



**XINERGY Ltd.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**OF**

**FINANCIAL CONDITION**

**AND**

**RESULTS OF OPERATIONS**

**FOR THE THREE MONTHS ENDED MARCH 31, 2011**

**MAY 24, 2011**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND  
RESULTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED MARCH 31, 2011**

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with Xinerger Ltd's ("Xinerger") unaudited condensed consolidated interim financial statements for the three months ended March 31, 2011 and notes thereto and audited consolidated financial statements for the years ended December 31, 2010 and 2009 and notes thereto. In this MD&A, "Xinerger," "the Company," "we," "us," or "our" refers to Xinerger Ltd. and its subsidiaries. The consolidated financial statements have been prepared in conformity with International Financial Reporting Standards ("IFRS"). This discussion provides management's analysis of our historical financial and operating results and provides estimates of future financial and operating performance based on information currently available. Actual results will vary from estimates and the variances may be significant. Readers should be aware that historical results are not necessarily indicative of future performance. All references to "\$" or "dollars" are to United States dollars unless otherwise indicated.

This MD&A was prepared using information that is current as of May 23, 2011.

**Forward Looking Information**

In the interest of providing our shareholders and potential investors with information regarding Xinerger, including management's assessment of our future plans and operations in the "Outlook" section of this MD&A, certain statements in this MD&A are "forward-looking information" within the meaning of applicable Canadian securities legislation. In some cases, forward-looking information can be identified by terminology such as "anticipate," "believe," "continue," "could," "estimate," "expect," "forecast," "intend," "may," "objective," "ongoing," "outlook," "potential," "project," "plan," "should," "target," "would," "will" or similar words suggesting future outcomes, events or performance. The forward-looking information contained in this MD&A speaks only as of the date of this document and is expressly qualified by this cautionary statement.

Specifically, this MD&A contains forward-looking information relating to:

- Tons under contract for remainder of 2011 and 2012, 2013 and 2014;
- Price per ton for remainder of 2011 and 2012, 2013 and 2014 tons that are committed under contract;
- Estimated cash cost of production for remainder of 2011 and 2012;
- Increased production capacity as the result of recently acquired properties, additional capital expenditures and additional permitted mines;
- Reserves that have recently been leased or acquired; and
- Future development of recently acquired properties and leased reserves.

This forward-looking information is based on certain key assumptions regarding, among other things: no material disruption in production; no material variation in anticipated coal sales volumes; no material variations in markets and pricing of steam coal other than anticipated variations; continued availability of and no material disruption in rail service; no production or shipping disruptions due to adverse weather conditions other than normal, seasonal patterns; no material delays in the current timing for completion of ongoing projects; financing will be available on terms favorable to the Company; no material variation in historical coal purchasing practices of customers; coal sales contracts will be entered into with new customers; parties execute and deliver contracts currently under negotiation; and no material variations in the current regulatory environment. The reader is cautioned that such assumptions, although considered reasonable by us at the time of preparation, may prove to be incorrect.

Actual results achieved during the forecast period may vary from the information provided herein as a result of numerous known and unknown risks and uncertainties and other factors. Such factors include, but are not limited to: changes in general economic, market and business conditions; uncertainties associated with estimating the quantity and quality of coal reserves and resources; commodity prices, currency exchange rates, the availability of credit facilities for capital expenditure requirements, debt service requirements; dependence on a single rail system; changes to legislation; liabilities inherent in coal mine development and production; competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel; geological, mining and processing technical problems; ability to obtain required mine licenses, mine permits and regulatory approvals required to proceed with mining and coal processing operations; ability to comply with current and future environmental and other laws; actions by governmental or regulatory authorities including increasing taxes and changes in other regulations; the occurrence of unexpected events involved in coal mine development and production; and other factors, many of which are beyond our control. Many of these risk factors and uncertainties are discussed in our Annual Information Form in a section entitled “Risk Factors” and other documents we file with the Canadian securities regulatory authorities available on SEDAR at [www.sedar.com](http://www.sedar.com).

**We make no representation that actual results achieved during any forecast period will be the same, in whole or in part, as forecasted results and we do not undertake any obligation to update publicly or to revise any of the included forward-looking information, whether as a result of new information, future events or otherwise, except as may be required by applicable securities law.**

**Readers of this MD&A should refer to the section entitled “Risk Factors” in Xinerge’s Annual Information Form for factors which could cause actual results to differ materially from those anticipated in the forward-looking information contained in this report and which could potentially impact the Company’s financial performance and its ability to meet its targets.**

## **OVERVIEW**

Headquartered in Knoxville, Tennessee, we currently mine, process and sell high quality bituminous thermal coal from coal mines located in eastern Kentucky and West Virginia. We sell our thermal coal to electric utilities and industrial companies throughout the southeastern United States. We commenced mining in April 2008 at our Straight Creek property in Kentucky and expanded our thermal coal operations into West Virginia in April 2010 with the acquisition of Raven Crest Mining, LLC (“Raven Crest”).

Xinerge Corp. was incorporated in October 2007. On December 21, 2009, we completed a reverse takeover, or RTO, of Greenwich Global Capital, Inc., or GGC, which was previously listed on the NEX Board of the TSX Venture Exchange. GGC was incorporated under the Business Corporations Act (Ontario) on February 11, 2005, and was classified as a capital pool company as defined in the TSX Venture Exchange Policy 2.4 and, accordingly, had no significant assets other than cash and no commercial operations. GGC changed its name to Xinerge Ltd. on December 21, 2009.

We lease the mineral rights to approximately 76,000 acres of land, comprised of 37,000 acres in Kentucky and 39,000 acres in West Virginia. As of March 31, 2011, our mining complexes include five active mines in Kentucky and two active mines in West Virginia. In addition, we have one preparation plant and one unit train load-out facility in operation in Kentucky, and one unit train load-out facility in operation in West Virginia. In West Virginia, we have permits for a new preparation plant and refuse facility and a planned upgrade to our existing unit train load-out facility. We hold seven permits that allow us to open new mines or re-open existing mines close to current operations, three for mines in Kentucky and four for mines in West Virginia. We also have eight permit applications for new mines in various stages of processing, two for mines in Kentucky and six for mines in West Virginia. As of March 31, 2011, we controlled approximately 87.2 million proven and probable coal reserves, of which we estimate 30% is mid-volatility metallurgical coal and 70% is thermal coal.

Since our inception, substantially all of our revenues have resulted primarily from the sale of coal we produce to electric utility companies in the southeastern United States. For the three months ended March 31, 2011, approximately 90% of our revenue was generated from coal sales to electric utility companies in the southeastern United States and our largest customers represented approximately 42%, 16% and 14% of our revenues, respectively.

Our results of operations greatly depend on the cost of coal production. Our primary expenses are wages and benefits, repair and maintenance expenditures, diesel fuel purchases, blasting and related supplies, coal transportation costs, cost of purchased coal, freight and handling costs, royalties and taxes incurred in selling coal. We expect that our exploration costs in the next few years will be relatively significant but that costs will decline as a percentage of revenues. Given that the coal mining business is capital intensive, we expect our depreciation expenses to increase in 2011 and beyond as we continually increase our capital expenditures for mine development and various surface and underground equipment needed to expand our business.

In January 2011, we acquired coal mineral leases in Greenbrier County West Virginia (“Greenbrier”) that contains high quality, mid-volatility metallurgical coal reserves. We expect to commence production from this acquisition in the second half of 2011.

In March 2011, we entered into leases with Penn Virginia Operating Co., LLC (“Penn Virginia”) on a tract of land known as Brier Creek, which is adjacent to and north of our Raven Crest properties in Kanawha and Boone Counties, West Virginia. The leases include surface leases and coal subleases to thermal coal reserves at two fully-permitted and faced-up deep mines. We also acquired active permits for a coal preparation plant and refuse area on the adjacent property known as Bull Creek.

In May 2011, we entered into a non-binding letter of intent to acquire a currently active, high volatility metallurgical surface mining operation in southwestern Virginia. We are currently conducting due diligence on this property and could enter into a purchase agreement by June 30, 2011.

#### **Highlights for the Quarter Ended March 31, 2011 and Subsequent Events**

- Coal sales increased 448% to \$43.1 million from \$7.9 million in same quarter of 2010.
- Gross margin per ton increased 583% to \$14.42 from \$2.11 in same quarter of 2010.
- EBITDA was \$4.7 million for the quarter as compared to a negative \$1.4 million in same quarter of 2010.
- In May 2011, we issued at par \$200.0 million face amount of our 9.25% senior secured notes due May 15, 2019. Interest payments are required semi-annually beginning November 2011. We may redeem the notes, in whole or in part, at any time on or after May 15, 2015 at redemption prices ranging from 104.625% beginning May 15, 2015 to 100% beginning on May 15, 2018. We used approximately \$72 million of the net proceeds from the offering to repay in full our existing 9.75% senior secured notes due 2015 (including prepayment penalties of 10% of the principal amount thereof). The remaining funds will be used for the construction of a preparation plant, the purchase of underground mining equipment along with support equipment as well as necessary infrastructure development at the recently acquired Brier Creek underground mining property in West Virginia, the construction of a rail siding and loading facility and surface mining equipment at the recently acquired Greenbrier County, West Virginia metallurgical property and for general corporate purposes. As of the date of this filing, the Company has approximately \$123.0 million of these proceeds on hand and expects to begin employing these funds late in the second quarter and early third quarter of 2011.

- We have been working with a nationally recognized investment banking firm to assist in our efforts to list our common stock on a United States securities exchange. We expect this listing to be completed during the third quarter of 2011.
- In May 2011, we entered into a non-binding letter of intent ("LOI") to acquire a high volatility metallurgical surface mining operation in southwestern Virginia. We believe this property contains approximately 4.0 million tons of coal mineral reserves and anticipate ultimate production at an annual rate of approximately 200,000 to 300,000 tons. We expect to pay \$18.0 million in aggregate consideration consisting of (i) \$200,000 non-refundable deposit that was paid upon execution of the LOI, (ii) \$13.8 million payable at closing, (iii) \$4.0 million upon execution of certain leases and receipt of certain mining permits, subject to a net working capital adjustment. We are currently conducting due diligence on this property and expect to enter into a purchase agreement no later than June 30, 2011.
- In April 2011, we entered into a coal reserve lease with Michael Dean for 7,000 acres of a tract of land adjacent to and west of our Straight Creek properties in Bell County, Kentucky (referred to herein as the Dean property). We have begun a drilling program on this tract in order to prepare a technical report in accordance with NI 43-101 standards.
- In March 2011, we entered into leases with Penn Virginia Operating Co., LLC on a tract of land known as Brier Creek, which is adjacent to and north of our Raven Crest properties in Kanawha and Boone Counties, West Virginia. The leases include surface leases and coal subleases to thermal coal reserves at two fully-permitted and faced-up deep mines. We also acquired active permits for a coal preparation plant and refuse area on the adjacent property known as Bull Creek. Summit Engineering completed a mineral reserve estimate report compliant with National Instrument 43-101 ("NI 43-101") standards on March 30, 2011. We expect initial production to begin in early 2012 after construction of a new preparation plant on the Bull Creek property, initially at a rate 50,000 tons per month, with production expected to increase to an annual rate of 1.2 million tons per year in 2013, subject to market conditions.
- In February 2011, we had a major customer temporarily idle a facility that was receiving coal from our Kentucky mining operations. This resulted in a shipment deferral of approximately 90,000 to 100,000 tons in the quarter ended March 31, 2011. The customer has re-opened this facility and has scheduled for the Company to resume shipments beginning May 28, 2011. The first quarter impact of deferring these shipments was approximately \$5.0 to \$5.5 million in EBITDA in addition to increases in production costs associated with temporary changes in mine plans, scheduled production and additional coal handling costs to accommodate new short term customer requirements.
- In January 2011, we acquired a high quality, mid-volatility metallurgical coal reserve located in Greenbrier County, West Virginia. Summit Engineering completed a mineral reserve estimate report compliant with NI 43-101 standards on March 16, 2011. We expect to receive permits for one and possibly two mines on a portion of the property referred to as Blue Knob by late in the third quarter of 2011, and expect initial production to begin in the early part of the fourth quarter of 2011 initially at a rate of 10,000 to 20,000 tons per month, with production expected to increase to an annual rate of approximately 1.0 million tons once fully developed.

## Outlook

### *Thermal Coal Production and Sales*

In December 2010, we announced plans to produce from then controlled thermal coal properties 2.8 to 3.0 million tons in 2011 and 3.5 to 4.0 million tons in 2012. At this time we are updating this guidance as follows:

- In 2011, we expect to sell 2.8 million tons of thermal coal including coal that will be produced from existing mining operations and coal purchased from third parties. This adjustment is being driven due to our desire to defer the ramp up of previously expected 2011 production from current mines until 2012 in anticipation of sales commitments in 2012 through 2014 at prices above current 2011 market prices. To date this strategy has allowed us to develop relationships with new customers as evidenced by the increase in committed sales for 2012 of 1.6 million tons at an average sales price per ton of \$82.65 or \$134.4 million in the aggregate, 2.0 million tons in 2013 at an average sales price per ton of \$82.90 or \$165.8 million in the aggregate and 1.7 million tons in 2014 at an average sales price per ton of \$87.04 or \$144.5 million in the aggregate. As of March 31, 2011, we have contracted thermal coal sales of 1,192,553 tons at an average sales price of \$95.62 per ton for the remainder of 2011. We are continuing to develop and strengthen long term relationships with potential customers and increase committed sales in the near term.
- As previously discussed, in February 2011, we had a major customer temporarily idle a facility that was receiving coal from our Kentucky mining operations resulting in a shipment deferral of approximately 90,000 to 100,000 tons in the quarter ending March 31, 2011. The customer has re-opened this facility and has scheduled for the Company to resume shipments beginning May 28, 2011.

In each of 2012 and 2013, we expect to produce and sell 3.0 to 3.5 million tons from all thermal mining operations. This includes the following:

- 1.8 to 2.1 million tons from the Kentucky Straight Creek mines;
  - 0.8 to 0.9 million tons from the West Virginia Raven Crest surface mines; and
  - 0.4 to 0.5 million tons from the West Virginia Brier Creek underground mines.
- We anticipate maintaining cash production costs on our currently active surface mines between \$50 and \$55 per ton through 2011, \$57 and \$62 per ton in 2012 and \$60 to \$65 per ton 2013. This increase in mining costs in 2012 and 2013 is a direct result of additional hauling and handling costs associated with ongoing mine development and additional areas under permit as the mines continue to expand from their present locations. We anticipate cash production costs for the Brier Creek underground mining operations to be \$65 to \$70 per ton in 2012 and 2013.
  - We expect construction to begin on the coal preparation plant at the recently acquired Brier Creek underground property in West Virginia in the second quarter of 2011 along with upgrades to the load out facility that is currently in place and being used by the Raven Crest surface mines. Production from these permitted underground mines is expected to begin in early 2012, slowly increasing to 40,000 to 50,000 tons per month in 2012.
  - Based on recent upward pricing for 2012 through 2014, as reported by NYMEX and other commodity future pricing sources, we expect to be able to secure additional coal supply agreements in the near term for thermal production from Kentucky and West Virginia mines for 2012 and through 2014 at prices at or above the current 2011 NYMEX Central Appalachia market prices. We are cautiously optimistic that we will be in a position to achieve price realizations on term contracts that amply justify the production levels discussed above.

## *Metallurgical Coal Production and Sales*

In January 2011, we acquired a high quality, mid-volatility metallurgical coal reserve located in Greenbrier County, West Virginia through our wholly owned subsidiary, South Fork Coal Co., LLC (“South Fork”). We expect to receive permits for one and possibly two mines on a portion of the property referred to as Lost Flats by late in the third quarter of 2011, and another permit in the first quarter of 2012 on a portion of the property known as Blue Knob. We expect initial production to begin in the early part of the fourth quarter of 2011 initially at a rate of 10,000 to 20,000 tons per month, with production expected to increase to an annual rate of up to 1.0 million tons in 2012 and up to 1.2 million tons in 2013. Currently we do not have any metallurgical tons available for sale. However, based on indications of interest that we have received and current benchmark pricing (as adjusted for the specifications of our Blue Knob and Lost Flats product), we anticipate price realizations in excess of \$200 per ton at the mine. We expect our cash costs on the Greenbrier surface operations to be in the range of \$95.00 to \$100.00 per ton.

### **Trends in our business**

Near-term, the global economic slowdown has lowered demand for coal which has resulted in a decline in spot coal prices. The price of spot coal also has been impacted by a decrease in the price of competing fuel sources including natural gas. The coal industry has made cutbacks in supply in response to the decrease in demand for coal and has experienced additional declines due to a number of regulatory factors. Due to the uncertainties in the global market place, we are unable to forecast the price or demand for coal over the next few years. Long-term, we believe that the demand for coal worldwide will continue to be strong and that supply challenges will continue in the regions that we mine coal. We also believe that in the United States coal will continue to be one of the most economical energy sources. A number of factors beyond our control impact coal prices, including:

- the supply of domestic and foreign coal;
- the demand for electricity;
- the demand for steel and the continued financial viability of the domestic and foreign steel industries;
- the cost of transporting coal to the customer;
- domestic and foreign governmental regulations and taxes;
- world economic conditions;
- air emission standards for coal-fired power plants; and
- the price and availability of alternative fuels for electricity generation.

Our business is very sensitive to changes in supply and demand for coal and we carefully manage our mines to maximize operating results. As our current long term contracts are fulfilled, our profitability in the future will be impacted by the price levels that we achieve on future long term contracts. Events beyond our control could impact our profit margins.

## **Financial Overview**

The following tables present selected balance sheet, statement of operations and coal production and sales data as of March 31, 2011 and December 31, 2010 and for the three months ended March 31, 2011 and 2010.

| (\$ '000) | <b>As of<br/>March 31,<br/>2011</b> | <b>As of<br/>December 31,<br/>2010</b> |
|-----------|-------------------------------------|--|
|-----------|-------------------------------------|--|

### **Balance Sheet**

|                             |           |           |
|-----------------------------|-----------|-----------|
| Cash and cash equivalents   | \$ 17,192 | \$ 17,029 |
| Total current assets        | 41,334    | 47,442    |
| Total assets                | 162,156   | 153,234   |
| Total current liabilities   | 38,446    | 28,659    |
| Total long term liabilities | 81,084    | 75,449    |
| Shareholders' equity        | 42,626    | 49,126    |

| (\$ '000, except per share) | <b>For the three<br/>months ended<br/>March 31, 2011</b> | <b>For the three<br/>months ended<br/>March 31, 2010</b> |
|-----------------------------|--|--|
|-----------------------------|--|--|

### **Statement of Operations**

|   |          |          |
|---|----------|----------|
| Total coal revenues                     | \$43,051 | \$ 7,860 |
| Cost of coal sales                      | 35,067   | 7,616    |
| Gross margin                            | 7,983    | 244      |
| Loss before taxes                       | (12,845) | (6,797)  |
| Net loss                                | (10,251) | (5,072)  |
| Basic and diluted net<br>loss per share | (0.18)   | (0.09)   |

| <b>Statistics</b> | <b>For the three<br/>Months ended<br/>March 31, 2011</b> | <b>For the three<br/>Months ended<br/>March 31, 2010</b> |
|-------------------|--|--|
|-------------------|--|--|

|                         |         |         |
|-------------------------|---------|---------|
| Tons sold               | 553,485 | 115,876 |
| Tons produced           | 465,620 | 155,623 |
| Sale price/ton          | \$77.78 | \$67.83 |
| COGS/ton sold           | \$63.36 | \$65.72 |
| Gross margin/ton sold   | \$14.42 | \$ 2.11 |
| Cash costs/ton produced | \$61.18 | \$62.09 |

The following table presents selected coal production and sales data by region for the three months ended March 31, 2011 and March 31, 2010. Prior to April 2010, all of our production was in Kentucky.

| <b>For the three months ended March 31, 2011</b> |                 |                      |              |
|--|-----------------|----------------------|--------------|
|  | <b>Kentucky</b> | <b>West Virginia</b> | <b>Total</b> |
| Tons sold  | 346,276         | 207,209              | 553,485      |
| Tons produced                                    | 292,187         | 173,433              | 465,620      |
| Sale price/ton                                   | \$70.10         | \$90.61              | \$77.78      |
| COGS/ton sold                                    | \$63.05         | \$63.87              | \$63.36      |
| Gross margin/ton sold                            | \$ 7.05         | \$26.74              | \$14.42      |
| Cash costs/ton produced                          | \$60.29         | \$62.68              | \$61.18      |
| Total cash costs                                 | \$17,616,910    | \$10,870,770         | \$28,487,680 |

  

| <b>For the three months ended March 31, 2010</b> |                 |                      |              |
|--|-----------------|----------------------|--------------|
|  | <b>Kentucky</b> | <b>West Virginia</b> | <b>Total</b> |
| Tons sold  | 115,876         | N/A                  | 115,876      |
| Tons produced                                    | 155,623         | N/A                  | 155,623      |
| Sale price/ton                                   | \$67.83         | N/A                  | \$67.83      |
| COGS/ton sold                                    | \$65.72         | N/A                  | \$65.72      |
| Gross margin/ton sold                            | \$ 2.11         | N/A                  | \$ 2.11      |
| Cash costs/ton produced                          | \$62.09         | N/A                  | \$62.09      |
| Total cash costs                                 | \$9,662,193     | N/A                  | \$9,662,193  |

## Results of operations

The following table presents consolidated statement of operations data as a percentage of revenues for each of the years indicated:

|   | For the three months ended March 31, |        |
|---|--------------------------------------|--------|
|   | 2011                                 | 2010   |
|   | (In percentages)                     |        |
| Coal revenues .....   | 100.0                                | 100.0  |
| Cost of coal sales .....                                      | 81.5                                 | 96.9   |
| General and administrative expenses .....                     | 8.4                                  | 32.2   |
| Amortization of above market coal supply agreement .....      | 7.7                                  | —      |
| Depreciation, depletion and amortization .....                | 14.3                                 | 33.7   |
| Operating loss .....  | (11.9)                               | (62.7) |
| Other income (expense):                                       |                                      |        |
| Fair value movement on derivative financial instruments ..... | (12.3)                               | (25.3) |
| Finance income .....  | 0.0                                  | 2.0    |
| Finance cost .....  | (5.5)                                | (0.1)  |
| Other expense .....   | (0.1)                                | (0.3)  |
| Loss before income tax .....                                  | (17.9)                               | (23.7) |
| Income tax benefit .....                                      | 6.0                                  | 21.9   |
| Loss for the year .....                                       | (23.8)                               | (64.5) |

Our net loss for the first quarter of 2011 was \$10.3 million, as compared to a net loss of \$5.1 million for the first quarter of 2010. The net loss for the first quarter of 2011 increased significantly from the first quarter 2010 primarily due to an increase in the non-cash unrealized loss associated with IFRS guidelines that required the classification of outstanding share purchase warrants previously accounted for as equity to liability and an increase in finance cost associated with debt incurred with the Raven Crest acquisition in April 2010. Our gross margin from operations was \$8.0 million for the first quarter of 2011 as compared to \$0.2 million for the first quarter of 2010. The increase in gross margin is due to the lower operating costs at our Kentucky mines and the addition of our Raven Crest properties, which we acquired in April 2010. Operating loss for the first quarter 2011 increased to \$5.1 million from \$4.9 million in the first quarter of 2010; however, operating loss included non-cash depreciation, depletion and amortization expense of \$6.2 million for first quarter 2011 as compared to \$2.6 million for first quarter of 2010.

### Comparison of three months ended March 31, 2011 and 2010

*Revenues.* Our coal revenues increased to \$43.1 million for the first quarter 2011 from \$7.9 million for the first quarter 2010, an increase of \$35.3 million or 448% as compared to the prior period. The increase in revenues is the result of increased production and sales volumes at our Kentucky operations and the April 2010 acquisition of Raven Crest.

The following table shows comparative detail regarding coal sales volumes:

| Coal sales volumes:              | For the three months ended<br>March 31, |         |
|----------------------------------|---|---------|
|                                  | 2011                                    | 2010    |
|                                  | (In tons)                               |         |
| Coal sales .....                 | 553,485                                 | 115,876 |
| Sales by operation:              |   |         |
| Straight Creek (Kentucky) .....  | 346,276                                 | 115,876 |
| Raven Crest (West Virginia)..... | 207,209                                 | N/A     |

Coal sales volume for the first quarter 2011 was 0.6 million tons, a 378% increase from 0.1 million tons sold for the first quarter 2010. The increase in sales volume was primarily the result of the addition of the Raven Crest operations in West Virginia commencing in April 2010 and resuming coal shipments in June 2010 from our Kentucky operations to a major customer as scheduled under a supplemental contract that was executed in May 2010.

The following table shows comparative detail regarding sales prices per ton:

| Sales prices per ton by operation: | For the three months<br>ended March 31, |          |
|------------------------------------|---|----------|
|                                    | 2011                                    | 2010     |
| Straight Creek (Kentucky) .....    | \$ 70.10                                | \$ 67.83 |
| Raven Crest (West Virginia).....   | \$ 90.61                                | N/A      |
| Average sales price .....          | \$ 77.78                                | \$ 67.83 |

Our average sale price per ton was \$77.78 for the first quarter 2011 as compared to \$67.83 for the first quarter 2010. The 15% increase for the first quarter 2011 as compared to the first quarter 2010 was due to the addition of the Raven Crest operations in West Virginia commencing in April 2010 and resuming coal shipments in June 2010 from our Kentucky operations to a major customer as scheduled under a supplemental contract that was executed in May 2010.

*Cost of coal sales.* Cost of coal sales consists primarily of direct mining costs associated with the production and sale of coal including salaries and benefits, blasting, fuel, repairs and maintenance, processing and indirect mining costs including hauling costs, royalties and coal related taxes. The total cost of coal sales was \$35.1 million for the first quarter 2011 as compared to \$7.6 million for the first quarter 2010, an increase of \$27.5 million, or 362%, which was attributable to the Raven Crest acquisition in April 2010. Per ton cost of sales, however, decreased for the first quarter 2011 to \$63.36 as compared to \$65.72 for the first quarter 2010, resulting in an increase in gross margin from operations for the first quarter of 2011 as compared to the first quarter of 2010 due to reductions in most mining related costs resulting from changes in mine plans at the Kentucky operations in 2011 as compared to same period in 2010. Our cash cost per ton produced, which we calculate as cost of sales plus or minus change in inventory and third party purchases, divided by tons produced, decreased by \$0.91 for the first quarter 2011 as compared to the first quarter of 2010.

The following table shows comparative costs of sales data:

| Costs of coal sales data:     | For the three months ended March 31, |              |
|-------------------------------|--------------------------------------|--------------|
|                               | 2011                                 | 2010         |
| Sale price/ton .....          | \$ 77.78                             | \$ 67.49     |
| COGS/ton sold.....            | \$ 63.36                             | \$ 65.72     |
| Gross margin/ton sold.....    | \$ 14.42                             | \$ 1.77      |
| Cash costs/ton produced ..... | \$ 61.18                             | \$ 62.09     |
| Total cash costs.....         | \$28,487,680                         | \$ 9,662,193 |

We attribute our lower per ton cost of sales and cash costs to the purchase of essential surface mining equipment, resulting in increased utilization, the termination of all of our third party mining contractor agreements effective September 30, 2009, and our continuing efforts to increase operating efficiencies with emphasis on safety and productivity throughout our operations. Our surface mine plans allow us to utilize larger volumes of overburden removal minimizing the handling of material through the use of cast blasting and dozer push as compared to hauling. The Company also does not have any valley fills which allow us to maintain all overburden removal on previously mined areas versus hauling material into valley fills. We also have been successful in managing some of our expenses that are more prone to price volatility, such as fuel, by entering into purchasing agreements at fixed prices over several quarters.

*General and administrative expenses.* Our general and administrative expenses were \$3.6 million for the first quarter 2011 compared to \$2.5 million for the first quarter 2010. This increase of \$1.1 million, or 43%, is primarily the result of an increase in the executive and operating management teams, support staff, and professional fees associated with the Raven Crest acquisition, as well as an increase in other expenses due to the substantial growth in our operations in 2010 and 2011.

*Amortization of above market coal supply agreement.* Amortization of above market coal supply agreement for the first quarter 2011 was \$3.3 million which was the result of the purchase of an above market coal supply agreement associated with the Raven Crest operations acquired in April 2010. This contract amortization will continue until the expiration of the coal supply agreement in December 2011.

*Depreciation, depletion and amortization.* Depreciation, depletion, and amortization expenses for the first quarter 2011 were \$6.2 million as compared to \$2.6 million for the first quarter of 2010, an increase of \$3.6 million, or 133%. This increase was primarily driven by the increase in property, plant and equipment including mineral rights, mine development costs throughout 2010 and first quarter of 2011.

*Change in fair value on derivative financial instrument.* Our loss on the fair value movement on derivative financial instrument for the first quarter 2011 was \$5.3 million as compared to \$2.0 million for the first quarter 2010, an increase of 165%. This increase was due to the change in the fair value of our share purchase warrants required as a result of converting our financial statements to satisfy IFRS reporting requirements versus previous reporting requirements as outlined by Canadian Generally Accepted Accounting Principal guidelines.

*Finance income (expense).* Finance expense was \$2.3 million for the first quarter 2011, which was due to the increase in overall indebtedness from the Raven Crest acquisition completed in April 2010 and increases in various equipment related debt.

*Income taxes.* Our income tax benefit for the first quarter 2011 was \$2.6 million compared to \$1.7 million for the first quarter 2010, this increase in benefit was due to the increase in operating loss excluding the loss on the fair value movement on derivative financial instruments.

## **Liquidity and capital resources**

*General.* Our primary uses of cash have been coal production and other operating expenses, capital expenditures, debt service and the funding and performance of reclamation obligations. Our primary sources of liquidity have been revenues generated from sales of our produced coal, cash on hand, and proceeds from the sale of debt and equity securities.

In May 2011, we issued \$200.0 million in senior secured notes at 9.25%, due May 15, 2019. Interest payments are required semi-annually beginning November 2011. We may redeem the notes, in whole or in part, at any time on or after May 15, 2015 at redemption prices ranging from 104.625% beginning May 15, 2015 to 100% beginning on May 15, 2018. We used the net proceeds from the offering to repay our existing 9.75% senior secured notes due 2015, including prepayment penalties of 10% of the principal amount being repaid. The remaining funds will be used for the construction of a preparation plant, the purchase of underground mining equipment along with support equipment as well as necessary infrastructure development at the recently acquired Brier Creek underground mining property in West Virginia, the construction of a rail siding and loading facility and surface mining equipment at the recently acquired Greenbrier County, West Virginia metallurgical property and for general corporate purposes.

As a regular part of our business model, we review opportunities for the acquisition of coal mining properties, coal reserves and other assets that we believe will create stakeholder value. When we find opportunities that are consistent with our growth plans and acquisition criteria, we enter into discussions and negotiations, and at times make bids or proposals and enter into letters of intent or other similar agreements. The discussions, negotiations, bids, proposals, and agreements are customarily subject to conditions that allow us to terminate them if, among other things, we are not satisfied with our due diligence investigations. Any acquisition opportunities we pursue could materially affect our liquidity and capital resources and may require us to incur indebtedness, seek equity capital or both.

We believe that our existing cash flow from operations and the net proceeds from the recent debt offering will be sufficient to fund ongoing working capital requirements and provide the capital necessary to fund development and operations at our recently acquired metallurgical coal property in West Virginia. We expect that 2011 coal production and coal inventory from existing thermal operations in Kentucky and West Virginia will be sufficient to meet customer requirements for 2011.

We manage our exposure to changing commodity prices for our non-trading, long-term coal contract portfolio through the use of long-term coal supply agreements. We enter into fixed price, fixed volume supply contracts with terms greater than one year with customers with whom we have historically had limited collection issues. Our ability to satisfy debt service obligations, to fund planned capital expenditures, and to make acquisitions will depend on our future operating performance, which will be affected by prevailing economic conditions in the coal industry and financial, business and other factors, some of which are beyond our control. We also enter into term commitments for diesel fuel to reduce the effects of volatility in prices and to allow us to fix a portion of one of the company's major mining related costs.

We had operating cash of \$17.2 million at March 31, 2011 as compared to \$17.0 million at December 31, 2010.

*Operating activities.* Cash provided by operating activities for the first quarter 2011 generated \$11.5 million, compared to cash used in operating activities of \$0.8 million for the first quarter 2010. This increase in cash provided by operating activities was mainly due to an increase in depreciation, depletion and amortization expense resulting from significant equipment acquisitions since March 31, 2010, reduction in coal inventories since December 31, 2010 and an increase in the loss in fair value of the financial liability of share based warrants as a result of IFRS guidelines.

As of March 31, 2011, we had \$5.3 million of inventory as compared to \$9.7 million in inventory as of December 31, 2010. This reduction was directly related to the company's decision to reduce our inventory and handling costs associated with larger inventory volumes in Kentucky. Also at March 31, 2011 we had \$8.1 million of trade accounts receivable as compared to \$6.0 million as of December 31, 2010 which resulted in increased sales volume as the Company continues to grow.

*Investing activities.* Cash used in investing activities for the first quarter 2011 increased to \$13.1 million from \$4.2 million for the first quarter 2010. This was directly related to the increase in the purchase of property, plant, and equipment.

*Financing activities.* Cash provided by financing activities decreased to \$1.8 million for the first quarter of 2011 from \$3.3 million for the first quarter of 2010. This decrease can be attributed to debt payments made on equipment and vehicle notes offset by proceeds received from the issuance of notes payable and proceeds from the exercise of stock options and warrants.

*Capital expenditures.* Capital expenditures for the first quarter 2011 were \$9.7 million as compared to \$3.6 million for the first quarter 2010. Our capital expenditures for the first quarter 2011 were for mining production equipment, including a high wall miner, haul trucks, dozers, loaders and drills.

We expect to invest approximately \$40.0 million to develop our recently acquired metallurgical mining property in West Virginia, including approximately \$8.0 million for the construction of a rail siding and coal loading facility, \$1.0 to \$2.0 million for the refurbishing of approximately seven miles of rail line and up to \$30.0 million for the purchase of two spreads of surface mining equipment including production equipment similar to Caterpillar 992 type loaders, Caterpillar 777 type haul trucks, Caterpillar D-11 type dozers and various support equipment. We also expect to invest approximately \$40.0 million to develop our recently acquired Brier Creek thermal coal reserve including \$20.0 to \$25.0 million for the construction of a new preparation plant to enlarge the existing rail loading facility at Raven Crest and up to \$20.0 million to purchase underground mining equipment.

### **EBITDA and Adjusted EBITDA**

EBITDA is defined as net income (loss) plus (i) interest expense and (ii) depreciation, depletion, accretion and amortization, minus (iii) interest income (iv) future income tax benefit (expense) (v) fair value movement on derivative financial liability – warrants and (vi) stock-based compensation expense. We define Adjusted EBITDA as EBITDA plus or minus non-recurring gains or losses.

EBITDA and Adjusted EBITDA are not required by, or presented in accordance with, IFRS. EBITDA and Adjusted EBITDA are not measurements of our financial performance or financial position under IFRS and should not be considered as alternatives to total revenues, net income (loss) or any other performance measures derived in accordance with IFRS or as alternatives to cash flow from operating activities as measures of our liquidity. We present EBITDA and Adjusted EBITDA because we consider them important supplemental measures of our performance and believe EBITDA and Adjusted EBITDA are frequently used by securities analysts, investors and other interested parties in the evaluation of high yield issuers, many of which present EBITDA and Adjusted EBITDA when reporting their operating results.

Management uses EBITDA and Adjusted EBITDA as internal measures of operating performance, to establish operational goals, to allocate resources and to analyze business trends and financial performance. EBITDA and Adjusted EBITDA have limitations as analytical tools, and you should not consider them in isolation or as substitutes for analysis of our results as reported under IFRS.

**EBITDA**

|   | <b>For the three months<br/>ended<br/>March 31, 2011</b> | <b>For the three months<br/>ended<br/>March 31, 2010</b> |
|---|--|--|
| Net loss  | \$(10,251,325)   | \$(5,072,324)  |
| Finance cost  | \$ 2,362,989   | \$ 10,416  |
| Depreciation, depletion,<br>amortization and accretion              | \$ 6,158,644   | \$ 2,597,835   |
| Amortization of above market coal<br>supply agreement               | \$ 3,333,689   | \$ –   |
| Income tax (benefit) expense  | \$ (2,593,831)   | \$ (1,725,126)   |
| Finance income  | \$ (13,989)  | \$ (153,919)   |
| Fair value movement on derivative<br>financial liability – warrants | \$ 5,303,289   | \$ 1,989,223   |
| Stock based compensation  | \$ 358,997   | \$ 933,496   |
| <i>EBITDA</i>   | <u>\$ 4,658,463</u>                                      | <u>\$ (1,420,399)</u>                                    |

The Company is exposed to credit risk, liquidity risk and market risk associated with its financial instruments.

**Summary of Quarterly Results**

| <b>As reported under IFRS</b>      |             |           |           |           |          |  |
|------------------------------------|-------------|-----------|-----------|-----------|----------|--|
| <b>2011</b>                        | <b>2010</b> |           |           |           |          |  |
| <b>Q1</b>                          | <b>Q4</b>   | <b>Q3</b> | <b>Q2</b> | <b>Q1</b> |          |  |
| Tons Produced                      | 466         | 419       | 423       | 338       | 152      |  |
| Tons Sold                          | 553         | 436       | 434       | 292       | 116      |  |
| Sales price/ton                    | \$77.78     | \$87.28   | \$86.86   | \$86.20   | \$67.49  |  |
| COGS/ton                           | \$63.36     | \$57.78   | \$54.06   | \$63.61   | \$65.72  |  |
| Cash costs/ton produced            | \$61.18     | \$55.23   | \$51.32   | \$49.64   | \$62.09  |  |
| Revenue                            | \$43.05     | \$38.08   | \$37.72   | \$25.18   | \$7.86   |  |
| Net Income (loss)                  | (\$10.25)   | (\$2.52)  | \$1.67    | \$3.85    | (\$5.07) |  |
| Basic net income (loss) share      | (\$0.18)    | (\$0.05)  | \$0.03    | \$0.07    | (\$0.09) |  |
| Diluted net income (loss)<br>share | (\$0.18)    | (\$0.05)  | \$0.03    | \$0.07    | (\$0.09) |  |

| <b>As reported, under Canadian GAAP</b> |           |           |
|---|-----------|-----------|
| <b>2009</b>                             |           |           |
| <b>Q4</b>                               | <b>Q3</b> | <b>Q2</b> |

|                                 |          |          |          |
|---------------------------------|----------|----------|----------|
| Tons Produced                   | 118      | 168      | 148      |
| Tons Sold                       | 112      | 185      | 148      |
| Sales price/ton                 | \$78.18  | \$78.38  | \$86.39  |
| COGS/ton                        | \$62.43  | \$64.89  | \$85.50  |
| Cash costs/ton produced         | \$63.67  | \$66.02  | \$81.19  |
| Revenue                         | \$8.80   | \$14.50  | \$12.90  |
| Net Income (loss)               | (\$6.10) | (\$1.80) | (\$5.50) |
| Basic net income (loss) share   | (\$0.17) | (\$0.06) | (\$0.17) |
| Diluted net income (loss) share | (\$0.17) | (\$0.06) | (\$0.17) |

#### **Outstanding Share Data**

The Company has authorized an unlimited number of voting shares at no par value. As of March 31, 2011, the Company has issued and fully paid 38,010,356 voting shares and as of December 31, 2010 there were 37,125,825 voting shares outstanding.

The holders of ordinary shares are entitled to one vote per share at meetings of the Company. All shares are ranked equally with regards to the Company's residual assets.

The Company has an authorized an unlimited number of non-voting shares at no par value and has 19,467,541 non-voting shares outstanding at March 31, 2011 with an allocated share capital amount of \$4,500,015. All remaining share capital transaction amount affect voting shares.

|   | <b>Number of<br/>Shares Voting<br/>and Non-Voting</b> | <b>Share Capital<br/>Amount</b> |
|---|---|---------------------------------|
| Balance at January 1, 2010              | 53,752,070  | \$ 61,747,806                   |
| Issuances for services                  | 573,145   | 1,481,044                       |
| Issuance of shares exercise of options  | 1,975,925   | 2,002,569                       |
| Issuance of shares exercise of warrants | 292,226   | 397,320                         |
| Balance at December 31, 2010            | <u>56,593,366</u>                                     | <u>\$ 65,628,739</u>            |
| Issuance of shares exercise of warrants | 768,964   | 3,284,348                       |
| Issuance of shares exercise of options  | 115,567   | 167,875                         |
| Balance at March 31, 2011               | <u>57,477,897</u>                                     | <u>\$ 69,080,962</u>            |

#### **Share Purchase Warrants**

As at March 31, 2011, the Company had outstanding Warrants to purchase 9,884,314 common shares of the Company at a price of Cdn\$4.20 per share until December 10, 2011, and Warrants to purchase 3,000,000 common shares at a price of Cdn\$4.20 per share until December 31, 2012. In order to determine the valuation of its common stock purchase warrants, the Company used the Black-Scholes pricing model.

|                                     | <b>Number of<br/>Warrants</b> | <b>Exercise<br/>Price</b> | <b>Expiry Date</b> |
|-------------------------------------|-------------------------------|---------------------------|--------------------|
| Balance at January 1, 2010          | 12,629,203                    |                           |                    |
| Exercised during first quarter 2010 | (1,975,925)                   | \$0.96                    |                    |
| Issued for Marret note payable      | <u>3,000,000</u>              | Cdn\$4.20                 | December 2012      |
| Balance at December 31, 2010        | <u>13,653,278</u>             |                           |                    |
| Exercised during first quarter 2011 | <u>(768,964)</u>              | Cdn\$4.20                 | December 2012      |
| Balance at March 31, 2011           | <u>12,884,314</u>             |                           |                    |

### **Credit risk**

Credit risk arises from the potential that a customer or counterparty will fail to perform its obligations. Our exposure to credit risk exists primarily related to our trade accounts receivable. While economic factors can affect credit risk, we manage risk by providing credit terms on a case by case basis. Our customers are primarily investment grade companies and quasi-governmental agencies. We previously made periodic advances to certain contract miners; however, this practice has since been terminated. During 2009, we ceased operations with certain contract miners with whom we had advanced monies and recognized credit losses of \$2.6 million. Our cash and certificates of deposit are on deposit with quality financial institutions and such deposits are subject to insurance by the Federal Deposit Insurance Corporation, an independent agency of the United States of America, and the Canada Deposit Insurance Corporation, a federal Crown corporation created by Canadian Parliament. Our maximum credit risk exposure at March 31, 2011 is approximately \$33.8 million and is equal to the carrying amount of all cash, restricted cash and trade accounts receivable as listed on the accompanying consolidated balance sheet.

### **Market risk**

Market risk includes interest rate risk and pricing risk. Our interest rate risk primarily relates to our interest bearing debt. As our debt has fixed interest rates, we have minimized our exposure to cash flow interest rate risk.

Our price risk primarily relates to significant fluctuations in coal sales prices which is caused by many factors outside of our control. We minimize our price risk by entering into long-term sales contracts with customers which fix the price of coal sold.

### **Liquidity risk**

Liquidity risk is the risk that we will have difficulty meeting our obligations associated with financial liabilities. To manage this risk, we ensure, to the extent possible, that we will have sufficient liquidity to meet our obligations when due by continually monitoring our cash balances and our cash flow projections.

We have sustained losses since operations commenced in 2008 and have financed these losses mainly through a combination of equity and debt offerings. As a result of the RTO and equity issuance in December 2009, we have significantly increased our cash balances, reduced our outstanding debt and increased our shareholders' equity. Subsequently in 2010 we incurred debt to finance a business acquisition. Management believes that we have sufficient resources to meet all of our obligations in 2011.

### **Foreign currency**

All of our transactions are denominated in U.S. dollars, and as a result, we do not have material exposure to currency exchange rate risk.

## Contractual obligations

| Description                           | 2011                | 2012-2013          | Thereafter          | Total               |
|---------------------------------------|---------------------|--------------------|---------------------|---------------------|
| Accounts payable and accrued expenses | \$ 13,932,109       | \$ –               | \$ –                | \$13,932,109        |
| Accrued interest payable              | 2,824,161           | –                  | –                   | 2,824,161           |
| Notes payable                         | 8,738,480           | 7,062,494          | 63,379,664          | 79,180,638          |
| Leases                                | 101,723             | 126,371            | –                   | 228,094             |
|                                       | <u>\$25,596,473</u> | <u>\$7,188,865</u> | <u>\$63,379,664</u> | <u>\$96,165,022</u> |

## Customer concentration

Our three largest customers individually accounted for approximately 42%, 16% and 14% of our revenues during the first quarter 2011, and approximately 55%, 35% and 10% of our revenues for the first quarter 2010.

Trade accounts receivable consists primarily of contractual receivables from coal sales to our customers, which are nationally recognized public utilities and industrial companies, as is typical in the industry. Two customers accounted for approximately 42% and 16% of trade accounts receivable as of March 31, 2011. Two customers accounted for approximately 49% and 15% of trade accounts receivable as of December 31, 2010. It is our policy not to require collateral on trade accounts receivable. Accounts are charged to bad debt expense as they are determined to be uncollectible based upon a review of aging and collections. Credit losses from coal sales, when realized, have been in the range of our expectations and, historically, have not been significant.

## Debt obligations

The following table summarizes our long-term debt obligations, excluding capital leases, as of the dates indicated:

|   | As of March<br>31, 2011 | As of December<br>31, 2010 |
|---|-------------------------|----------------------------|
| 9.75% senior secured notes due 2015, net of unamortized discount of \$2,884,624 ..... | \$ 62,247,857           | \$ 67,115,376              |
| Equipment and vehicle notes payable.....  | 16,668,060              | 13,218,501                 |
| Total notes payable, net of unamortized discount.....                                 | 78,915,917              | 80,333,877                 |
| Less current portion of notes payable .....   | 8,738,480               | 12,736,702                 |
| Long-term portion of notes payable, net of unamortized discount .....                 | <u>\$ 70,177,437</u>    | <u>\$ 67,597,175</u>       |

### 9.75% senior secured notes due 2015

During April 2010, we issued \$75.0 million in principal amount of our 9.75% senior secured notes due 2015 to Marret Asset Management, Inc., or Marret, primarily to fund the Raven Crest acquisition. We received \$72.8 million in net proceeds from the issuance of these notes. The 9.75% senior secured notes are collateralized by substantially all of our assets, including a pledge of 100% of the capital stock or other equity interests of our subsidiaries, and bear interest at an annual rate of 9.75%, payable in semi-annual payments of \$3.7 million (\$1.3 million accrued as at December 31, 2010). We have certain early redemption options, in whole or in part, which would result in the payment of premiums on such indebtedness ranging from 110% to 102% of the principal amount of the notes, based on the dates of the early redemption. If a change in control occurs, we will be required to offer to redeem the outstanding notes for a redemption price equal to 109.75% of the outstanding principal balance of the notes. In November 2010, in order to secure a required consent of the note holders to acquire the Elk Horn membership units, we agreed to redeem \$10 million in principal amount of the notes in four separate monthly redemptions of \$2.5 million each beginning in November 2010 at a redemption price of 110% of the face amount of the notes. The full \$10 million in principal amount of the notes was redeemed by February 2011, resulting in early redemption penalties totaling \$1.0 million.

In connection with the issuance of the 9.75% senior secured notes, we issued 3,000,000 common share purchase warrants to the note holders with an exercise price of Cdn\$4.20 and term expiring in December 2012. The value of these common share purchase warrants was estimated at the date of issuance to be \$1.0 million and was recorded as a discount to the notes payable. Additionally, we paid \$2.9 million of fees in connection with the financing, which have been capitalized as deferred financing costs.

These senior secured notes were scheduled to mature in April 2015. However, we paid redeemed 100% of these notes in May 2011 as discussed below.

***\$200 million Senior secured notes due 2019***

In May 2011 we issued \$200.0 million aggregate principal amount of 9.25% senior secured notes due May 15, 2019. Interest payments are required semi-annually. We may redeem the senior notes due 2019, in whole or in part, at any time on or after May 15, 2015 at redemption prices ranging from 104.625% beginning May 15, 2015 to 100% beginning on May 15, 2018. We used the net proceeds from the offering to repay our existing 9.75% senior secured notes due 2015 discussed above, including prepayment penalties of 10% of the principal amount being repaid.

***Equipment and vehicle notes payable***

We have numerous equipment and vehicle notes totaling \$16.1 million and \$13.2 million as of March 31, 2011 and December 31, 2010, respectively. These notes bear interest at fixed rates ranging from 4.16% to 9.60% and are due in various monthly payments through April 2014. All of these notes are collateralized by the related equipment and vehicle purchased. One note with an outstanding balance of \$0.9 million at March 31, 2011 was personally guaranteed by one of our officers and was paid off in May 2011.

In connection with two of our equipment notes payable, we are required to maintain restricted cash of \$0.6 million as additional collateral. Of that amount, \$0.4 million was released upon the repayment of the applicable note in May 2011. Additionally, in connection with one of our equipment notes we placed a \$0.3 million security deposit with the lender.

*Scheduled maturities of notes payable.*

Aggregate annual future maturities of notes payable as of March 31, 2011 are as follows:

|   |                     |
|---|---------------------|
| 2012.....                                 | \$8,738,480         |
| 2013.....                                 | 4,487,741           |
| 2014.....                                 | 2,574,753           |
| 2015.....                                 | <u>65,867,086</u>   |
| Total .....                               | 81,668,060          |
| Less unamortized discount.....            | <u>2,752,143</u>    |
| Total notes payable, net of discount..... | <u>\$78,915,917</u> |

*Derivatives.*

We have not entered into any derivative hedging actives since our incorporation.

*Off Balance Sheet Arrangements.*

The Company has no off balance sheet arrangements.

*Related Party Transactions.*

The Company has no related party transactions.

## Critical accounting estimates

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in conformity with IFRS requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to computing depreciation, depletion, amortization, accretion, reclamation liability, asset impairment, valuation of non-cash transactions, and recovery of receivables. Estimates are then based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Our use of estimates, however, is limited, as we have adequate time to process and record actual results from operations.

We believe our most critical accounting policies include revenue recognition, the corresponding accounts receivable and the methods of estimating depletion and reclamation expense of actual mining operations in relation to estimated total mineable tonnage on our properties. We believe the following accounting policies affect our more significant judgments and estimates used in preparation of our consolidated financial statements.

*Revenue recognition.* We recognize revenue when all of the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the seller's price to the buyer is fixed or determinable, and (4) collectability is reasonably assured. In the case of coal we mine and sell, we negotiate a specific sales contract with each customer, which includes a fixed price per ton, a delivery schedule, and terms for payment. We recognize revenue from sales made pursuant to these contracts at the time of possession of our coal legally transfers from us to our customer which generally occurs at the time of shipment.

*Accounts receivable.* Accounts receivable balances are evaluated on a continual basis and allowances, if any, are provided for potentially uncollectible accounts based on management's estimate of the collectability of customer accounts. If the financial condition of a customer were to deteriorate, resulting in an impairment of our ability to make payments, an additional allowance may be required. Allowance adjustments, if any, are charged to operations in the period in which the facts that give rise to the adjustments become known. It is our policy not to require collateral on trade accounts receivable. Credit losses, when realized, have been in the range of our expectations and, historically, have not been significant.

*Asset retirement obligations.* Our asset retirement obligation, or ARO, liabilities primarily consist of estimated costs related to reclaiming surface land and support facilities at our mines in accordance with federal and state reclamation laws as defined by each mining permit.

We estimate the fair value of our ARO liabilities for final reclamation and mine closure based upon detailed engineering calculations of the amount and timing of future costs for third-party's to perform the required work. Cost estimates are escalated for inflation, and then discounted at the risk-free rate, which approximated 4% at March 31, 2011. Total estimated undiscounted future costs related to the ARO liabilities totaled approximately \$12.1 million as of March 31, 2011, with costs expected to be paid from 2011 to 2019. We record a capital asset retirement cost associated with the initial recorded liability. The capital asset retirement cost is amortized based on the units of production method over the estimated recoverable, proven and probable reserves at the related mine, and the ARO liability is accreted to the projected settlement date. Changes in estimates could occur in the near term due to revisions of mine plans, changes in estimated costs, and changes in timing of the performance of reclamation activities.

As of March 31, 2011 and December 31, 2010, we had restricted certificates of deposit in the amount of \$8.4 million and \$7.7 million, respectively, which are required by surety agencies as collateral in order to issue necessary reclamation bonds as required by authoritative agencies for various permitting to allow mining and to ensure the completion of future reclamation.

*Stock-based compensation.* We use the fair value method of accounting for stock options and warrants granted. The fair value of stock options and warrants is determined using the Black-Scholes option pricing model with assumptions for risk-free interest rates, volatility factors of the expected market price of our common shares and an expected life of the options and warrants. The fair value of the instruments granted is amortized over the vesting period.

Contribution expense attributable to stock options granted is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to stock options, a component of shareholders' equity. Upon exercise of the stock options, consideration received together with the amount previously recognized is recorded as an increase to share capital.

When warrants or stock options expire, or stock options are forfeited, the amount is transferred to contribute surplus. We have not incorporated an estimated forfeiture rate of stock options that will not vest; rather, we account for actual forfeitures as they occur.

*Reserves.* We amortize our mineral rights, mine development costs, and capitalized asset retirement costs using the units-of-production method and estimates of proven and probable reserves. We review these estimates on a regular basis and adjust them to reflect our current mining plans. The rate at which we record depletion also depends on the estimates of our reserves. If the estimates of proven and probable reserves decline, the rate at which we record depletion increases. Such a decline in reserves may result from geological conditions, coal quality, effects of governmental, environmental and tax regulations, and assumptions about future prices and future operating costs.

*Internal controls and procedures.* Management has designed or caused to be designed under management's supervision, disclosure controls and procedures that provide reasonable assurance that (i) material information relating to us is made known to management by others, particularly during the period in which the annual and interim filings are being prepared; and (ii) information required to be disclosed by us in our annual filings or other reports filed or submitted by us under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation.

Management is also responsible to ensure that internal controls over financial reporting are designed, or caused to be designed under management's supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in conformity with IFRS. We continue to work with an independent accounting firm to determine if any material weaknesses exist in our current internal controls, suggest best practices when they are not being applied and also to test the material controls. No material weaknesses were found and as a result, no significant changes in internal controls over financial reporting were made during 2010 that have materially affected, or are reasonably likely to materially affect, management's internal control over financial reporting.

It should be noted that while our Officers, as certified in our interim filings and as required under National Instrument 52-109 issued by the Canadian Securities Administrators, have evaluated the effectiveness of these disclosure controls and procedures and internal controls over financial reporting for the year ended December 31, 2010 and have concluded that they are effective, they do not expect that the disclosure controls and procedures or internal controls over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can only provide reasonable, not absolute, assurance that the objectives of the control system are met.

**Risk Factors**

Please refer to the Annual Information Form for the year ended December 31, 2010 for a discussion of our risk factors which is available on SEDAR at [www.sedar.com](http://www.sedar.com).

**Additional Information**

Additional information regarding the Company and its business operations, including the Company's Annual Information Form, that was filed on March 31, 2010 for the year ended December 31, 2009 and the Annual Information Form for the year ended December 31, 2010 are and will be available on the Company's SEDAR company profile at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.xinergycorp.com](http://www.xinergycorp.com).