



Xanadu Mines Ltd

ACN 114 249 026

Half Year Financial Report

December 2010

CORPORATE DIRECTORY

Board of Directors:

Brian Thornton *Executive Chairman*
Roger Perry *Executive Director & CFO*
Rod Williams *Executive Director*
Ganbayar Lkhagvasuren *Non Executive Director*
Ron Heeks *Non Executive Director*
Robert Westphal *Non Executive Director*

Company Secretaries:

Roger Perry
Richard Pillinger

Management:

Dr. Andrew Stewart *Manager Mongolia & Chief Geologist*

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Registered Office Mongolia:

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Military Town, Bayanzurkh District
Ulaanbaatar, Mongolia
Telephone: +976 11 5011 0211

Share Registry:

Computershare Investor Services Pty Ltd
Level 3, 60 Carrington Street
Sydney, NSW 2000, Australia

Auditors

Ernst & Young
680 George Street
Sydney, NSW 2000, Australia

Solicitors - Australia

Sparke Helmore
Level 16, 321 Kent Street
Sydney, NSW 2000, Australia

Solicitors - Mongolia

Anand & Batzaya Advocates
10F Metro Business Centre
Sukhbaatar Street
Sukhbaatar District
Ulaanbaatar 210646, Mongolia

Stock Exchange Listing

Xanadu Mines Ltd shares are listed on the Australian Stock Exchange (ASX: XAM)

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Chairman's Report

Highlights

- Xanadu (ASX : XAM) completes capital raising of A\$24m
- ASX listing on the 21st December 2010
- Commencement of Scoping Study – Galshar Coal Project
- Earns 51% in the highly prospective Elgen-Zos Gold Project in the South East Gobi
- US\$6m exploration and evaluation budget approved for 2011 including an aggressive expansion in the evaluation of coking coal opportunities.
- Discussions continue with several international groups interested in exploiting the potential of the Khar Tavaga coal project
- Xanadu and Noble Group form a strategic alliance in Mongolia to explore for and develop coking and thermal coal, iron ore and ferrous metals

Coal Projects

Galshar Coal Project

A scoping study commenced into options and costs for moving the Galshar coal project forward into a mining operation.

Discussions have been held with a number of mining and engineering consultants to allow for the selection of a Project Team to evaluate the project economics. It is expected that the team will comprise international standard mining, engineering, hydrological metallurgical and environmental Consultants based in Australia and Mongolia. The team will be coordinated and managed by Xanadu.

Selection of consultants to assist with the study will be finalised in the near term, and it is expected that the study will then take some four months to complete. At this time a prefeasibility study (PFS) will be commenced to gain a tighter control on costs and process methodology.

It is currently expected that Galshar will be a conventional truck and shovel open pit with initial coal transfer by road truck to the rail line, some 65 kilometres away. The scoping study will evaluate the construction of a rail spur from the open pit to further reduce operational costs and reduce environmental issues. Marketing options, beneficiation potential, hydrology, mining methodology and transport will form the basis of the scoping study and, if positive, will provide a firm basis on which to move the project forward.

As part of the scoping study, drilling of the currently identified coal seams will also commence to further refine the geological model and increase the quality definition to bring the model into line with JORC Code criteria. It is expected that some 7500 metres of drilling will be required for this task and drilling is expected to commence in late February, as winter recedes.

Concurrent with the scoping study, an aggressive exploration program aimed at delineating further resources within the entire project area will also be undertaken. Currently only a small area of the total ground holding has been explored and an ongoing wide-spaced drilling program will systematically work through the known coal basin targeting further coal resources. This program will continue for most of the 2011 Mongolian field season.

Khar Tarvaga

Planning of a comprehensive work program required to convert the exploration title over the coal resource at Khar Tarvaga to a mining licence has commenced. Documentation required in Mongolia to register the resource includes resource and prefeasibility reports according to Mongolian standards. The necessary field activities, primarily drilling for hydrological investigations, will be undertaken once the weather improves.

Discussions continue with several groups interested in exploiting the potential of the Khar Tarvaga resource. The company will further these discussions and brief an international standard agency to assist with making contact with potential multinational coal to liquid (CTL) partners.

Copper-Gold Projects

Hutag Uul Copper-Gold Project

The large Hutag Uul exploration license is located approximately 750 kilometres SSE of Ulaanbaatar in the south east Gobi region of Mongolia. The licence covers a highly prospective block of late Devonian to early Carboniferous volcanic and intrusive rocks known to host other porphyry deposits, including the Oyu Tolgoi copper-gold porphyry, the Kharmagtai copper-gold porphyry, and the Tsagaan Suvarga copper-molybdenum porphyry deposits.

A large regional soil geochemistry program was recently completed at Hutag Uul with a total of 9,537 soil samples taken across the license

Xanadu's geologists believe that there is a strong possibility of discovering additional mineralised porphyry gold copper targets within the Hutag Uul license, as well as along the defined structural corridor at Nogtot. Geological mapping, detailed geophysics and geochemical rock-chip sampling will continue throughout the Hutag Uul area in 2011.

Gold Exploration Program

Hust Uul Gold Project

The Hust Uul project is located approximately 780 kilometres northeast of Ulaanbaatar and 210 kilometres west from the provincial city of Choibalsan. The railway connecting Choibalsan with Russia is 70-80 kilometres east of the project area.

A scout drill program was completed at the Hust Uul gold project in the northeast of Mongolia in November 2010. Drilling here focused on the prospective Zuunbulag Prospect which comprises a quartz-stibnite breccia which is thought to represent the upper levels of a mineralised auriferous intrusion-related system. Four diamond drill holes were completed for a total of 595.5 meters targeting zones of high resistivity thought to represent buried silica alteration which may be associated with mineralisation. All drill holes reached their target depths and intercepted some encouraging geology. The presence of extensive sulphide bearing silica alteration is promising.

Elgen Zos JV Gold Project

Following the completion of a reconnaissance diamond drilling program in late 2010, Xanadu has earned a 51% equity interest in the Altan Xanadu LLC company, owner of the highly prospective Elgen-Zos gold project, located approximately 30 kilometres north of the Chinese border.

The Joint Venture (JV) area was recently expanded with the acquisition, in September 2010, of two new licences, bringing the total area of exploration licences held to 417 square kilometres. These two licences are contiguous with the previous ground package and help consolidate Xanadu's land holding over the highly prospective Elgen-Zos area. Within the recently acquired licences, earlier exploration focused on the Suug prospect, an area of altered sedimentary rocks with strongly anomalous gold, antimony and mercury rock samples.

Diamond drilling was undertaken late in the year to test targets generated from controlled source audio-frequency magnetotellurics (CSAMT) geophysics and geochemistry. One hole was drilled on a CSAMT target south west of the Suug prospect. The remaining drilling focused on the immediate Elgen area.

Extensive geophysical surveys were completed to provide gravity and ground magnetics coverage of all the licences being explored by the joint venture. This geophysical data plus the CSAMT resistivity is being reviewed by an Australian based geophysical consultant. In addition, high resolution satellite imagery has been obtained over the JV licences to provide a topographic base for geological mapping to be undertaken early in 2011.

With the increased area now held by the JV, the extent of significant antimony, mercury, arsenic and gold results obtained from earlier rock sampling data, together with the geology and structural setting, Xanadu believes the JV areas have the potential for a major sediment hosted gold discovery.

Corporate

Following the ASX listing and the associated capital raising, Xanadu plans to significantly increase its exploration effort in the forthcoming field season due to commence in late February early March 2011. Its focus will be both coking and thermal coal opportunities identified during the winter recess together with its existing copper gold projects in the South East Gobi.

Xanadu has seen a significant increase in the number of new shareholders on its register and at 21 February the number of shareholders totalled 1219.

As part of the expanded exploration program in 2011, a small office is being established in Perth for the Western Australian based geological directors and associated IT and technical support.

On 3 February 2011, Xanadu and Noble Group of Hong Kong announced the formation of a strategic alliance for the exploration and development of coking and thermal coal, iron ore and ferro alloys in Mongolia. The two companies will participate in the alliance through joint venture companies, with each party holding 50% of the joint venture. Xanadu's existing assets at the time of the IPO will not form part of the alliance.

Subject to the drafting and final sign off of long form agreements in March, it is anticipated that the strategic alliance and respective joint ventures will commence operating as soon as practicable thereafter. Under the terms of the Strategic Alliance, Xanadu has agreed to offer to Noble to take a placement in Xanadu as of 23 March 2011 at 70 cents per share based, on a 10 day VWAP prior to the term sheet being signed, to take its equity interest in the company to 9.9%. The funds from the placement will be applied to joint venture undertakings in Mongolia.



Brian Thornton

Chairman

Competent Person Statement

Information on the Company's exploration results is sourced from information compiled by Mr. Rod Williams. Mr. Williams is an employee of Xanadu Mines and is a Member of the Australasian Institute of Mining and Metallurgy and has sufficient experience in the areas being reported on to qualify as the "Competent Person" as defined in the 2004 Edition of the "Australasian Code for the Reporting of Mineral Resources and Reserves". Mr. Williams consents to the information in the form and context in which it appears.

Directors' Report

The directors submit their report for the half year ended 31 December 2010.

DIRECTORS

The names of the Company's directors in office during the half year and until the date of this report are as follows. Directors were in office for this entire period unless otherwise stated.

Brian F Thornton (Chairman)
Roger J Perry
Rodney E Williams
Ronald Heeks
Ganbayar Lkhagvasuren
Robert G Westphal (appointed 2 September 2010)

DIVIDENDS

No dividends have been paid during the period (2009: nil) and no dividend is recommended.

PRINCIPAL ACTIVITIES

The principal activity of the group is exploration in Mongolia for gold, copper and coal.

REVIEW OF OPERATIONS

During the period the company focused on exploration on existing licences, acquisition of additional licence areas, review of existing exploration data with a view to progressing the company's exploration plans in the 2011 exploration season and detailed studies designed to enhance project acquisition and development.

The loss after tax of the consolidated entity for the half year ended 31 December 2010 was \$1,367,001 (31 December 2009: \$953,835). The Company had approximately \$24 million in cash at 31 December 2010.

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

Significant changes in the state of affairs of the company during the period were:

- The Company successfully listed on the Australian Securities Exchange (ASX) in December 2010 (ASX code: XAM)
- Contributed equity increased by \$28,334,008 through:
 - the issue of 40,000,000 shares during the Initial Public Offering (IPO) process;
 - the issue of 9,727,022 fully paid ordinary shares as a result of conversions of Options; and
 - the issue of 4,655,069 fully paid ordinary shares at an issue price of \$0.80 per share in a restricted offer issue.
- In September 2010 the Group acquired two additional licences in southern Mongolia adjacent to the Elgen-Zos JV Area of influence at a cost of US\$ 70,000.
- On 14 October 2010 a General Meeting of Members was held that approved:
 - a. The extension of the exercise date of 7,000,000 Options exercisable at \$1.00, held by Directors, from 30 June 2011 to 31 December 2014;
 - b. The split of the Company's issued shares on a two for one basis with corresponding alterations to the number and exercise price of existing options; and

Directors' Report (cont'd)

- c. The adoption of a new Constitution that complies with the Listing Rules of the Australian Securities Exchange (ASX).

SIGNIFICANT EVENTS AFTER THE BALANCE DATE

On 3 February 2011, Xanadu Mines Ltd announced a strategic alliance with Noble Group (Noble) SGX: N21, to explore and develop coal, iron ore and ferro alloys opportunities in Mongolia ("Strategic Alliance").

Xanadu and Noble have executed a Term Sheet in relation to the scope of the Strategic Alliance. Subject to the parties executing formal agreements, Xanadu and Noble will participate in the Strategic Alliance through joint venture companies with each party holding 50% in the joint ventures. Any existing assets held by Xanadu do not form part of the Strategic Alliance.

The initial focus of the joint ventures will be the pursuit of a number of identified opportunities. The Strategic Alliance will seek to maximise the benefits of Xanadu and Noble's respective competencies and strengths. The agreement executed will include an obligation to make an offer of a placement shares to Noble of up to 10,429,726 shares at 70 cents each based on a 10 day VWAP prior to the term sheet being signed, with the placement occurring as of 23 March 2011 to take Noble's equity interest in Xanadu to 9.9% at that date. The funds from the placement will be applied to the exploration and development of opportunities in Mongolia.

LIKELY DEVELOPMENTS AND EXPECTED RESULTS

Information on likely developments in the company's operations and the expected result of operations has not been included because the directors believe it would be likely to result in unreasonable prejudice to the company.

ENVIRONMENTAL REGULATION AND PERFORMANCE

Entities in the extractive industries incur rehabilitation obligations which are imposed under contractual or licensing arrangements, or by legislation, or are undertaken on the basis of entity policy or in accordance with industry best practice. While the company's activities are still in the exploration phase, no provision for rehabilitation work has been recognised in relation to expenditures for dismantling and removing structures, rehabilitating quarries and mines, dismantling operating facilities and restoring affected areas expected to be incurred as the level of disturbance to date has been minimal. However, the company recognises that such remedial work will be required should mining operations commence and is committed to the adoption of industry best practice in regard to any remediation required. The company has adopted a Code of Environmental Practice that is implemented on all field operations in which the company engages.

AUDITOR'S INDEPENDENCE DECLARATION

The auditor's independence declaration is included on page 18

Signed in accordance with a resolution of the directors.

On behalf of the Directors



Brian Thornton

Chairman

Sydney

Dated: 3 March 2011

Consolidated Statement of Comprehensive Income for the Half-Year Ended 31 December 2010

	Notes	31-Dec-10 \$	31-Dec-09 \$
Revenue	4(a)	111,038	12,069
Total revenue		111,038	12,069
Other income / (expenses)	4(b)	193,919	(65,854)
Depreciation and amortisation expense		(20,190)	(16,947)
Administrative expenses	4(c)	(1,651,768)	(883,103)
Loss before income tax		(1,367,001)	(953,835)
Income tax expense		-	-
Loss after income tax		(1,367,001)	(953,835)
Other comprehensive loss, net of tax		-	-
Total comprehensive loss for the period		(1,367,001)	(953,835)
Loss per share for loss attributable to the ordinary equity holders of the parent			
Basic loss per share (cents per share)		(1.12)	(1.02)
Diluted loss per share (cents per share)		(1.12)	(1.02)

The above Statement of Comprehensive Income should be read in conjunction with the accompanying notes.

Consolidated Statement of Financial Position for the Half-Year Ended 31 December 2010

		31-Dec-10	30-Jun-10
	Notes	\$	Restated \$
ASSETS			
Current assets			
Cash and cash equivalents	5	23,902,579	677,059
Prepayments and other assets		-	3,861
Other receivables		429,075	268,249
Total current assets		24,331,654	949,169
Non current assets			
Other investments		378,480	162,970
Deferred exploration and evaluation costs	6	9,544,150	8,431,350
Property, plant and equipment		928,394	847,332
Intangible assets		6,780	8,253
Total non current assets		10,857,804	9,449,905
Total assets		35,189,458	10,399,074
LIABILITIES			
Current liabilities			
Trade and other payables		694,593	3,117,934
Total current liabilities		694,593	3,117,934
Total liabilities		694,593	3,117,934
Net assets		34,494,865	7,281,140
Equity			
Equity attributable to equity holders of the parent			
Issued capital	7	43,778,916	15,444,908
Reserves	8	5,335,611	5,088,893
Accumulated losses		(14,619,662)	(13,252,661)
Total equity		34,494,865	7,281,140

The above Statement of Financial Position should be read in conjunction with the accompanying notes.

Consolidated Statement of Cash Flows for the Half-Year Ended 31 December 2010

	Notes	31-Dec-10 \$	31-Dec-09 \$
Cash flows from operating activities			
Payments to suppliers and employees		(1,360,373)	(613,764)
Net cash flows used in operating activities		(1,360,373)	(613,764)
Cash flows from investing activities			
Interest received		111,038	12,069
Acquisition of exploration and evaluation assets	9	(2,075,656)	-
Purchase of property, plant and equipment and intangible assets		(122,110)	-
Proceeds on disposal of property, plant and equipment and intangible assets		-	156,305
Loans to other entities		(180,845)	-
Deferred exploration and evaluation costs		(1,150,756)	(917,017)
Net cash flows used in investing activities		(3,418,329)	(748,643)
Cash flows from financing activities			
Proceeds from issue of shares (net of share issue costs)		28,334,008	2,718,482
Repayment of borrowings		-	(188,490)
Net cash flows from financing activities		28,334,008	2,529,992
Net increase in cash and cash equivalents		23,555,306	1,167,585
Net foreign exchange differences		(329,786)	(67,141)
Cash and cash equivalents at beginning of period		677,059	590,978
Cash and cash equivalents at end of period		23,902,579	1,691,422

The above Statement of Cash Flows should be read in conjunction with the accompanying notes.

Consolidated Statement of Changes in Equity

	Attributable to equity holders			
	Issued capital	Share-based compensation reserve	Accumulated losses	Total
	\$	\$	\$	\$
Balance as at 1 July 2009	12,726,426	4,562,273	(11,194,568)	6,094,131
Total comprehensive loss for the period	-	-	(690,525)	(690,525)
Transactions with owners in their capacity as owners				
Shares issued for the period	2,718,482	-	-	2,718,482
Balance as at 31 December 2009	<u>15,444,908</u>	<u>4,562,273</u>	<u>(11,885,093)</u>	<u>8,122,088</u>
Balance as at 1 July 2010	15,444,908	6,790,793	(13,252,661)	8,983,040
Adjustment for restatement	-	(1,701,900)	-	(1,701,900)
Restated total equity at the beginning of the financial period	<u>15,444,908</u>	<u>5,088,893</u>	<u>(13,252,661)</u>	<u>7,281,140</u>
Total comprehensive loss for the period	-	-	(1,367,001)	(1,367,001)
Transactions with owners in their capacity as owners				
Shares issued for the period	30,642,162	-	-	30,642,162
Cost of share issue	(2,308,154)	-	-	(2,308,154)
Share-based payments	-	246,718	-	246,718
Balance as at 31 December 2010	<u>43,778,916</u>	<u>5,335,611</u>	<u>(14,619,662)</u>	<u>34,494,865</u>

The above Statement of Changes in Equity should be read in conjunction with the accompanying notes.

Notes to the Consolidated Financial Statements

FOR THE HALF YEAR ENDED 31 DECEMBER 2010

1. CORPORATE INFORMATION

Xanadu Mines Ltd (the Company) was incorporated on 12 May 2005. The financial report of the Company for the half year ended 31 December 2010 was authorised for issue in accordance with a resolution of the directors on 3 March 2011.

Xanadu Mines Ltd is a company limited by shares incorporated in Australia.

The nature of the operations and principal activities of the Group are described in the directors' report.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

This general purpose condensed financial report for the half year ended 31 December 2010 has been prepared in accordance with AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*. The half year financial report does not include all notes of the type normally included within the annual financial report and therefore cannot be expected to provide as full an understanding of the financial performance, financial position and financing and investing activities of the consolidated entity as the full financial report.

It is recommended that the half year financial report be read in conjunction with the annual report for the year ended 30 June 2010 and considered together with any public announcements made by Xanadu Mines Ltd during the half year ended 31 December 2010 in accordance with continuous disclosure obligations of the ASX listing rules.

(b) Significant Accounting Policies

The accounting policies and methods of computation are the same as those adopted in the most recent annual financial report.

No new standards or interpretations have been issued (either effective or not yet effective) which are considered to have a material impact on the financial statements or performance of the Company.

(c) Prior Period Adjustment

The original MCEK LLC Sale and Purchase agreement ('SPA') required the outstanding payments to the vendor of US\$1,500,000 to be settled with an equivalent value in shares in Xanadu Mines. This liability should have been recorded as part of trade and other payables, but was recorded in the share based payment measures as at 30 June 2010.

This has led to the restatement of the Financial Reports of the Company at 30 June 2010. The impact of this amended agreement is as follows:

	As previously reported	Impact of amendment to settlement terms	Restated
	\$	\$	\$
Share based payments reserve	6,790,793	(1,701,900)	5,088,893
Trade and other payables	1,416,034	1,701,900	3,117,934

Variation to previous business combination

On 26 October 2010, an amendment to the MCEK LLC SPA was signed whereby the outstanding payments to the vendor of US\$1,500,000 (A\$1,701,900) which were to be settled with an equivalent value in shares in Xanadu Mines Ltd, would now be settled in cash and the amount to be paid was reduced to US\$1,250,000. Refer to Note 9 for the current year impact of the amendments to the SPA.

Notes to the Consolidated Financial Statements (continued)

FOR THE HALF YEAR ENDED 31 DECEMBER 2010

3. SEGMENT INFORMATION

The consolidated entity operates predominantly in the minerals exploration sector. The principal activity of the consolidated entity is exploration for gold, copper and coal. The consolidated entity classifies these activities under a single operating segment; the Mongolian exploration projects.

Regarding the exploration operating segment, the Chief Operating Decision Maker (determined to be the Board of Directors) receives information on the exploration expenditure incurred. This information is disclosed in Note 6 of the half year financial report. No segment revenues are disclosed as each exploration tenement is not at a stage where revenues have been earned. Furthermore, no segment costs are disclosed as all segment expenditure is capitalised, with the exception of expenditure written off. Refer to Note 6.

4. REVENUE AND EXPENSES

	Note	31-Dec-10 \$	31-Dec-09 \$
(a) Revenue			
Finance income		111,038	12,069
Total revenue		111,038	12,069
(b) Other income / (expense)			
Net foreign currency losses		(98,582)	(67,141)
Cost recovery		8,851	1,287
Discount recognised on business combination	9	283,650	(65,854)
Total other income / (expense)		193,919	(65,854)
(c) Administrative expenses			
Share based payments		246,718	263,310
Salaries and directors fees		425,000	262,500
Administration expense		980,050	357,293
Total administrative expenses		1,651,768	883,103

5. CASH AND CASH EQUIVALENTS

	31-Dec-10 \$	30-Jun-10 \$
Cash and cash equivalents are comprised of the following:		
Cash at bank and in hand	23,902,579	677,059
	23,902,579	677,059

Notes to the Consolidated Financial Statements (continued)

FOR THE HALF YEAR ENDED 31 DECEMBER 2010

6. DEFERRED EXPLORATION AND EVALUATION COSTS (NON-CURRENT)

	31-Dec-10	30-Jun-10
	\$	\$
Costs incurred in respect of current mining leases (net of costs expensed)	9,544,150	8,431,350

Reconciliation of movement in deferred exploration and evaluation expenditure in current period

Balance at 1 July 2010	8,431,350
Additions	1,112,800
Disposals	-
Expenditure written off during the year	-
Balance at 31 December 2010	<u>9,544,150</u>

7. CONTRIBUTED EQUITY

	31-Dec-10	30-Jun-10
	\$	\$
(a) Issued and paid up capital		
Ordinary shares fully paid	43,778,916	15,444,908

(b) Movements in ordinary shares on issue

Details	Number of shares	\$
Opening Balance at 1 July	49,048,643	15,444,908
Placement	4,655,069	3,724,055
Options exercised during the period	9,727,022	2,918,107
Share split	63,430,734	-
Shares issued on IPO	40,000,000	24,000,000
Share issue costs	-	(2,308,154)
Closing Balance at 31 December	<u>166,861,468</u>	<u>43,778,916</u>

(c) Options

At the balance date there were 29,680,000 options on issue. Details of these are as follows:

	Number of options	Exercise Price	Expiry Date
Unlisted options	10,440,000	22.5 cents	21-Apr-11
Unlisted options	14,000,000	50.0 cents	31-Dec-14
ESOP options - variable expiry dates	5,240,000	50.0 cents	Various
	<u>29,680,000</u>		

Notes to the Consolidated Financial Statements (continued)

FOR THE HALF YEAR ENDED 31 DECEMBER 2010

8. RESERVES

	31-Dec-10	30-Jun-10
	\$	Restated \$
Share-based compensation reserve	5,335,611	5,088,893
Total reserves	5,335,611	5,088,893

Reconciliation of movement in share-based compensation reserve in current period

Balance at 1 July 2010	5,088,893
Expense arising from amortisation of equity settled share based payment transactions	246,718
Balance at 31 December 2010	<u>5,335,611</u>

9. BUSINESS COMBINATION

No entities were acquired during the current period.

During the year ended 30 June 2010, Xanadu Mines Ltd acquired 100% of MCEK LLC for total consideration of US\$3,000,000. US\$500,000 of the total consideration was paid prior to 30 June 2010, and a further US\$2,000,000 (AU\$2,075,656) was paid in cash during the current period.

Subsequent to 30 June 2010, the settlement terms of the acquisition were amended, whereby the balance owing on the acquisition was to be paid in cash rather than shares. The Company received a discount of US\$250,000 (AU\$283,650) on the acquisition price for agreeing to this amendment. This discount received has been recognised in Other Income in the half year ended 31 December 2010.

Notes to the Consolidated Financial Statements (continued)

FOR THE HALF YEAR ENDED 31 DECEMBER 2010

10. EVENTS AFTER BALANCE SHEET DATE

On 3 February 2011, Xanadu Mines Ltd announced a strategic alliance with Noble Group (Noble) SGX: N21, to explore and develop thermal and coking coal, iron ore and ferro alloys opportunities in Mongolia (“Strategic Alliance”).

Xanadu and Noble have executed a Term Sheet in relation to the scope of the Strategic Alliance. Subject to the parties executing formal agreements, Xanadu and Noble will participate in the Strategic Alliance through joint venture companies with each party holding 50% in the joint ventures. Any existing assets held by Xanadu do not form part of the Strategic Alliance.

The initial focus of the joint ventures will be the pursuit of a number of identified opportunities. The Strategic Alliance will seek to maximise the benefits of Xanadu and Noble’s respective competencies and strengths. The agreement executed will include an obligation to make an offer of a placement of shares to Noble of up to 10,429,726 shares at 70 cents each, based on a 10 day VWAP prior to the term sheet being signed, with the placement occurring as of 23 March 2011 to take Noble’s equity interest in Xanadu to 9.9% at that date. The funds from the placement will be applied to the exploration and development of opportunities in Mongolia.

Other than the above, no events have occurred subsequent to balance date which would materially affect the operations or financial results of the Company.

11. COMMITMENTS AND CONTINGENCIES

The Group issued a financial guarantee to Khan Bank in respect of a loan granted to Khasuu Construction LLC during the prior year. The financial guarantee committed the Group to make a payment to the bank in the event the borrower defaulted on the loan payment. The Group became aware on 8 July 2010 that the loan was in default and at 3 August 2010, the amount owing under the loan agreement was US\$172,850. In accordance with the guarantee, the Company has paid this amount to Khan Bank LLC and received an assignment of all of the bank’s equity in the loan. On 4 August 2010, Khasuu Construction LLC entered into an Agreement with the Group whereby they have given the Group security over the assets with an assessed value of US\$220,000. These assets can, if necessary, be liquidated by the Group in the immediate future and the proceeds used to meet any loan balance due by Khasuu Construction LLC and any costs incurred by the Group. On 31 January an amount of US\$89,600 was received in part repayment of the debt and the balance is expected to be received by 31 March 2011.

Directors' Declaration

In accordance with a resolution of the directors of Xanadu Mines Ltd, I state that:

In the opinion of the directors:

- (a) the financial statements and notes of the consolidated entity are in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the financial position as at 31 December 2010 and its performance, for the half year ended on that date of the consolidated entity; and
 - (ii) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*; and
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

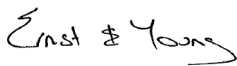
On behalf of the Board

A handwritten signature in blue ink, appearing to read 'B. Thornton', with a long horizontal flourish extending to the right.

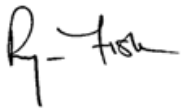
Brian Thornton
Chairman

Auditor's Independence Declaration to the Directors of Xanadu Mines Ltd

In relation to our review of the financial report of Xanadu Mines Ltd for the half-year ended 31 December 2010, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.



Ernst & Young



Ryan Fisk
Partner
3 March 2011

To the members of Xanadu Mines Ltd

Report on the Half-Year Financial Report

We have reviewed the accompanying half-year financial report of Xanadu Mines Ltd, which comprises the consolidated statement of financial position as at 31 December 2010, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the half-year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the half-year end or from time to time during the half-year.

Directors' Responsibility for the Half-Year Financial Report

The directors of the company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal controls as the directors determine are necessary to enable the preparation of the half-year financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of Interim and Other Financial Reports Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2010 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Xanadu Mines Ltd and the entities it controlled during the half-year, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

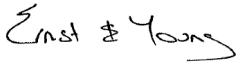
Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the Financial Report.

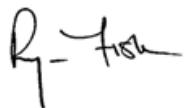
Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Xanadu Mines Ltd is not in accordance with the *Corporations Act 2001*, including:

- a) giving a true and fair view of the consolidated entity's financial position as at 31 December 2010 and of its performance for the half-year ended on that date; and
- b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

A handwritten signature in black ink that reads 'Ernst & Young'.

Ernst & Young

A handwritten signature in black ink that reads 'R. Fisk'.

Ryan Fisk
Partner
Sydney
3 March 2011