

Consolidated Financial Statements

Xinergy Ltd.

*Years ended December 31, 2010 and 2009
with Report of Independent Auditors*

Xinergy Ltd.
Consolidated Financial Statements
Years ended December 31, 2010 and 2009

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Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements are the responsibility of management and have been reviewed by the Board of Directors of Xinery Ltd. (the "Company"). These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and, where necessary, include amounts that are based on management's judgment and estimates.

To assist management in fulfilling its responsibilities, a system of internal accounting controls has been established to provide reasonable assurance the consolidated financial statements are accurate and reliable and that assets are safeguarded.

Coulter & Justus, P.C., our independent external auditors appointed by the Audit Committee, have audited the consolidated financial statements of the Company and their report outlines the scope of their examination and provides their opinion on the consolidated financial statements.

The Board of Directors of the Company has established an Audit Committee, consisting of three non-management directors. The Audit Committee reviews the consolidated financial statements with management and with the independent external auditors prior to submission to the Board of Directors for approval. The independent external auditors have full and free access to the Audit Committee. The Audit Committee reviews all filings with consolidated financial statements and Management's Discussion and Analysis, as well as the Company's Annual Information Form.

(Signed) Chairman of the Board and Chief Executive Officer

(Signed) Michael R. Castle
Chief Financial Officer

February 18, 2011



Report of Independent Auditors

To the Shareholders of Xinergy Ltd.

We have audited the accompanying consolidated financial statements of Xinergy Ltd., and its subsidiaries which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of operations, shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Xinergy Ltd. as at December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Coulter & Justus, P.C.

Knoxville, Tennessee
February 18, 2011

Xinergy Ltd.

Consolidated Balance Sheets
(Expressed in U.S. Dollars)

As at December 31

	<u>2010</u>	<u>2009</u>
Assets		
Current assets:		
Cash	\$17,028,862	\$10,192,766
Restricted cash, current portion (Notes 1 and 7)	810,638	–
Trade accounts receivable (Note 1)	6,026,365	830,777
Coal inventories	9,660,330	1,772,871
Above market coal supply agreement, net (Note 4)	12,641,728	–
Future income taxes, current portion (Note 10)	367,063	–
Other current assets	907,425	467,201
Total current assets	47,442,411	13,263,615
Deferred financing costs, net (Note 7)	2,605,815	–
Future income taxes, less current portion (Note 10)	7,754,867	8,366,660
Restricted cash, less current portion (Notes 1 and 7)	6,917,465	9,089,989
Recoupable royalties	1,221,400	1,598,180
Investment in entity (Notes 2 and 3)	7,750,000	1,884,792
Property, plant and equipment, net (Note 5)	47,035,522	22,384,236
Mineral rights, net (Note 1)	29,649,234	4,526,662
Mine development costs, net (Note 1)	2,983,000	1,730,727
Other noncurrent assets	120,551	412,840
Total assets	<u>\$153,480,265</u>	<u>\$63,257,701</u>

See accompanying Notes to Consolidated Financial Statements, which form an integral part of these Consolidated Financial Statements.

	<u>2010</u>	<u>2009</u>
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued expenses	\$ 8,868,892	\$ 3,116,088
Early redemption penalties payable (Note 7)	500,000	-
Accrued interest payable (Note 7)	1,256,147	-
Income taxes payable	-	61,000
Current portion of asset retirement obligations (Note 6)	428,357	428,357
Current portion of senior secured notes payable (Note 7)	5,000,000	-
Current portion of equipment and vehicle notes payable (Note 7)	7,736,702	2,128,959
Total current liabilities	<u>23,790,098</u>	<u>5,734,404</u>
Asset retirement obligations, less current portion (Note 6)	8,247,984	5,293,307
Equipment and vehicle notes payable, less current portion (Note 7)	5,481,799	1,175,436
Senior secured notes payable, \$70,000,000 net of discount of \$2,884,624, less current portion (Note 7)	62,115,376	-
Deferred gain on sale and leaseback (Note 1)	-	750,000
Total liabilities	<u>99,635,257</u>	<u>12,953,147</u>
Shareholders' equity:		
Share capital	65,628,739	61,747,806
Contributed surplus	2,936	2,936
Warrants	5,236,614	4,365,380
Stock options	3,815,091	2,111,623
Accumulated deficit	(20,838,372)	(17,923,191)
Net shareholders' equity	<u>53,845,008</u>	<u>50,304,554</u>
Total liabilities and shareholders' equity	<u>\$153,480,265</u>	<u>\$63,257,701</u>
Commitments and contingencies (Note 15)		

See accompanying Notes to Consolidated Financial Statements, which form an integral part of these Consolidated Financial Statements.

(Signed) Jon E. Nix
Chairman of the Board

(Signed) Robert J. Metcalfe
Director

Xinergy Ltd.

Consolidated Statements of Operations
(Expressed in U.S. Dollars)

Years ended December 31

	<u>2010</u>	<u>2009</u>
Coal revenues	\$108,840,562	\$ 59,448,264
Cost of coal sales	74,883,994	46,353,871
Gross margin	33,956,568	13,094,393
General and administrative expenses	12,792,298	7,159,052
Amortization of above market coal supply agreement (Note 4)	8,148,272	–
Depreciation, depletion and amortization	17,395,635	9,648,593
Operating loss	(4,379,637)	(3,713,252)
Other income (expense):		
Interest income	279,977	196,123
Interest expense (Note 7)	(5,610,302)	(10,637,893)
Investment income (Notes 2 and 3)	827,127	–
Amortization of deferred financing costs (Note 7)	(309,521)	(184,865)
Early redemption penalties (Note 7)	(1,000,000)	–
Gain on business acquisition (Note 2)	4,669,105	–
Gain on sale of mineral rights (Note 1)	750,000	655,472
Gain on sale of subsidiary (Note 11)	2,141,069	–
Gain (loss) on sale of equipment	129,504	(33,662)
Loss on advances to contract miners (Note 14)	–	(2,602,147)
Write-off of deferred financing costs (Note 7)	–	(231,082)
Other expense	(228,773)	(64,435)
Net other income (expense)	1,648,186	(12,902,489)
Loss before income taxes	(2,731,451)	(16,615,741)
Provision for income tax expense (benefit):		
Current	(61,000)	–
Future (Note 10)	244,730	(5,226,889)
Total provision for income tax expense (benefit)	183,730	(5,226,889)
Net loss	\$ (2,915,181)	\$(11,388,852)
Weighted average number of basic and diluted shares outstanding	55,815,051	33,656,729
Basic and diluted loss per share	\$ (0.05)	\$ (0.34)

See accompanying Notes to Consolidated Financial Statements, which form an integral part of these Consolidated Financial Statements.

Xinergy Ltd.

Consolidated Statements of Shareholders' Equity (Expressed in U.S. Dollars)

	Shares Capital		Contributed Surplus	Warrants	Stock Options	Accumulated Deficit	Receivable Key Employee	Total
	Voting and Non-Voting Shares	Amount						
Balance at January 1, 2009	15,573,475	\$ 7,318,708	\$1,580	\$224,114	\$443,521	\$(5,575,270)	\$ –	\$2,412,653
Stock based compensation expense	–	–	–	–	407,711	–	–	407,711
Issuance for exercised stock options	250,000	459,155	–	–	(146,655)	–	(312,500)	–
Balance at December 21, 2009 pre-merger, pre-share issue, and prior to recording net loss for the year	15,823,475	7,777,863	1,580	224,114	704,577	(5,575,270)	(312,500)	2,820,364
Greenwich Global Capital, Inc. equity balances pre-reverse takeover	6,153,125	675,037	–	–	129,795	(229,723)	–	575,109
Greenwich Global Capital, Inc. shares consolidated on the basis of 1 share for every 19.92 outstanding	(5,844,237)	–	–	–	–	–	–	–
Xinergy Corp. shares consolidated on the basis of 2.0857 share for every 1 share outstanding	17,127,369	(161,119)	–	–	–	–	–	(161,119)
Reverse takeover adjustment	–	(229,723)	–	–	–	229,723	–	–
Reverse takeover costs incurred	–	–	–	–	–	(959,069)	–	(959,069)
Acquisition from entity controlled by principal shareholder	(385,700)	(1,275,163)	–	–	–	–	–	(1,275,163)
Issuance to investors	18,985,700	56,514,869	–	–	–	–	–	56,514,869
Issuance to investors	42,572	149,000	–	–	–	–	–	149,000
Issuance of warrants to investors	–	(3,794,871)	–	3,794,871	–	–	–	–
Issuance of warrants to agents	–	(464,828)	–	464,828	–	–	–	–

See accompanying Notes to Consolidated Financial Statements, which form an integral part of these Consolidated Financial Statements.

Xinergy Ltd.

Consolidated Statements of Shareholders' Equity (continued)
(Expressed in U.S. Dollars)

	Shares Capital		Contributed Surplus	Warrants	Stock Options	Accumulated Deficit	Receivable Key Employee	Total
	Voting and Non-Voting							
	Shares	Amount						
Balance at December 21, 2009, prior to recording of net loss for the year	51,902,304	\$59,191,065	\$1,580	\$4,483,813	\$ 834,372	\$ (6,534,339)	\$(312,500)	\$57,663,991
Issuance for exercised warrants	1,079,566	118,433	–	(118,433)	–	–	–	–
Stock based compensation expense	–	–	–	–	1,278,607	–	–	1,278,607
Issuance for professional services rendered	200	661	–	–	–	–	–	661
Issuance to employees for services	120,000	396,732	–	–	–	–	–	396,732
Issuance to directors for services	150,000	495,915	–	–	–	–	–	495,915
Proceeds from payment of key employee receivable	–	–	–	–	–	–	312,500	312,500
Issuance to sellers of acquired net assets	500,000	1,545,000	–	–	–	–	–	1,545,000
Forfeiture of stock options	–	–	1,356	–	(1,356)	–	–	–
Net loss	–	–	–	–	–	(11,388,852)	–	(11,388,852)
Balance at December 31, 2009	53,752,070	61,747,806	2,936	4,365,380	2,111,623	(17,923,191)	–	50,304,554
Issuance for exercised warrants	1,975,925	2,002,569	–	(105,681)	–	–	–	1,896,888
Issuance for exercised stock options	292,226	397,320	–	–	(190,586)	–	–	206,734
Issuance to CFO for services	100,000	333,295	–	–	–	–	–	333,295
Issuance to directors for services	210,000	550,224	–	–	–	–	–	550,224
Issuance for employee compensation	197,500	453,525	–	–	–	–	–	453,525
Issuance to CEO for services	65,645	144,000	–	–	–	–	–	144,000
Issuance of warrants for senior secured notes payable (Note 7)	–	–	–	976,915	–	–	–	976,915
Stock based compensation expense	–	–	–	–	1,894,054	–	–	1,894,054
Net loss	–	–	–	–	–	(2,915,181)	–	(2,915,181)
Balance at December 31, 2010	56,593,366	\$65,628,739	\$2,936	\$5,236,614	\$3,815,091	\$(20,838,372)	\$ –	\$53,845,008

See accompanying Notes to Consolidated Financial Statements, which form an integral part of these Consolidated Financial Statements.

Xinergy Ltd.

Consolidated Statements of Cash Flows
(Expressed in U.S. Dollars)

Years ended December 31

	2010	2009
Operating activities		
Net loss	\$ (2,915,181)	\$(11,388,852)
Items not affecting cash:		
Depreciation, depletion and amortization	17,395,635	9,648,593
Amortization of above market coal supply agreement	8,148,272	–
Gain on sale of subsidiary	(2,141,069)	–
(Gain) loss on sale of equipment	(129,504)	33,662
Amortization of deferred financing costs	309,521	184,865
Amortization of discount on notes payable	342,291	88,831
Accretion of assets retirement obligations	436,739	361,544
Future income tax expense (benefit)	244,730	(5,226,889)
Gain on sale of mineral rights	(750,000)	(655,472)
Gain on business acquisition	(4,669,105)	–
Stock-based compensation expense	1,894,054	1,686,318
Issuance of common shares for services rendered	1,481,044	893,308
Write-off of deferred financing costs	–	231,082
Loss on advances to contract miners	–	2,602,147
Changes in operating assets and liabilities:		
Trade accounts receivable	(3,519,188)	1,139,621
Advances to contract miners	–	356,629
Coal inventories	(2,619,752)	(591,411)
Deposit on equipment lease agreement	–	1,370,451
Other current assets	(325,786)	23,680
Recoupable royalties	(402,220)	(1,044,400)
Accrued interest payable	1,256,147	–
Early redemption penalties payable	500,000	–
Income taxes payable	(61,000)	–
Other noncurrent assets	143,038	(157,296)
Accounts payable and accrued expenses	2,764,413	(2,783,134)
Assignment of overriding coal royalty interest payable	–	(2,948,750)
Asset retirement obligations settled	(270,944)	(337,961)
Net cash provided by (used in) operating activities	<u>\$17,112,135</u>	<u>\$ (6,513,434)</u>

See accompanying Notes to Consolidated Financial Statements, which form an integral part of these Consolidated Financial Statements.

Xinergy Ltd.

Consolidated Statements of Cash Flows (continued)
(Expressed in U.S. Dollars)

Years ended December 31

	<u>2010</u>	<u>2009</u>
Investing activities		
Acquisition of Raven Crest, net of cash acquired	\$(42,477,878)	\$ -
Net cash acquired in merger, prior to public offering	-	566,760
Acquisition of Shenendoah net assets	-	(499,792)
Investment in entity	(7,750,000)	-
Purchases of property, plant and equipment	(24,660,080)	(4,631,126)
Purchases of mine development costs	(210,167)	(750,754)
Proceeds from sale of equipment	213,955	1,299,600
Proceeds from sale of subsidiary	3,124,500	-
Proceeds from sale of mineral rights	-	1,750,000
Change in restricted cash	2,539,839	(104,773)
Net cash used in investing activities	<u>\$(69,219,831)</u>	<u>\$(2,370,085)</u>
Financing activities		
Proceeds from issuance of common shares, net	-	56,663,869
Payment for acquisition of common shares from entity controlled by principal shareholder	-	(1,275,163)
Proceeds from issuance of senior secured notes payable	72,750,000	-
Proceeds from issuance of equipment and vehicle notes payable	13,562,827	3,016,417
Repayment on notes payable to TCW	-	(35,000,000)
Repayments on Raven Crest equipment notes payable	(17,908,600)	-
Repayments on equipment and vehicle notes payable	(3,648,721)	(3,684,963)
Repayment on senior secured notes payable	(5,000,000)	-
Payments for deferred financing costs	(2,915,336)	-
Payments for dissenting common shares	-	(161,119)
Proceeds from exercise of options and warrants	2,103,622	312,500
Reverse takeover costs incurred	-	(959,069)
Net cash provided by financing activities	<u>\$ 58,943,792</u>	<u>\$18,912,472</u>
Net change in cash	<u>6,836,096</u>	<u>10,028,953</u>
Cash at beginning of year	<u>10,192,766</u>	<u>163,813</u>
Cash at end of year	<u>\$ 17,028,862</u>	<u>\$10,192,766</u>

See accompanying Notes to Consolidated Financial Statements, which form an integral part of these Consolidated Financial Statements.

Xinergy Ltd.

Consolidated Statements of Cash Flows (continued)
(Expressed in U.S. Dollars)

Years ended December 31

	<u>2010</u>	<u>2009</u>
Supplemental disclosure of noncash activities		
Issuance of common shares warrants for senior notes payable	\$ 976,915	\$ –
Issuance of common shares for assets acquired	–	1,545,000
<p>In connection with the Raven Crest acquisition, the Company acquired assets with a fair value of \$71,736,192 and assumed liabilities with a fair value of \$24,016,166. These amounts were inclusive of the 5% investment in Raven Crest the Company previously had with a carrying value of \$1,884,792.</p>		
<p>In connection with the sale of its subsidiary, the Company sold assets with a carrying value of \$992,431 and liabilities with a carrying value of \$9,000.</p>		
Supplemental disclosure of cash flow information		
Interest paid	\$4,340,552	\$13,615,810

See accompanying Notes to Consolidated Financial Statements, which form an integral part of these Consolidated Financial Statements.

Xinergy Ltd.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Xinergy Ltd. (the “Company”), through its wholly owned subsidiary, Xinergy Corp. (“Xinergy”), which was incorporated on October 2, 2007, is engaged in coal mining in eastern Kentucky and West Virginia. Currently, the Company sells high quality coal to electric utilities and industrial companies through the southeastern United States.

On December 21, 2009, Xinergy completed a reverse takeover (“RTO”) of Xinergy Ltd. (the “Company”), formerly Greenwich Global Capital, Inc. (“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 Xinergy Ltd. on December 21, 2009. Where context requires, in respect to transactions prior to the RTO, the “Company” also refers to Xinergy.

Principles of Consolidation

Pursuant to the RTO transaction, these consolidated financial statements for the year ended December 31, 2009, reflect the assets, liabilities, and results of operations of Xinergy prior to the RTO and the consolidated assets, liabilities, and results of operations of the Company and Xinergy subsequent to the RTO. The consolidated financial statements are issued under the name of the legal parent, which is the Company, but are deemed to be a continuation of the legal subsidiary, Xinergy. The consolidated financial statements include Xinergy Ltd. and its subsidiaries, all of which are wholly-owned. All significant intercompany accounts and transactions have been eliminated.

Basis of Presentation

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). All monetary references expressed in these notes are references to United States dollars, except occasional references to Canadian dollar amounts, where the dollar amount is preceded by “Cdn”.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Reverse Takeover Accounting

The RTO was completed on December 21, 2009. Prior to the completion of the RTO, GGC affected a reverse split of its outstanding common shares on the basis of one new share for each 19.92 shares outstanding and Xinergy affected a split of its outstanding common shares on the basis of 2.0857 new shares for each one share outstanding (net of 25,000 dissenting shares which were paid out in the amount of \$161,119). In addition, warrants and options to purchase Xinergy shares outstanding immediately prior to the RTO were replaced with warrants and options to purchase an equivalent number of common shares of the Company, on economically equivalent terms and conditions. Stock warrants and options disclosed in these consolidated financial statements reflect the converted number of shares and exercise prices.

The acquisition of the shares of Xinergy has been accounted for as an RTO transaction as GGC did not qualify as a business for accounting purposes; accordingly, the transaction has been accounted for as a capital transaction of Xinergy.

Revenues

The Company recognizes revenue from coal sales when title or risk of loss passes to the carrier or customer, which generally occurs at the time of shipment. Sales contracts typically have a fixed and determinable price and collectability is reasonably assured. Shipping and handling costs are classified as a component of cost of sales.

The Company's three largest customers individually accounted for approximately 52%, 23% and 8% of the Company's sales during 2010. The Company's three largest customers individually accounted for approximately 45%, 30% and 21% of the Company's sales during 2009.

Trade Accounts Receivable

Trade accounts receivable consists primarily of contractual receivables from coal sales to its customers, which are nationally recognized public utilities and industrial companies, as is typical in the industry. Two customers accounted for approximately 49% and 15% of trade accounts receivable at December 31, 2010, while two customers accounted for approximately 54% and 43% of trade accounts receivable at December 31, 2009. It is the Company's 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 the Company's expectations and, historically, have not been significant.

Coal Inventories

Coal inventories are valued at the lower of cost or net realizable value using the weighted average method.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Recoupable Royalties

The Company has various arrangements to pay royalties, related to properties with coal reserves, based on coal production. For certain of these arrangements, the Company makes royalty prepayments, which are then recouped by the Company as coal production progresses. The recoupable royalties recorded under these arrangements are routinely evaluated by management to ensure all amounts recorded are expected to be recouped.

Property, Plant and Equipment

Property, plant and equipment is stated at cost. Additions and improvements that significantly add to productive capacity or extend the useful lives of assets are capitalized. Maintenance and repair costs are expensed as incurred. Depreciation is based on estimated useful lives of the assets, which range from 3 to 10 years for plant and improvements and 3 to 7 years for equipment and autos and trucks, and is computed by the straight-line method.

Mineral Rights and Mine Development Costs

Mineral rights and mine development costs are recorded at cost. The Company's mine development costs and mineral rights are controlled through leasing arrangements and non-cancellable royalty lease agreements, under which future mining lease payments are due, and generally last until the recoverable reserves are depleted. Depletion of reserves and amortization of mine development costs are computed using the units of production method over estimated total recoverable tons. Accumulated depletion of mineral rights was \$2,510,338 and \$703,505 as at December 31, 2010 and 2009, respectively. Accumulated depletion of mine development costs was \$734,471 and \$301,963 as at December 31, 2010.

During March 2009, the Company sold certain mineral rights with a recorded cost of \$344,528 for \$1,750,000. The Company 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 had been recorded as recoupable royalties in the accompanying consolidated balance sheet. The Company deferred the portion of the gain associated with the prepaid royalty payments (\$750,000) until which time the Company determined to mine these properties. A gain of \$655,472 was recognized in the accompanying consolidated statement of operations during 2009. During 2010, the Company mined the requisite areas and recorded the remaining gain on the sale of mineral rights.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Impairment of Long-lived Assets

Long-lived assets, such as property, plant and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. The Company did not recognize any impairment charges during 2010 and 2009.

Asset Retirement Obligations

The Company's asset retirement obligation ("ARO") liabilities primarily consist of estimated costs related to reclaiming surface land and support facilities at its mines in accordance with federal and state reclamation laws as defined by each mining permit.

The Company estimates the fair value of its 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 escalated for inflation, and then discounted at the credit-adjusted risk-free rate, which approximated 10% at December 31, 2010. Total estimated undiscounted future costs related to the ARO liabilities totaled approximately \$10,101,000 at December 31, 2010, with costs expected to be paid from 2011 to 2019. The Company records 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.

At December 31, 2010 and 2009, the Company had restricted certificates of deposit in the amount of \$7,328,103 and \$8,689,989, respectively, which are required by authoritative agencies for necessary permitting to allow mining and as collateral to ensure the completion of future reclamation.

Income Taxes

United States future income taxes are provided for temporary differences arising from differences between the financial statement and tax basis of assets and liabilities at each balance sheet date using substantially enacted tax rates expected to be in effect when the related taxes are expected to be paid or recovered.

There are no significant Canadian income taxes recorded through December 31, 2010.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Stock-based Compensation

The Company uses 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 the Company's 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. The Company has not incorporated an estimated forfeiture rate of stock options that will not vest; rather, the Company accounts for actual forfeitures as they occur.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates. The most significant estimates include, but are not limited to, asset retirement obligations, stock-based compensation and provision for income taxes.

Financial Instruments

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.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

1. Description of Business and Summary of Significant Accounting Policies (continued)

Recently Issued Accounting Pronouncements

In February 2008, the Accounting Standards Board of the Canadian Institute of Chartered Accountants announced that Canadian GAAP for publicly accountable enterprises will be converged with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) for fiscal years beginning on or after January 1, 2011. Companies will be required to provide IFRS comparative information for the previous fiscal year. The transition date of January 1, 2011, will require the restatement for comparative purposes amounts reported by the Company for the year ended December 31, 2010, for which the current and comparative information will be prepared under IFRS.

2. Business Acquisition

Effective in December 2009, the Company purchased 100% of the membership interest in Shenendoah Energy, LLC (“Shenendoah”). Shenendoah’s assets consist of a 5% ownership interest in Raven Crest Mining, LLC (“Raven Crest”), a West Virginia coal producer, and \$160,000 in accounts receivable from Raven Crest. Pursuant to the purchase agreement, all liabilities of Shenendoah were retained by the seller. Management has evaluated this transaction and has determined that Shenendoah does not meet the definition of a business under GAAP; accordingly, this transaction was considered acquiring a group of assets and not a business combination and was recorded as investment in entity at December 31, 2009.

On March 11, 2010, the Company executed a definitive membership interest purchase agreement with JMP Coal Holdings, LLC (“JMP”) and Raven Crest to acquire the remaining 95% membership interest from JMP in Raven Crest.

On April 28, 2010, the Company completed the acquisition of the remaining 95% membership interest in Raven Crest (“the Acquisition”), which was accounted for in accordance with CICA 1582. The operations of Raven Crest are included in the accompanying consolidated financial statements beginning April 28, 2010. Total fair value consideration for the Acquisition was \$43,990,000 in cash (net of \$1,479,333 of cash acquired from Raven Crest).

Prior to acquiring the remaining 95% membership interest in Raven Crest, the Company accounted for its 5% membership interest in Raven Crest using the cost method. The Company recognized a loss of \$32,789 as a result of re-measuring its prior investment in Raven Crest to fair value as of the date of the Acquisition. The re-measured fair value of the previous membership interest in Raven Crest was \$1,852,003 and was determined based on the fair value paid for the 95% interest in Raven Crest less a 20% discount to exclude the control and deal size premium inherent in the purchase price of the Acquisition. In connection with the Acquisition, Shenendoah wrote-off the \$160,000 in accounts receivable from Raven Crest, which has been netted against \$375,000 in investment income received from Raven Crest prior to the acquisition.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

2. Business Acquisition (continued)

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the Acquisition date. The Company obtained an independent third-party valuation firm to assist in determining the fair value of the acquired tangible and intangible assets. The fair value of the assets acquired and liabilities assumed as of the Acquisition date (April 28, 2010) are as follows:

Trade accounts receivable	\$ 1,676,400
Coal inventories	5,267,707
Other current assets	114,438
Property, plant and equipment	14,401,682
Mine development costs and mineral rights	28,249,472
Coal supply contract	20,790,000
Restricted cash	1,209,003
Other assets	27,490
Total identifiable assets acquired	71,736,192
Accounts payable and accrued expenses	2,997,391
Notes payable	17,908,600
Asset retirement obligations	1,798,426
Total liabilities assumed	22,704,417
Net identifiable assets acquired	49,031,775
Fair value of consideration transferred for 100% of the membership interest	44,362,670
Gain on acquisition	4,669,105
Less provision for future income tax benefit	(1,311,749)
Gain, net of future income tax benefit	\$ 3,357,356

As further discussed in Note 7, the Company issued \$75,000,000 of senior secured notes payable and received \$72,750,000 in net proceeds, after a 3% discount, to finance the Acquisition, repay approximately \$17,900,000 of long-term debt acquired in the Acquisition, fund reclamation bond collateral payments of approximately \$2,800,000, financing costs and transaction expenses of approximately \$3,900,000 and the remaining proceeds of approximately \$6,900,000, inclusive of approximately \$1,500,000 of cash acquired, will be used for general corporate purposes.

The Company recognized \$994,250 of acquisition related expenses that were expensed in 2010. These expenses are included in the consolidated statement of operations in general and administrative expenses.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

2. Business Acquisition (continued)

In connection with the Acquisition, certain future income tax items were created to reflect the tax effects of temporary differences between the carrying amounts of certain assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The components of the \$1,311,749 in net future income taxes included transaction costs, which resulted in a future income tax asset of \$354,950, and the gain on the Acquisition, which resulted in a future income tax liability of \$1,666,699.

The following represents the pro forma consolidated statements of operations as if Raven Crest had been included in the consolidated results of the Company for the entire year ended December 31:

	<u>2010</u>	<u>2009</u>
Revenue	\$126,122,681	\$128,268,262
Net loss	3,950,494	11,470,331

The pro forma amounts have been calculated after applying the Company's accounting policies and adjusting the results of Raven Crest to reflect the fair value adjustments for (i) depreciation and amortization related to plant and equipment, (ii) the amortization of the coal supply agreement and mineral rights, (iii) the change in accretion expense, (iv) additional interest expense related to the financing, net of historical interest expense related to the assumed debt that was repaid at closing, (v) additional interest income from the net proceeds of the financing, (vi) elimination of the effect of a change in a Raven Crest accounting principle in 2010 that will not have a continuing effect on the results of operations, (vii) elimination of the non-recurring transaction expenses included in the Company's historical financial statements and (viii) income tax adjustments. These adjustments assume that the Acquisition and the related financing occurred on January 1 of each period presented.

In January 2011, the Company entered into an asset purchase agreement with Meral, Inc. to acquire certain real property and related interests (including leases, mineral rights, and mining rights) in Greenbrier County, West Virginia. Pursuant to the purchase agreement, the purchase price consisted of an initial deposit of \$200,000 and an additional \$1,500,000 paid at the closing date. Also, the provisions of the purchase agreement provide for a \$2,500,000 payment once certain permitting is obtained and an additional \$1,000,000 18 months after this permitting is obtained. Terms of the agreement also include an overriding royalty paid at a rate ranging from \$1.50 to \$2.00 per ton, determined based gross sales price, with a possible reduction to \$0.40 per ton if certain quality measurements are not achieved. The purchase price allocation has not yet been finalized.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

3. Investment in Entity

During November 2010, the Company acquired 1,852,367 membership units, representing a 17.5% minority interest, in an entity that is primarily engaged in leasing coal reserves to other parties. The entity does not have a quoted market price nor is it traded on an active market, and the Company does not have control of the entity; accordingly, the investment is accounted for on the cost basis. During 2010, dividends of \$612,127 were received, which have been included in investment income on the consolidated statement of operations.

4. Long-term Coal Supply Agreement

In order to hedge against the risk of falling coal prices, the Company periodically enters into long-term sales contracts. As at December 31, 2010, the Company has various existing sales contracts which provide for the Company to deliver a specified amount of coal. Company management has evaluated and concluded that the Company has the capacity to fulfill these obligations without purchasing coal from a third-party and does not anticipate sustaining any losses from the inability to fulfill these sales commitments.

The application of purchase accounting related to the acquisition of Raven Crest (Note 2) resulted in the recognition of an asset in the amount of \$20,790,000 for an above market priced coal supply agreement in relation to the market prices at the date of acquisition. The amortization of the asset for this agreement was \$8,148,272 during 2010. As shipments on this agreement are completed, the asset balance, of which the carrying amount is \$12,641,728 at December 31, 2010, will diminish through 2011 when this coal supply agreement is estimated to be complete.

5. Property, Plant and Equipment

Property, plant and equipment consists of the following at December 31:

	2010		
	Cost	Accumulated Depreciation and Depletion	Net
Land	\$ 283,421	\$ —	\$ 283,421
Plant and improvements	6,373,657	2,000,765	4,372,892
Mining equipment	61,860,751	23,628,991	38,231,760
Autos and trucks	2,121,482	947,525	1,173,957
Other equipment	568,907	135,001	433,906
Capitalized asset retirement costs	3,469,682	930,096	2,539,586
	<u>\$74,677,900</u>	<u>\$27,642,378</u>	<u>\$47,035,522</u>

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

5. Property, Plant and Equipment (continued)

	2009		
	Cost	Accumulated Depreciation and Depletion	Net
Land	\$ 133,421	\$ –	\$ 133,421
Plant and improvements	6,183,419	1,250,544	4,932,875
Mining equipment	25,267,491	10,681,792	14,585,699
Autos and trucks	1,109,075	481,885	627,190
Other equipment	184,567	78,227	106,340
Capitalized asset retirement costs	2,479,226	480,515	1,998,711
	<u>\$35,357,199</u>	<u>\$12,972,963</u>	<u>\$22,384,236</u>

6. Asset Retirement Obligations

Changes in the Company's asset retirement obligations are summarized as follows for the year ended December 31:

	2010	2009
Asset retirement obligations, beginning of year	\$5,721,664	\$4,994,135
Asset retirement obligations assumed in acquisition	1,798,426	–
Liabilities incurred	990,456	703,946
Accretion expense	436,739	361,544
Revisions in estimated cash flows	–	17,028
Liabilities settled	(270,944)	(354,989)
Asset retirement obligations, end of year	<u>\$8,676,341</u>	<u>\$5,721,664</u>

7. Notes Payable

Notes payable consist of the following at December 31:

	2010	2009
Senior secured notes payable to Marret, net of unamortized discount of \$2,884,624 at December 31, 2010	\$67,115,376	\$ –
Equipment and vehicle notes payable	13,218,501	3,304,395
Total notes payable, net of unamortized discount	<u>80,333,877</u>	<u>3,304,395</u>
Less current portion of notes payable	<u>12,736,702</u>	<u>2,128,959</u>
Long-term portion of notes payable, net of unamortized discount	<u>\$67,597,175</u>	<u>\$1,175,436</u>

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

7. Notes Payable (continued)

In 2008, the Company issued notes payable totaling \$35,000,000 and entered into an assignment of overriding coal royalty interest, all of which were paid in full during December 2009. Total interest expense related to these notes payable and assignment of royalty interest amounted to \$9,056,917 in 2009. Also in connection with the notes being paid in full, the remaining unamortized deferred financing costs of \$231,082 were written-off.

Notes Payable to Marret:

In conjunction with the Acquisition discussed in Note 2, during April 2010 the Company issued \$75,000,000 of senior secured notes payable to Marret Asset Management, Inc. ("Marret") and received \$72,750,000 in net proceeds, after a 3% discount. These senior secured notes are collateralized by substantially all assets of the Company and bear interest at an annual rate of 9.75%, payable in semi-annual payments of \$3,656,250 (\$1,256,147 accrued as at December 31, 2010). These senior secured notes mature in April 2015. The Company is required to maintain certain debt covenants, including certain restrictions on dividends, and has limitations on additional indebtedness.

The Company has certain early redemption options, in whole or in part, which would result in percentages 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, the Company 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 required consent of the note holders to acquire the membership units in a separate entity (Note 3), the Company agreed to redeem \$10,000,000 of the principal amount of the notes outstanding pursuant to four separate redemptions in the amount of \$2,500,000 per month beginning in November 2010 at 110% of the principal amount, resulting in early redemption penalties totaling \$1,000,000. As at December 31, 2010, \$5,000,000 had been redeemed and \$500,000 in early redemption penalties were paid.

In consideration for the closing of the financing, the Company issued 3,000,000 common share purchase warrants to the note holders with an exercise price of Cdn\$4.20 expiring in December 2012. The value of these common share purchase warrants was estimated at the date of issuance to be \$976,915 and was recorded as a discount to the notes payable. Additionally, the Company paid \$2,915,336 of fees in connection with the financing, which have been capitalized as deferred financing costs.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

7. Notes Payable (continued)

Equipment and Vehicle Notes Payable

The Company has numerous equipment and vehicle notes totaling \$13,218,501 and \$3,304,395 at December 31, 2010 and 2009, respectively. These notes bear interest at fixed rates ranging from 5.25% to 9.50% and are due in various monthly payments through April 2014. All these notes are collateralized by the related equipment and vehicle purchased, and a certain note with an outstanding balance of 1,175,436 at December 31, 2010 is personally guaranteed by a Company officer.

During 2011, the Company entered into additional equipment and vehicle notes payable totaling \$4,253,700. These notes payable, which bear interest at fixed rates ranging from 4.95% to 5.54%, have annual future maturities of up to an additional \$1,535,388.

In connection with a certain equipment note payable, the Company is required to maintain restricted cash of \$400,000 as additional collateral.

Scheduled Maturities of Notes Payable

Aggregate annual future maturities of notes payable at December 31, 2010, are as follows:

2011	\$12,736,702
2012	4,622,498
2013	653,361
2014	205,940
2015	65,000,000
Total	83,218,501
Less unamortized discount	2,884,624
Total notes payable, net of discount	<u>\$80,333,877</u>

8. Shareholders' Equity

Share Capital

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

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

8. Shareholders' Equity (continued)

Share Capital (continued)

In connection with the RTO during December 2009, the Company acquired 385,700 common shares for \$1,275,163 from an entity controlled by its principal shareholder and issued 18,985,700 common shares at Cdn\$3.50 per share and 9,492,850 common share purchase warrants valued at \$3,786,325 for net cash proceeds of \$56,514,869. The Company also issued to the placement agents an aggregate of 1,139,142 common share purchase warrants valued at \$464,828, which has been recorded as a reduction to share capital. Additionally, the Company issued 42,572 common shares at \$3.50 per share and 21,286 common share purchase warrants valued at \$8,546 for total cash proceeds of \$149,000. All these common share purchase warrants have an exercise price of Cdn\$4.20 and expire in December 2011. In connection with this offering, the Company incurred offering costs totaling \$6,253,754 which has been recorded as a reduction to share capital.

Common share activity of GGC during 2009, up to and including the RTO closing date, is as follows:

	Number of Shares Voting and Non-Voting	Share Capital Amount
Balance at January 1, 2009	6,153,125	\$ 675,037
Consolidated on the basis of 1 share for every 19.92 shares outstanding (Note 1)	(5,844,237)	—
Balance after consolidation	308,888	675,037
Share capital arising from RTO transaction on December 21, 2009 (Note 1)	32,950,844	7,616,744
Acquisition from entity controlled by principal shareholder	(385,700)	(1,275,163)
Issued to investors	19,028,272	56,663,869
RTO adjustment	—	(229,723)
Value of warrants issued to investors	—	(3,794,871)
Value of warrants issued to agents	—	(464,828)
Balance at December 21, 2009	<u>51,902,304</u>	<u>\$59,191,065</u>

In addition to the offering costs, the Company incurred \$959,069 in costs related to the RTO which have been treated as a capital transaction and charged to accumulated deficit.

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 became exercisable in December 2010 and 50,000 shares are exercisable in December 2011. These shares were valued at the trading price at the date of issuance.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

8. Shareholders' Equity (continued)

Share Capital (continued)

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 valued at the trading price at the date of issuance.

In September 2010, in connection with the Vice President of Surface Mining's employment agreement, the Company issued 25,000 restricted common shares all of which are exercisable in September 2011. These shares were valued at the trading price at the date of issuance.

In September 2010 and December 2010, in connection with the Chief Executive Officer's compensation agreement, the Company issued 30,177 and 35,468 restricted common shares, respectively, all of which are immediately exercisable. These shares were valued at the average of the five day trading price immediately preceding the date of issuance.

In November 2010 the Company issued an aggregate of 150,000 restricted common shares to its three independent Directors which are exercisable January 2012.

Also in November 2010, the Company issued an aggregate of 125,000 common shares to officers and 47,500 common shares to employees.

Stock Options

During February 2008, the Company 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 the Company's 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 note presents the converted number of stock options and exercise prices to reflect the effects of the RTO adjustment.

GGC previously had a stock option plan which authorized shares for grants of incentive awards to directors, officers, employees and consultants of GGC. The GGC plan remains in place and options issued prior to the RTO will continue to be governed by this plan; however, no further options will be issued pursuant to this plan.

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.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

8. Shareholders' Equity (continued)

Stock Options (continued)

Total stock-based compensation expense was \$1,894,054 in 2010 and \$1,686,318 in 2009.

During 2009, the Company issued stock options pursuant to the Plan as follows: in January 2009, options were granted to purchase 31,286 shares with an exercise price of \$0.60 per share; in September 2009, options were granted to purchase 93,858 shares with an exercise price of \$1.53; in October and November 2009, options were granted to purchase 1,001,139 shares with an exercise price of \$1.53; in December 2009, options were granted to purchase 500,000 shares with an exercise price of Cdn\$3.85. The weighted average grant-date fair value of options granted during 2009 was \$2.23 per share.

During 2010, the Company issued stock options pursuant to the Plan as follows: in January 2010, 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 common shares with an exercise price of \$3.62; in May 2010, options were granted to purchase 115,000 shares with an exercise price of \$2.71; in September 2010, options were granted to purchase 200,000 shares with an exercise price of \$1.65; in November 2010, options were granted to the three independent directors to purchase 150,000 shares with an exercise price of \$2.39, to the other officers to purchase 540,000 shares with an exercise price of \$2.39 and to employees to purchase 194,500 shares with an exercise price of \$2.39; in December 2010, options were granted to purchase 32,500 shares with an exercise price of \$2.56. The weighted average grant-date fair value of options granted during 2010 was \$1.60 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	1,752,000	2.58
Forfeited	(11,736)	0.60
Exercised	(292,226)	0.71
Outstanding at December 31, 2010	5,833,696	1.63

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

8. Shareholders' Equity (continued)

Stock Options (continued)

Of the stock options outstanding at December 31, 2010, 2,482,185 options expire in 2018, 1,599,511 options expire in 2019, 1,752,000 options expire in 2020. Details of the stock options exercisable at December 31, 2010 are as follows:

Number of Options	Weighted Average Exercise Price
3,800,472	\$1.40
4,518	Cdn1.99
3,804,990	1.40

Warrants

Summarized information about warrants, after reflection of the converted number of warrants and exercise prices, from January 1, 2009 to December 31, 2010, is as follows:

	Number of Warrants	Amount	Exercise Price	Expiry Date
Balance outstanding at January 1, 2009	3,540,200	\$ 224,114		
Issued to investors in December 2009	9,514,136	3,794,871	Cdn\$4.20	December 2011
Issued to agents in December 2009	1,139,142	464,828	Cdn4.20	December 2011
Exercised in December 2009	(1,564,275)	(118,433)		
Balance outstanding at December 31, 2009	12,629,203	4,365,380		
Exercised in March 2010	(1,975,925)	(105,681)	0.96	
Issued for Marret note payable	3,000,000	976,915	Cdn4.20	December 2012
Balance outstanding at December 31, 2010	13,653,278	\$5,236,614		

During 2011, 284,785 shares have been issued for exercised warrants, resulting in total proceeds received of approximately \$1,430,000.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

8. Shareholders' Equity (continued)

Black-Scholes Valuations

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

Expected term (years)	2.00	–	10.00
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 the Company's trading history is limited, and the expected term is determined using the simplified method.

9. Operating Leases

The Company leases office space for their corporate office under an agreement classified as an operating lease. Minimum rental payments under the terms of the agreement, which expires in October 2012, total \$135,630 for 2011 and 126,371 for 2012.

The Company also has various other equipment operating lease agreements under month-to-month operating leases.

10. Income Taxes

For tax purposes at December 31, 2010, the Company has United States net operating loss ("NOL") carryovers which are available to offset future taxable income. The Federal NOL carryovers are approximately \$27,300,000 and the state (Kentucky and Tennessee) NOL carryovers are approximately \$16,600,000. Collectively, the NOLs expire between 2023 and 2031. The future benefit of these NOLs may be limited on an annual basis and in total under Section 382 of the United States Internal Revenue Code as a result of ownership changes and depending on the extent of any future ownership changes.

Significant components of the provision for income tax expense (benefit) are as follows for the year ended December 31:

	<u>2010</u>	<u>2009</u>
Current federal	\$ (61,000)	\$ –
Future:		
Federal	(239,823)	(4,918,591)
State	484,553	(308,298)
Total future	<u>244,730</u>	<u>(5,226,889)</u>
Total provision for income tax expense (benefit)	<u>\$ 183,730</u>	<u>\$(5,226,889)</u>

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

10. Income Taxes (continued)

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Significant components of the Company's United States future income tax assets and liabilities are as follows at December 31:

	<u>2010</u>	<u>2009</u>
Future income tax assets:		
Asset retirement obligations	\$ 914,625	\$ 508,281
NOL carryovers	10,095,361	9,877,427
Long-term coal supply contract intangible	2,455,381	-
Inventory capitalization	806,763	-
Transaction costs intangible	361,012	-
Deferred gain on sale and leaseback	-	279,750
Other	-	136,823
Total future income tax assets	<u>14,633,142</u>	<u>10,802,281</u>
Valuation allowance for future income tax assets	(623,886)	-
Net future income tax assets	<u>14,009,256</u>	<u>10,802,281</u>
Future income tax liabilities:		
Capitalized asset retirement costs	(521,911)	(334,395)
Mine development and improvement costs	(503,424)	(146,082)
Tax over book depreciation	(1,380,581)	(1,331,682)
Recoupable royalties	(233,517)	(596,121)
Excess percentage depletion	(1,195,455)	-
Mineral rights acquired	(1,612,738)	-
Prepaid expenses	(439,700)	(27,341)
Total future income tax liabilities	<u>(5,887,326)</u>	<u>(2,435,621)</u>
Net future income tax assets	<u>8,121,930</u>	<u>8,366,660</u>
Portion classified as current	367,063	-
Portion classified as long-term	<u>\$ 7,754,867</u>	<u>\$ 8,366,660</u>

Based on their analysis of future taxable income that will be apportioned to the state of Tennessee, management believes there is not sufficient evidence indicating sufficient taxable income to realize the NOL carryover in future years; accordingly, a valuation allowance has been provided.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

10. Income Taxes (continued)

The reconciliation of income tax benefit computed at the U.S. federal statutory tax rates to the income tax benefit recorded is as follows for the year ended December 31:

	<u>2010</u>	<u>2009</u>
Federal income taxes at U.S. statutory rate of 34%	\$(928,693)	\$(5,649,352)
State income taxes (including change in valuation allowance)	484,553	(308,298)
Permanent differences	742,076	739,665
Other	(114,206)	(8,904)
Income tax expense (benefit)	<u>\$ 183,730</u>	<u>\$(5,226,889)</u>

11. Sale of Alabama Subsidiary

Effective July 27, 2010, the Company entered into a non-binding letter of intent to sell all its interests in Xinergy of Alabama, Inc., a wholly owned subsidiary of the Company with no significant operations, for net cash proceeds of \$3,124,500. On September 7, 2010, the Company executed the definitive stock purchase agreement with Cedar Lake Mining, Inc. for all the outstanding shares of Xinergy of Alabama, Inc. This resulted in a gain of \$2,141,069.

12. Net Earnings (Loss) per Share

The Company computes basic earnings (loss) per share by dividing net income (loss) attributable to shareholders by the weighted average number of shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss) attributable to shareholders by diluted weighted average shares outstanding. Potentially dilutive shares include the assumed exercise of stock options and warrants and the assumed vesting of stock option grants (using the treasury stock method), if dilutive.

Basic and diluted earnings (loss) per share disclosed in these financial statements reflect the converted weighted average number of shares outstanding after the RTO.

13. Capital Management

The Company's objective in managing capital is to ensure sufficient liquidity to pursue its growth strategy, fund mine development and undertake selective acquisitions, while also managing financial risk. At December 31, 2010, the Company defines capital as cash, certain debt and shareholders' equity.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

13. Capital Management (continued)

The Company's primary uses of capital are to finance ongoing operations, capital expenditures and increases in noncash working capital. The Company currently funds these requirements from internally generated cash flows and cash raised through equity issuances, as well as long-term debt as required. The Company's objectives when managing capital are to ensure that the Company will continue to have enough liquidity so it can provide its products to its customers and returns to its shareholders.

The Company continuously monitors its capital on the basis of the adequacy of its cash resources to fund its business plan. In order to maximize flexibility to finance the Company's ongoing growth, the Company does not currently pay a dividend to its shareholders.

14. Financial Instruments and Financial Risk Factors

The Company's financial instruments include cash, restricted cash, trade accounts receivable, accounts payable and accrued expenses, accrued interest payable 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, trade accounts receivable, and accounts payable and accrued expenses and accrued interest payable 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 follows:

Financial Instrument	Classification
Cash	Held-for-trading
Restricted cash	Held-to-maturity
Trade accounts receivable	Loans and receivables
Accounts payable and accrued expenses	Other financial liabilities
Accrued interest payable	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.

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Notes to Consolidated Financial Statements (continued)

14. Financial Instruments and Financial Risk Factors (continued)

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 previously made periodic advances to certain contract miners; however, this practice has since been terminated. During 2009, the Company ceased operations with certain contract miners with whom it had advanced monies and recognized credit losses of \$2,602,147. 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 December 31, 2010 is approximately \$6,900,000 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

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.

Xinergy Ltd.

Notes to Consolidated Financial Statements (continued)

14. Financial Instruments and Financial Risk Factors (continued)

Liquidity Risk (continued)

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. Subsequently in 2010 the Company secured debt offering to finance a business acquisition. 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 December 31, 2010:

Description	2011	2012 to 2013	Thereafter	Total
Accounts payable and accrued expenses	\$ 8,868,892	\$ -	\$ -	\$ 8,868,892
Accrued interest payable	1,256,147	-	-	1,256,147
Notes payable	12,736,702	5,275,859	65,205,940	83,218,501
Leases	135,630	126,371	-	262,001
	<u>\$22,997,371</u>	<u>\$5,402,230</u>	<u>\$65,205,940</u>	<u>\$93,605,541</u>

15. Commitments and Contingencies

The Company is subject to various claims in the ordinary course of business but management believes their ultimate resolution will have no material adverse effect on its financial condition, results of operations or cash flows.