



XINERGY Ltd.

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

FOR THE PERIOD ENDED MARCH 31, 2010

May 17, 2010

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This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the unaudited interim consolidated financial statements and notes thereto for the period ended March 31, 2010, and audited consolidated financial statements and notes thereto of Xinergy Ltd. (the "Company" or "Xinergy") for the year ended December 31, 2009. In this MD&A, "Xinergy", "the Company," "we," "us," or "our" refers to Xinergy Ltd. and its subsidiaries and where the context requires, in respect to transactions prior to the Reverse Takeover ("RTO"). The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. 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 are to United States dollars unless otherwise indicated.

This MD&A was prepared using information that is current as of May 17, 2010.

In the interest of providing our shareholders and potential investors with information regarding Xinergy, including management's assessment of our future plans and operations, 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.

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 will 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 and other documents we file with the Canadian securities regulatory authorities.

There is no representation by us that actual results achieved during the forecast period will be the same in whole or in part as those forecast 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 Management's Discussion and Analysis should refer to the section entitled "Risk Factors" in our Annual Information Form for factors which could potentially impact the Company's financial performance and its ability to meet its targets.

Financial Overview

	As at March 31	As at December 31
	2010	2009
<u>Balance Sheet</u>		
Cash	\$8,584,572	\$10,192,766
Total current assets	13,807,091	13,263,615
Total assets	66,363,164	63,257,701
Total current liabilities	7,720,236	5,734,404
Total long-term liabilities	8,474,884	7,218,743
Shareholders' equity	50,168,044	50,304,554

	Three months ended	
	March 31	
	2010	2009
<u>Statement of Operations</u>		
Total revenues	\$7,860,061	\$23,247,857
Cost of coal sales	7,615,643	14,883,043
Income (loss) from operations	(4,078,087)	4,865,672
Net income (loss)	(3,110,296)	1,929,607
Basic and diluted net income (loss) per share	(0.06)	0.06

	Three months ended	
	March 31	
	2010	2009

Statistics

Coal produced (tons)	155,623	236,222
Coal sold (tons)	115,876	221,444
Coal sales	\$7,819,938	\$23,159,322
Average sales price per ton	\$67.49	\$104.58
Average cost of sales per ton	\$65.72	\$67.21

Revenue

First quarter 2010 revenue was \$7.9 million on sales of 115,876 tons at an average sales price of \$67.49 as compared to revenues of \$23.2 million on sales of 221,444 tons at an average sales price of \$104.58 for the same period of 2009. Sales volumes and revenues were down in the first quarter to the comparable quarter because the Company did not ship coal to a major customer as a result of issues under our coal supply agreement. In addition, another customer issued force majeure notices on approximately 40,000 tons due to unusually poor weather during the period.

On May 10, 2010, the Company executed a Contract Supplement with the customer that amended our coal supply agreement referred to above. The terms of the amended agreement require the Company to resume shipping in June 2010 on schedules that includes 33,000 to 44,000 tons per month until the balance of the 816,000 tons is shipped. Overall, at March 31, 2010, the Company has 1.04 million tons remaining under all contracts for delivery in 2010 at an average sales price of \$90.66.

Cost of Sales

First quarter cost of sales was \$7.6 million, or \$65.72 per ton, compared to \$14.9 million, or \$67.21 per ton in the same period last year. This overall decrease to the comparable quarter in 2009 is primarily the result of issues with a coal supply agreement as previously discussed and the Company's reduced production schedules as a result of lower sales. The reduction in unit cost during the first quarter is partially the result of converting the Company's mines from contractor operated to company operated and a reduction in labor related costs due to the reduced production schedules hindered by unusually poor weather in Eastern Kentucky during the first quarter.

General and Administrative Expenses

General and administrative expenses were \$1.6 million during the quarter, up from \$1.0 million in the comparable period primarily the result of increasing the executive management team, additional support staff, professional fees and other expenses directly resulting from the public equity offering in December 2009 and associated efforts to grow the Company, organically and through acquisitions.

Depreciation, Depletion and Amortization

Depreciation, depletion and amortization expenses were \$2.7 million during the quarter, up from \$2.5 million in the comparable period mainly due to an increase in depreciation expense resulting from the acquisition of mining equipment that was previously being leased.

Other Income (Expense)

Other income and expenses decreased to \$748,000 from \$1.9 million in the comparable period primarily due to a reduction in interest expense of \$2.5 million offset by an increase in stock based compensation of \$775,000 and interest income of \$96,000. The majority of Company debt was paid off in December 2009 and the increase in stock based compensation was the result of stock options and restricted stock awarded to new employees.

Liquidity and Capital Resources

At March 31, 2010, the Company had cash and cash equivalents of \$8.6 million compared to \$10.2 million at December 31, 2009. This decrease is primarily due to a cash deposit made in the first quarter of \$1.25 million towards the purchase of Raven Crest, which the Company subsequently closed on April 28, 2010. Operating activities during the first quarter used \$756,000 in cash compared to cash provided by operations of \$3.0 million in the same period last year. The primary differences were a non-cash

change in future income tax benefits, a reduction in accounts receivable and increases in coal inventories. The change in accounts receivable and coal inventories is directly related to lower coal sales in the first quarter 2010 as compared to the same period last year.

Investing activities led to a cash decrease of \$4.2 million in the first quarter, compared to cash provided by investing activities of \$410,000 in the comparable period. Capital expenditures were \$3.6 million in the first quarter primarily consisting of the acquisition of equipment that was previously being leased. Cash provided by financing activities during the first quarter resulted in a cash increase of \$3.3 million as compared to a decrease in cash of \$2.0 million in the same period last year. The primary increases were from the receipt of \$2.1 million from the exercise of options and warrants and \$2.5 million from proceeds from financing capital expenditures.

The Company believes that existing cash flow from current operations, including the assumption that shipments to a significant customer will resume in June 2010, will be sufficient to fund ongoing working capital requirements.

The Company is maintaining a focus on cost reduction initiatives and productivity improvements and in conjunction with those efforts has entered into purchase commitments in April and May 2010 for approximately \$3.0 million of new surface mining equipment with deliveries scheduled in the second quarter 2010. Financing from equipment lenders has been committed to fund acquisitions.

Financial Instruments and Financial Risk Factors

All financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on how the financial instrument has been classified upon its inception. Financial instruments are classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. Held-for-trading financial instruments are measured at fair value with changes in those fair values recognized in net income (loss). Available-for-sale financial instruments are measured at fair value, with changes in those fair values recognized in other comprehensive income (loss). Financial assets held-to-maturity, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method. Transaction costs for financial instruments, other than held-for-trading, are included in the value of the financial instrument. Income and expense related to financial instruments is included in the consolidated statement of operations as interest income or interest expense.

The Company's financial instruments include cash, restricted cash and certificates of deposit, trade accounts receivable, advances to contract miners, accounts payable and accrued expenses, and notes payable.

The estimated fair value of financial instruments has been determined by the Company using available market information. The carrying value of the Company's cash, restricted cash and certificates of deposit, trade accounts receivable, advances to contract miners and accounts payable and accrued expenses and approximates their fair value due to the short-term nature of these items or the terms of the financial instruments. The estimated fair value of the Company's notes payable also approximate their carrying values because the effective interest rates are not significantly different from current market rates.

The Company's financial instruments have been classified as follow:

<u>Financial Instrument</u>	<u>Classification</u>
Cash	Held-for-trading
Restricted cash and certificates of deposit	Held-to-maturity
Trade accounts receivable	Loans and receivables
Advances to contract miners	Loans and receivables
Accounts payable and accrued expenses	Other financial liabilities
Notes payable	Other financial liabilities

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

Credit Risk

Credit risk arises from the potential that a customer or counterparty will fail to perform its obligations. The Company's exposure to credit risk exists primarily related to its trade accounts receivable. While economic factors can affect credit risk, the Company manages risk by providing credit terms on a case by case basis. Customers are primarily investment grade companies and quasi-governmental agencies. The Company's 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. The Company's maximum credit risk exposure at March 31, 2010, is approximately \$9,400,000 and is equal to the carrying amount of all cash, restricted cash and certificates of deposit and trade accounts receivable as listed on the accompanying consolidated balance sheet.

Market Risk

Interest rate risk is the risk the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. The Company's interest rate risk primarily relates to its interest bearing debt on the accompanying consolidated balance sheet. As the Company's debt has fixed interest rates, the Company has minimized its exposure to cash flow interest rate risk.

The Company's price risk primarily relates to the ability for coal prices to fluctuate widely and is affected by many factors outside of the Company's control. The Company minimizes its 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 the Company will have difficulty meeting its obligations associated with financial liabilities. To manage this risk, the Company ensures, to the extent possible, that it will have sufficient liquidity to meet its obligations when due by continually monitoring its cash balances and its cash flow projections.

The Company has sustained losses since operations commenced in 2008 and has financed these losses mainly through a combination of equity and debt offerings. As a result of the RTO and equity issuance in December 2009, the Company has significantly increased its cash balances, reduced its outstanding debt and increased its shareholders' equity. Management of the Company believes it has sufficient resources to meet all its obligations and also has the ability to fund the Company's operations in the upcoming year. The Company has contractual obligations with future minimum undiscounted amounts payable that are due as follows at March 31, 2010:

	Less than 1 Year	2-3 Years	Thereafter	Total
Accounts payable and accrued expenses	\$5,210,007	\$ –	\$ –	\$5,210,007
Notes payable	2,081,872	2,430,931	–	4,512,803
Leases	53,562	44,635	–	98,197
	<u>\$7,345,441</u>	<u>\$2,475,566</u>	<u>\$ –</u>	<u>\$9,821,007</u>

Derivatives

We have not entered into any hedging actives and have not had any derivatives since our incorporation.

Recent and Upcoming Changes in Accounting Policies

In February 2008, the Canadian Accounting Standards Board confirmed that International Financial Reporting Standards (“IFRS”) will replace Canadian generally accepted accounting principles (“GAAP”) for fiscal years beginning on or after January 1, 2011. As such, the Company will be required to adopt IFRS for the fiscal year beginning January 1, 2011 and provide IFRS comparative information for the previous fiscal year. A detailed assessment of the impact of adopting IFRS on the Company’s consolidated financial statements has not been completed nor has the Company established a transition plan. However, the Company has scheduled initial training sessions and has begun the process of engaging third party advisors to assist in the conversion and implementation and expects to have said advisors in place along with a transition and implementation plan in the second quarter of 2010.

The Company does expect the transition to IFRS to be a significant undertaking that may materially affect the reported financial position and results of operations. However, the Company is unable to quantify the impact of IFRS on its consolidated financial statements at this time as it continues to monitor the developments in accounting standards as issued by the International Accounting Standards Board.

Internal Controls and Procedures

Internal control weaknesses for most new public companies relate to the lack of sufficient staff with technical accounting knowledge and experience. It should be noted that the Company’s Chief Executive Officer and Chief Financial Officer believe that internal controls and procedures in place are reasonably effective and provide reasonable, not absolute, assurance that the objectives of the control system are met.

Internal control over financial reporting is a process designed to provide reasonable assurance about the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. The process includes policies and procedures to maintain records that accurately and fairly reflect transactions, to provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements and that receipts and expenditures are being made with proper authorization and to provide reasonable assurance regarding prevention or timely detection of unauthorized transactions that could have a material effect on the financial statements.

The Chief Executive Officer and Chief Financial Officer of the Company are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision. We assessed the design and implementation of our internal controls over financial reporting as of March 31, 2010 and during this process, management identified certain weaknesses in internal controls over financial reporting which are as follows:

- a) Due to the limited number of staff currently in place, it was not feasible to achieve complete segregation of incompatible duties through March 31, 2010.

- b) The Company does not currently have a sufficient number of finance personal with the technical accounting knowledge to address all complex and non-routine accounting transactions that may arise.

These weaknesses in the Company's internal controls over financial reporting result in more than a remote likelihood that a material misstatement would not be prevented or detected. Management and the Board of Directors work to mitigate the risk of material misstatement in financial reporting. In addition, when complex accounting and technical issues arise during preparation of the quarterly financial statements outside consulting expertise is engaged. In spite of management's best efforts, there can be no such assurance that this risk can be reduced to a remote likelihood of material misstatement.

Subsequent Events

On April 28, 2010, the Company completed its acquisition of the remaining 95% membership interests in Raven Crest Mining, LLC ("Raven Crest"). Pursuant to the purchase agreement, the purchase price totaled \$40,000,000 in cash and the assumption of approximately \$18,000,000 in debt, which was paid at closing. Terms also required the Company to deposit \$2,800,000 to collateralize approximately \$5,600,000 in reclamation bonds and will require the Company to pay approximately \$5,000,000 for a working capital adjustment within 30 days of closing. The purchase price allocation has not yet been finalized.

In conjunction with the Raven Crest acquisition, the Company issued \$75,000,000 par value of senior secured notes payable that bear interest at a stated rate of 9.75% and are due in April 2015. The Company is required to maintain certain debt covenants that include restrictions on dividends and additional indebtedness. The Company also issued 3,000,000 common stock purchase warrants to the note holders with an exercise price of Cdn\$4.20 and expiration date of December 2012. Raven Crest began shipping coal on May 2, 2010.

Summary of Quarterly Results

	<u>March 31, 2010</u>		<u>Fiscal 2009</u>		
	Q1	Q4	Q3	Q2	Q1
(thousands, except per ton amounts)					
Coal production (tons)	156	118	168	148	236
Coal sold (tons)	116	112	185	148	221
Average sales price per ton	\$67.49	\$78.18	\$78.38	\$86.39	\$104.58
Average cost of sales per ton	\$65.72	\$62.43	\$64.89	\$85.50	\$67.21
(millions, except per unit amounts)					
Revenues	7.8	8.8	14.5	12.9	23.2
Net (loss) income	(3.1)	(1.1)	(1.8)	(6.1)	1.9
Basic net (loss) income per share	(0.06)	(0.17)	(0.06)	(0.17)	0.06
Diluted net (loss) income per share	(0.06)	(0.17)	(0.06)	(0.17)	0.05

Outstanding Share Data

As of March 31, 2010, there were 56,180,221 common shares issued and outstanding. The following table lists stock options that were also outstanding as of March 31, 2010, that enables the option holder to purchase one common share for each option:

	Number Granted	Number Vested	Exercise Price	Expiration Date
	4,518	4,518	1.94	March 2010
	2,493,921	1,103,442	0.60	April to Oct. 2018
	1,094,993	–	1.53	Sept. to Oct. 2019
	500,000	500,000	3.62	December 2019
	400,000	–	3.10	January 2020
	120,000	–	3.62	January 2020
Total	4,613,432	1,607,960		

During January 2010, the Company issued stock options as follows: options were granted to purchase 400,000 shares with an exercise price of \$3.10 per share and options were granted to purchase 120,000 shares with an exercise price of \$3.62 per share.

Details of the stock options outstanding are as follows:

	Number of Options	Weighted Average Exercise Price
Outstanding at January 1, 2009	3,806,403	\$0.60
Granted	1,626,283	2.16
Options acquired as a result of RTO	27,108	Cdn1.99
Forfeited	(552,711)	0.60
Exercised	(521,425)	0.60
Outstanding at December 31, 2009	4,385,658	1.19
Granted	520,000	3.22
Exercised	(292,226)	0.71
Outstanding at March 31, 2010	4,613,432	1.44

Of the stock options outstanding at March 31, 2010, 4,518 options expire in 2010, 1,668,560 options expire in 2013, 813,625 options expire in 2018, 1,606,729 options expire in 2019 and 520,000 options expire in 2020.

Details of the stock options exercisable at March 31, 2010 are as follows:

	Number of Options	Weighted Average Exercise Price
	1,103,442	\$ 0.60
	4,518	Cdn1.99
	500,000	3.62
	1,607,960	\$1.54

During February 2009, 250,000 options were exercised in exchange for a \$312,500 nonrecourse note receivable from a key employee with interest at 4% and a maturity of December 31, 2009.

Summarized information about warrants, after reflection of the converted number of warrants and exercise prices, from inception to March 31, 2010, is as follows:

	Number of Warrants	Weighted Average Exercise Price
Outstanding at January 1, 2009	3,540,200	\$0.96
Issued to investors in December 2009	9,514,136	Cdn\$4.20
Issued to agents in December 2009	1,139,142	Cdn\$4.20
Exercised in December 2009	(1,564,275)	0.96
Outstanding at December 31, 2009	12,629,203	\$3.52
Exercised in March 2010	(1,975,925)	0.96
Outstanding at March 31, 2010	10,653,278	Cdn\$4.20

All the warrants outstanding at March 31, 2010 expire in December 2011.

Transactions with Related Parties

Effective in December 2009, the Company purchased 100% of the membership interests in Shenendoah Energy, LLC (“Shenendoah”) from an individual, who became a member of management in 2010, and his wife. Pursuant to the purchase agreement, the total purchase price was \$2.04 million, which included \$500,000 in cash and 500,000 shares of the Company’s common shares valued at \$1.55 million. Shenendoah’s assets consist of a 5% ownership interest in Raven Crest Mining, LLC (“Raven Crest”) and \$160,000 in accounts receivable from Raven Crest. Pursuant to the purchase agreement, all liabilities of Shenendoah were retained by the seller. Because Shenendoah does not meet the definition of a business under GAAP this transaction is considered acquiring a group of assets and not a business combination. The consolidated balance sheet as at December 31, 2009 includes the \$160,000 accounts receivable and an investment in Raven Crest of \$1.88 million which is accounted for on the cost basis. The Raven Crest operating agreement requires that all members must approve any sale of the LLC. The acquisition of Shenendoah provided us with leverage in our negotiations with Raven Crest.

In December 2009, in connection with the private equity placement and the RTO, we acquired 385,700 common shares from JEN for \$1.28 million, a company owned by our Chairman and Chief Executive Officer and principal shareholder. We purchased these shares to further reduce the non-Canadian citizens total ownership percentage of the Company to below 51% to maintain our “foreign private issuer” status under United States securities law.

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 accordance with Canadian generally accepted accounting principles. The preparation of these financial statements 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 its 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

The Surface Mining Control and Reclamation Act of 1977 and similar state statutes require that mine properties be restored in accordance with specified standards and an approved reclamation plan. Significant reclamation activities include reclaiming refuse and slurry ponds, reclaiming the pit and support acreage at surface mines, and sealing portals at deep mines. Reclamation activities that are performed outside of the normal mining process are accounted for as asset retirement obligations ("ARO"). We record our reclamation obligations on a mine-by-mine basis based upon current permit requirements and estimated reclamation obligations for such mines in accordance with federal and state reclamation laws as defined by each mining permit.

In accordance with each mining permit application, we post a predetermined amount of reclamation bond prior to commencing mining operations. State and/or federal estimates of disturbed acreage are determined based on approved mining plans and related engineering data. 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 to perform the required work. Cost estimates are based upon estimates approved by the U.S. Department of Interior's Office of Surface Mining ("OSM") based on historical costs. We determine the fair value of our ARO using a discounted cash flow methodology based on a discount rate related to the rates of U.S. Treasury bonds with maturities similar to the expected life of a mine, adjusted for our credit standing, which approximated 6.5% at March 31, 2010. 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 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.

On at least an annual basis, we intend to review our entire reclamation liability and make necessary adjustments for permit changes granted by the permit-issuing authorities, additional costs resulting from accelerated mine closures, and revisions to cost estimates and productivity assumptions, to reflect current experience. At March 31, 2010, we had recorded asset retirement obligation liabilities of approximately \$5.72 million. While the precise amount of these future costs cannot be determined with certainty, as of March 31, 2010, we estimate that the aggregate undiscounted cost of final mine closure is approximately \$6.62 million.

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 contributed 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.

During February 2008, we established a Stock Incentive Plan (the "Plan"), which authorizes up to 3,000,000 shares for grants of incentive awards to employees, consultants and directors who will contribute to our long range success. Stock options issued under the Plan may have a term up to ten years and are subject to vesting periods determined by the Board of Directors. Stock options issued under the Plan prior to the RTO were converted into stock options to purchase an equivalent number of shares. This MD&A reflects the converted number of stock options and exercise prices to reflect the effects of the RTO adjustment.

As a result of the RTO, the Company established a revised Stock Option Plan to reflect the Company's current equity structure. This revised plan authorizes up to 7,000,000 shares, including options issued under the previous plans, for grants of incentive awards to employees, executive officers, directors and consultants to the Company. The Board of Directors will administer this plan and have the authority to determine the terms, limitations, restrictions and conditions, if any, applicable to the exercise of the stock options. The exercise price per share of options issued under this plan must not be less than the market price at the time the stock options are granted.

In order to determine the valuation of our common stock purchase warrants and common stock options, we used the Black-Scholes pricing model with the following weighted average assumptions:

	2.00 – 10.00
Expected term (years)	
Risk-free interest rates	0.37% – 3.82%
Expected / weighted-average volatility	40.49% – 58.47%

The risk-free interest rate is based on the U.S. Treasury rate for the expected life at the time of grant, volatility is based on the average long-term implied volatilities of peer companies as our trading history is limited, and the expected term is determined using the simplified method.

Share Capital

The authorized share capital consists of an unlimited number of no par voting and non-voting shares. The non-voting shares were created in connection with the RTO in December 2009, resulting in the issuance of 19,467,541 shares with an allocated share capital amount of \$4,500,015. All remaining share capital transaction amounts affect voting shares.

In January 2010, in connection with the Chief Financial Officer's employment agreement, the Company issued 100,000 restricted common shares, of which 50,000 shares are exercisable in December 2010 and 50,000 shares are exercisable in December 2011. These shares were valued based on the trading price at the date of issuance.

Additionally, in January 2010 the Company issued an aggregate of 60,000 restricted common shares to its three independent Directors, which are exercisable in January 2011. These shares were value based on the trading price at the date of issuance.

Reserves

We amortize our mineral rights, mine development costs, capitalized asset retirement costs and some plant and equipment 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.

During March 2009, we sold certain mineral rights with a recorded cost of \$345,000 for \$1.75 million. We then leased back the associated mineral rights under an operating lease agreement and made prepaid royalty payments related to this lease of \$750,000, which have been recorded as recoupable royalties in the accompanying consolidated balance sheet. The resulting gain that could otherwise be recognized should be deferred and amortized in proportion to the related gross rental charged to expense over the lease term; accordingly, the rental payments begin after production, the revenue will be recognized in proportion to the rent expense and related production of tonnage mined. We deferred the portion of the gain associated with the prepaid royalty payments (\$750,000) until such time we determine to mine these properties. At the time mining commences, the gain will be recognized in relation to the tons mined. We have included these tracks to our mining plan and expect to fully mine these areas within the next 4 years. Therefore, the gain will be fully recognized within this time frame. A gain of \$655,000 was recognized in the accompanying consolidated statement of operations for the year ended December 31, 2009.

RISK FACTORS

Risk Factors Relating to Xinergy

Please refer to the Annual Information Form for a discussion of our risk factors.

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, is available on the Company's SEDAR company profile at www.sedar.com and on the Company's website at www.xinergycorp.com.