	277,502	66,983	–
Cost of revenue	**(420,400)**	(336,368)	(164,368)	(38,682)	–
Gross profit	**54,080**	206,200	113,134	28,301	–
Other revenue	**1,121**	435	511	70	81
Other net income/(expenses)	**5,418**	76	(187)	(35)	(8)
Administrative expenses	**(48,183)**	(60,303)	(38,685)	(10,427)	(4,044)
Profit/(loss) from operations	**12,436**	146,408	74,773	17,909	(3,971)
Finance income	**39,561**	22,236	12,335	342	13
Finance costs	**(50,994)**	(13,785)	(4,214)	(3,860)	(1,139)
Share of (losses)/profits of associates	**(362)**	(119)	2	(10)	30
Profit/(loss) before taxation	**641**	154,740	82,896	14,381	(5,067)
Income tax	**(3,183)**	(35,650)	(22,757)	(4,111)	1,488
(Loss)/profit attributable to the equity shareholders of the Company	**(2,542)**	119,090	60,139	10,270	(3,579)
Basic (loss)/earnings per share	**(0.07) cents**	3.21 cents	1.91 cents	0.34 cents	(0.12 cents)
Diluted (loss)/earnings per share	**(0.07) cents**	3.07 cents	1.91 cents	0.34 cents	(0.12 cents)

SUMMARY DATA OF CONDENSED CONSOLIDATED BALANCE SHEETS

	2012	2011	2010	2009	2008
Assets and liabilities					
Total assets	**2,177,277**	1,628,015	1,053,270	113,230	35,926
Total liabilities	**1,425,264**	859,151	325,989	69,389	21,135
Net assets	**752,013**	768,864	727,281	43,841	14,791
Equity attributable to equity shareholders of the Company	**752,013**	768,864	727,281	43,841	14,791

Glossary and Technical Terms

"Adoption date"	13 October 2010, the date the Share Option Scheme was adopted and became effective
"AGM"	Annual general meeting
"aimag"	The highest level of Mongolian administrative subdivision (essentially equivalent to a province), of which there are 21 in Mongolia
"ASP"	Average selling price
"BCM"	Bank cubic metre
"BN"	Baruun Naran
"BN deposit"	BN coal deposit located in the TT formation
"BN mine"	The area of the BN deposit that can be mined by open pit mining methods
"BN-UHG Road"	paved road between BN and UHG mines
"Board"	The Board of Directors of the Company
"BOT" or "Build-Operate-Transfer"	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
"CCTs"	Continuing connected transactions
"CG Code"	The Corporate Governance Code
"CHPP"	Coal handling and preparation plant
"coke"	Bituminous coal from which the volatile components have been removed
"coking coal"	Coal used in the process of manufacturing steel. It is also known as metallurgical coal

"Company", "our Company", "Group", "our Group", "we", "us", "our" or "Mongolian Mining Corporation"	Mongolian Mining Corporation, a company incorporated in the Cayman Islands with limited liability on 18 May 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
"Controlling Shareholders"	MCS Mining Group Limited, MCS (Mongolia) Limited, Novel Holdings Group Limited, Trimunkh Limited, Mr. Odjargal Jambaljamts, Mr. Od Jambaljamts, Ms. Batmunkh Dashdeleg and Ms. Munkhsuren Surenkhuu
"Convertible Bond"	USD85,000,000 aggregate principal amount convertible bond issued by the Company to QGX Holdings Ltd.
"CSR"	Corporate social responsibility
"DAP"	Delivery at place
"Deed of Non-competition"	Pursuant to a deed of non-competition dated 20 September 2010 executed by Mr. Odjargal Jambaljamts, MCS Holding LLC, MCS Mining Group Limited and MCS Group Limited
"Director(s)"	Director(s) of the Company
"EBITDA"	Earnings before interest, tax, depreciation and amortisation
"EIFR"	Environmental incident frequency rate
"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
"Fexos"	Fexos Limited
"FOB"	free-on-board
"Foreign Investment Regulation Law"	Law on Regulation of Foreign Investment in Business Entities which Operate in Sectors of Strategic Importance
"Ganqimaodu" or "GM"	The China side of the China-Mongolia border crossing

Glossary and Technical Terms

"Ger"	A ger is a portable, felt-covered, wood lattice-framed dwelling structure traditionally used by nomads. A ger is more home-like in shape and build, with thicker walls than that of a tent
"GoM"	Government of Mongolia
"Group"	The Company and its subsidiaries
"Gashuun Sukhait" or "GS"	The Mongolia side of the China-Mongolia border crossing
"Guiding Principle"	The Guiding Principles for Business and Human Rights endorsed by the United Nations
"HCC"	Hard coking coal
"HKD"	Hong Kong Dollar
"HR"	Human Resources
"HSE"	Health, safety and environmental
"IASs"	International Accounting Standards
"IASB"	International Accounting Standards Board
"IFC"	International Finance Corporation
"IFRSs"	International Financial Reporting Standards
"IPO"	The Company's initial public offering
"ILO"	International Labour Organisation
"Jigang Group"	Jinan Iron and Steel Group Co., Ltd.
"JORC"	Joint Ore Reserves Committee of The Australian Institute of Mining and Metallurgy, Australian Institute of Geoscientists and Minerals Council of Australia
"KGL"	Kerry Group Limited

"KHL"	Kerry Holdings Limited
"km"	kilometre
"KMM"	Kerry Mining (Mongolia) Limited
"KMUHG"	Kerry Mining (UHG) Limited
"kV"	kilo volts
"kVA"	kilo volt-amperes
"Listing Date"	13 October 2010
"Listing Rules"	The Rules Governing the Listing of Securities on the Stock Exchange
"LTIFR"	Lost Time Injury Frequency Rate
"MCS Group"	MCS Holding LLC, an associate of MCS Mining Group Limited (a controlling shareholder of the Company) and its subsidiaries
"middlings"	Washed thermal coal
"MIIT"	Ministry of Industry and Information Technology
"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
"MNT"	Togrog or tugrik, the lawful currency of Mongolia
"Model Code"	The Model Code for Securities Transactions by Directors of Listed Issuers
"Mongolian Customs"	Mongolian Customs General Administration

Glossary and Technical Terms

"Mt"	Million tonnes
"NGOs"	Non-governmental organisations
"NSO"	National Statistical Office
"Offer Date"	12 October 2011, the date of offer of a total of 37,500,000 Share Options to its Chief Executive Officer and certain employees under the Share Option Scheme adopted by the Company
"OHS"	Occupational health and safety
"OHSAS"	Occupational Health and Safety Assessment Series
"open-pit"	The main type of mine designed to extract minerals close to the surface; also known as "open cut"
"ore"	A naturally occurring solid material from which a metal or valuable mineral can be extracted profitably
"PACI"	The World Economic Forum Partnering Against Corruption Initiative
"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
"raw coal"	Generally means coal that has not been washed and processed
"RMB"	Renminbi
"ROM"	Run-of-mine, the as-mined material during room and pillar mining operations as it leaves the mine site (mined glauberite ore and out-of-seam dilution material)
"seam"	A stratum or bed of coal or other mineral; generally applied to large deposits of coal
"SEHK" or "Stock Exchange"	The Stock Exchange of Hong Kong Limited

"SFO"	Securities and Futures Ordinance
"share(s)"	Ordinary share(s) of USD0.01 each in the share capital of the Company
"Share Options"	The share options which were granted under the Share Option Scheme to eligible participants to subscribe for Shares of the Company
"Share Option Scheme"	A share option scheme which was adopted by the Company on 17 September 2010
"Share Purchase Agreement"	Share purchase agreement entered by the Company and its subsidiary Mongolian Coal Corporation Limited with Quincunx (BVI) Ltd and Kerry Mining (Mongolia) Limited in relation to the acquisition of the entire issued share capital of QGX Coal Ltd
"soum"	The second level of Mongolian administrative subdivisions (essentially equivalent to a sub-province)
"SSCC"	Semi-soft coking coal
"Standard Bank Facility"	A facility agreement with Standard Bank of South Africa Ltd as the original lender, and Standard Bank Plc as the lead arranger
"strip ratio" or "stripping ratio"	The ratio of the amount of waste removed (in bank cubic metres) to the amount of coal or minerals (in tonnes) extracted by open-pit mining methods
"Tavan Tolgoi"	The coal formation located in South Gobi, Mongolia which includes our UHG deposit
"the Articles"	The Articles of Association
"the Schemes"	The Group participates in defined contribution retirement benefit schemes
"thermal coal"	Also referred to as "steam coal" or "steaming coal," thermal coal is used in combustion processes by power producers and industrial users to produce steam for power and heat. Thermal coal tends not to have the carbonisation properties possessed by coking coals and generally has lower heat value and higher volatility than coking coal

Glossary and Technical Terms

"TKH"	Tsagaan Khad
"tonne"	Metric ton
"Tsetsii Town"	A residential town in Tsogttsetsii soum
"Tsogttsetsii"	Tsogttsetsii soum is the location where Tavan Tolgoi sits
"UHG"	Ukhaa Khudag
"UHG deposit"	Ukhaa Khudag deposit located in the Tavan Tolgoi coalfield which includes both aboveground (<300m) and underground (>300m) deposits
"UHG mine"	The aboveground (<300m) portion of our UHG deposit
"USD"	United States Dollar
"VAT"	Value added tax
"washed coal"	Coals that have been washed and processed to reduce its ash content

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