

KazakhGold Group Limited

**Interim condensed consolidated
financial statements
for the six months ended 30 June 2010
(unaudited)**

KAZAKHGOLD GROUP LIMITED

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED 30 JUNE 2010

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KAZAKHGOLD GROUP LIMITED

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED 30 JUNE 2010

The following statement, which should be read in conjunction with the report on the review of interim condensed consolidated financial statements set out on pages 2-3, is made with a view to distinguishing the respective responsibilities of management and those of the independent auditors in relation to the unaudited interim condensed consolidated financial statements of KazakhGold Group Limited and its subsidiaries (the "Group").

Management is responsible for the preparation of interim condensed consolidated financial statements that present fairly the financial position of the Group as at 30 June 2010 and the related interim condensed consolidated statements of income, comprehensive income, cash flows, changes in equity for the six months then ended, and selected explanatory notes, in accordance with International Accounting Standard 34 "Interim Financial Reporting" (IAS 34).

In preparing interim condensed consolidated financial statements, management is responsible for:

- selecting suitable accounting principles and applying them consistently;
- making judgments and estimates that are reasonable and prudent;
- stating whether IAS 34 has been followed, subject to any material departures disclosed and explained in the interim condensed consolidated financial statements; and
- preparing the interim condensed consolidated financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business for the foreseeable future.

Management is also responsible for:

- designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- maintaining statutory accounting records in compliance with local legislation and accounting standards in the respective jurisdictions in which the Group operates;
- taking steps to safeguard the assets of the Group; and
- detecting and preventing fraud and other irregularities.

The interim condensed consolidated financial statements of the Group for the six months ended 30 June 2010 were approved by the Board of Directors on 15 September 2010:

On behalf of the Management:



Ivanov E.I.
Chief Executive Officer
KazakhGold Group Limited

17 September 2010

REPORT ON THE REVIEW OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

To shareholders of KazakhGold Group Limited:

Introduction

We have reviewed the accompanying interim condensed consolidated statement of financial position of KazakhGold Group Limited and its subsidiaries (hereinafter the "Group") as at 30 June 2010 and the related interim condensed consolidated statements of income, comprehensive income, cash flows, changes in equity for the six months then ended, and selected explanatory notes. Management is responsible for the preparation and fair presentation of these interim condensed consolidated financial statements in accordance with International Accounting Standard 34 "Interim Financial Reporting" ("IAS 34"). Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim condensed consolidated financial statements consists of making inquiries, 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 International Standards on Auditing 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.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34.

Emphasis of Matter

We draw your attention to note 1 to the interim condensed consolidated financial statements, which describes a series of events which occurred subsequent to 30 June 2010, the resolution of which is uncertain at the date of issuance of these interim condensed consolidated financial statements and which may have a material impact on the Group's future operations and which may cast significant doubt about the Group's ability to continue as a going concern.

Deloitte + Touche

Moscow, Russia
17 September 2010

KAZAKHGOLD GROUP LIMITED

INTERIM CONDENSED CONSOLIDATED INCOME STATEMENT FOR THE SIX MONTHS ENDED 30 JUNE (UNAUDITED) (in thousands of US Dollars)

	Notes	<u>2010</u>	<u>2009</u>
Gold sales		42,385	25,633
Other sales		740	468
Total revenue		43,125	26,101
Cost of gold sales		(36,193)	(31,181)
Cost of other sales		(1,449)	(1,131)
Gross profit/(loss)		5,483	(6,211)
Selling, general and administrative expenses		(10,076)	(22,656)
Other expenses, net	2	(9,315)	(29,195)
Finance costs		(17,478)	(16,094)
Foreign exchange gain/(loss), net		1,573	(47,900)
Loss before income tax		(29,813)	(122,056)
Income tax benefit		-	3,081
Loss for the period		<u>(29,813)</u>	<u>(118,975)</u>
Attributable to:			
Shareholders of the parent company		(28,472)	(118,135)
Non-controlling interests		(1,341)	(840)
		<u>(29,813)</u>	<u>(118,975)</u>
Loss per share			
Weighted average number of ordinary shares in issue during the period		52,941,666	52,941,666
Basic and diluted (US Dollars)		(0.54)	(2.23)

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

KAZAKHGOLD GROUP LIMITED

INTERIM CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR SIX MONTHS ENDED 30 JUNE (UNAUDITED) *(in thousands of US Dollars)*

	<u>2010</u>	<u>2009</u>
Loss for the period	<u>(29,813)</u>	<u>(118,975)</u>
Other comprehensive (loss)/income		
Effect of translation to presentation currency	(1,765)	5,834
Revaluation surplus on property, plant and equipment, net of tax in the amount of USD 1,598 thousand	<u>-</u>	<u>8,627</u>
Other comprehensive (loss)/income for the period, net of tax	<u>(1,765)</u>	<u>14,461</u>
Total comprehensive loss for the period, net of tax	<u><u>(31,578)</u></u>	<u><u>(104,514)</u></u>
Attributable to:		
Shareholders of the parent company	(30,239)	(104,514)
Non-controlling interests	<u>(1,339)</u>	<u>-</u>
	<u><u>(31,578)</u></u>	<u><u>(104,514)</u></u>

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

KAZAKHGOLD GROUP LIMITED

INTERIM CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 30 JUNE 2010 (UNAUDITED) (in thousands of US Dollars)

	Notes	30 June 2010	31 December 2009
ASSETS			
Non-current assets			
Property, plant and equipment	3	204,089	197,051
Inventories	4	3,189	2,867
		207,278	199,918
Current assets			
Inventories	4	19,639	14,265
Trade and other receivables		3,872	2,124
Advances paid to suppliers		1,710	1,905
Income tax prepaid		1,612	3,057
Other current assets		2,605	953
Cash and cash equivalents		7,517	3,531
		36,955	25,835
TOTAL ASSETS		244,233	225,753
EQUITY AND LIABILITIES			
Capital and reserves			
Share capital		9	9
Additional paid-in capital		220,950	220,950
Capital contribution		12,686	12,686
Revaluation surplus		7,787	7,787
Option premium on convertible debt		15,598	15,598
Translation reserve		23,634	25,401
Accumulated losses		(438,073)	(409,601)
Equity attributable to shareholders of the parent company		(157,409)	(127,170)
Non-controlling interests		(1,339)	-
		(158,748)	(127,170)
Non-current liabilities			
Borrowings	5	21,913	20,812
Environmental obligations		14,197	13,356
Other non-current liabilities		6,129	15,526
		42,239	49,694
Current liabilities			
Borrowings	5	303,742	257,816
Trade payables		1,312	1,771
Other payables and accrued expenses		22,541	18,897
Other taxes payable		33,147	24,745
		360,742	303,229
TOTAL LIABILITIES		402,981	352,923
TOTAL EQUITY AND LIABILITIES		244,233	225,753

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

KAZAKHGOLD GROUP LIMITED

INTERIM CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE SIX MONTHS ENDED 30 JUNE (UNAUDITED) (in thousands of US Dollars)

	<u>2010</u>	<u>2009</u>
Operating activities		
Loss before income tax	(29,813)	(122,056)
Adjustments for:		
Amortisation and depreciation	11,150	9,295
Finance costs	17,478	16,094
Foreign exchange (gain)/loss, net	(1,573)	47,900
Non-recoverable value added tax on construction, repair, maintenance and exploration works	9,625	5,219
Bank guarantee provision	-	11,650
Loss on revaluation of property, plant and equipment	-	11,079
Other	201	6,273
	7,068	(14,546)
Movements in working capital:		
Inventories	(5,906)	3,623
Trade and other receivables	(1,841)	(3,492)
Advances paid to suppliers	395	(634)
Other current assets	(1,856)	(4,647)
Trade payables	(470)	1,478
Other payables and accrued expenses	(3,319)	8,590
Other taxes payable	1,580	3,232
Cash flows used in operations	(4,349)	(6,396)
Interest paid	(9,911)	(11,549)
Income tax paid	(1,087)	(1,022)
Net cash used in operating activities	(15,347)	(18,967)
Investing activities		
Purchase of property, plant and equipment	(18,976)	(467)
Proceeds from sale of property, plant and equipment	232	-
Net cash used in investing activities	(18,744)	(467)
Financing activities		
Proceeds from borrowings	49,960	37,294
Repayments of borrowings	(6,262)	(27,592)
Repayment of bank guarantees	(5,930)	-
Net cash generated from financing activities	37,768	9,702
Net increase/(decrease) in cash and cash equivalents	3,677	(9,732)
Cash and cash equivalents at beginning of the period	3,531	13,966
Effect of translation to presentation currency on cash and cash equivalents	309	(919)
Cash and cash equivalents at end of the period	7,517	3,315

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

KAZAKHGOLD GROUP LIMITED

INTERIM CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE SIX MONTHS ENDED 30 JUNE 2010 (UNAUDITED)

(in thousands of US Dollars)

	Equity attributable to shareholders of the parent company										
	Notes	Share capital	Additional paid-in capital	Capital contribution	Translation reserve	Revaluation surplus	Option premium on convertible debt	Accumulated losses	Total	Non-controlling interests	Total
Balance at 1 January 2009		9	220,950	12,686	11,840	-	-	(266,702)	(21,217)	-	(21,217)
Loss for the period		-	-	-	-	-	-	(118,135)	(118,135)	(840)	(118,975)
Revaluation surplus on property, plant and equipment, net of tax in the amount of USD 1,598 thousand		-	-	-	-	7,787	-	-	7,787	840	8,627
Effect of translation to presentation currency		-	-	-	5,834	-	-	-	5,834	-	5,834
Total other comprehensive income, net of tax		-	-	-	5,834	7,787	-	-	13,621	840	14,461
Total comprehensive loss, net of tax		-	-	-	5,834	7,787	-	(118,135)	(104,514)	-	(104,514)
Issuance of convertible debt	5	-	-	-	-	-	13,371	-	13,371	-	13,371
Balance at 30 June 2009		9	220,950	12,686	17,674	7,787	13,371	(384,837)	(112,360)	-	(112,360)
Balance at 1 January 2010		9	220,950	12,686	25,401	7,787	15,598	(409,601)	(127,170)	-	(127,170)
Loss for the period		-	-	-	-	-	-	(28,472)	(28,472)	(1,341)	(29,813)
Effect of translation to presentation currency		-	-	-	(1,767)	-	-	-	(1,767)	2	(1,765)
Total other comprehensive loss, net of tax		-	-	-	(1,767)	-	-	-	(1,767)	2	(1,765)
Total comprehensive loss, net of tax		-	-	-	(1,767)	-	-	(28,472)	(30,239)	(1,339)	(31,578)
Balance at 30 June 2010		9	220,950	12,686	23,634	7,787	15,598	(438,073)	(157,409)	(1,339)	(158,748)

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED 30 JUNE 2010 (UNAUDITED)

1. GENERAL INFORMATION

Organisation

KazakhGold Group Limited (the “Company” or “KazakhGold”) was incorporated in Jersey on 26 September 2005. The principal activities of the Company and its subsidiaries (the “Group”) are the extraction, production and sale of cathodic gold, free gold and other gold-bearing products. Mining and processing facilities of the Group are located in the northern part of the Republic of Kazakhstan. The Group also performs research and exploration works, primarily in the existing production locations, in Central and Eastern Kazakhstan and in Romania.

On 30 July 2009, 50.2% of the Group was acquired by Polyus Gold through its 100% owned subsidiary Jenington International Inc (“Jenington”). Subsequent to the acquisition, management has focused on investing in the mining infrastructure to increase production and cost reduction. As a result of these actions, combined with the increase in gold prices, the Group has increased the gross margin to USD 5,483 thousand for the six months ended 30 June 2010 from a negative gross margin of USD 6,211 thousand for the six months ended 30 June 2009 and decreased its selling, general and administrative costs to USD 10,076 thousand for the six months ended 30 June 2010 from USD 22,656 thousand for the six months ended 30 June 2009. While there has been an increase in profitability, the Group continued to incur cash outflows from its operations.

The Group has historically been financed by loans from third parties and with loans from Polyus Gold since its agreement to acquire 50.2% of the Company. The loans from third parties include various restrictive covenants including limitations on additional indebtedness, reporting requirements and certain financial covenants. At 30 June 2010, the Group is not in compliance with certain of these covenants, and as a result has classified the USD 200 million outstanding on the senior notes as a current liability.

At 30 June 2010, due to (a) the classification of the USD 200 million of senior notes as current, (b) short-term borrowings entered into with Jenington of USD 100 million and (c) the deficit generated from its operations, the Group has a working capital deficit of USD 323,787 thousand.

In addition to financial uncertainty described above, there is a dispute between the former and current shareholders of the Company whereby the current shareholders are asserting that the former shareholders were negligent in their fiduciary responsibilities related to the Group. On 25 June 2010, the current shareholders filed a lawsuit against the former controlling shareholders.

Subsequent to that date, the Government of the Republic of Kazakhstan has taken various actions against the current management and directors that have had both a direct and indirect impact on the Group. These actions include the following:

- on 12 July 2010, JSC “MMC Kazakhaltyn” (“Kazakhaltyn”), a major production subsidiary of the Company located in the Republic of Kazakhstan, received notification from the Ministry of Industry and New Technologies of the Republic of Kazakhstan indicating that the previous decisions of the competent authorities in Kazakhstan providing a waiver of the state’s pre-emptive right to acquire the Company’s securities had been annulled. These waivers were obtained in connection with (a) the acquisition of 50.2% of the shares of the Company in July 2009, (b) the issuance of shares in July 2010 that resulted in proceeds of USD 100 million to the Company and (c) the proposed combination between Polyus Gold and the Company announced on 30 June 2010;
- on 2 August 2010, the Group was notified that a freeze had been placed by the Agency on Economic and Corruption Crimes (“AECC”) in Kazakhstan on certain bank accounts held in Kazakhstan by Kazakhaltyn. This freeze is in connection with an investigation by the AECC into allegations of fraud by three members of its current Board of Directors. After clarification, Kazakhaltyn was permitted limited access to make payments to employees and certain key suppliers;
- on 23 August 2010, an unscheduled tax audit of Kazakhaltyn commenced for the fiscal years 2009 and 2010 and further the tax audit was extended for 2007 and 2008 years; and

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- on 7 September 2010, major production assets owned by Kazakhaltyn were frozen under AECC freezing order which had been made in the connection with the investigation being processed by AECC. The restriction only refers to possible disposal of property, plant and equipment and has no influence on current operating activity.

Management of the Group believe that based on the rapid sequence of these events, the actions of the Government of the Republic of Kazakhstan is in direct response to the legal proceedings brought by the current shareholders against the former shareholders.

The directors have concluded that the factors described above related to the financial position at 30 June 2010, and the actions taken by the Government of the Republic of Kazakhstan represent a material uncertainty that casts significant doubt upon the Group's ability to continue as a going concern and that therefore, the Group may be unable to realise its assets and discharge its liabilities in the ordinary course of business.

Management has considered the following in determining whether or not these interim condensed consolidated financial statements should be prepared on a going concern basis:

- on 1 July 2010, the Company issued 66,666,667 of ordinary shares, resulting in total proceeds of USD 100 million. Polyus Gold, through its subsidiary Jenington, subscribed for 51,194,922 of the shares increasing its ownership in the Company to 65% of the issued share capital;
- on 6 July 2010, the Company repaid a USD 50 million loan to Jenington. There remains a USD 50 million loan, convertible at the option of the holder, and, if converted prior to the proposed combination of KazakhGold and Polyus Gold, is subject to regulatory approval from the Government of the Republic of Kazakhstan and given the situation described in this note such approval may not be received;
- Polyus Gold has guaranteed the USD 200 million of senior notes;
- Polyus Gold has provided the Group a commitment that it will provide the necessary financial support to ensure the Group is able to finance its operations and obligations;
- on 27 July 2010, the Company received the bondholders' waiver of the breaches existed at 30 June 2010 under the terms and conditions of senior notes and pre-emptively certain breaches of the terms and conditions of senior notes that are expected to arise in connection with the Proposed Combination of KazakhGold and Polyus Gold; and
- the importance of the survival of the business to the particular region in Kazakhstan.

Based on this assessment, the directors have concluded that it is reasonable that they will be able to finance their operation and meet their obligations for a period no less than twelve months from the date of issuance of these interim condensed consolidated financial statements and accordingly have continued to adopt the going concern basis of accounting in preparing the interim condensed consolidated financial statements.

The Group is unable to predict the outcome of the actions taken by the Government of the Republic of Kazakhstan and therefore cannot reasonably predict the impact on its operations, ability to meet its obligations or ability to realise its assets that may result from the ultimate resolution between the Group and the Government of the Republic of Kazakhstan. Should the outcome be unfavourable to the Group, there is a risk of significant material adjustment to the financial statements.

Basis of presentation

The interim condensed consolidated financial statements have been prepared using accounting policies consistent with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*.

The statement of financial position at 31 December 2009 has been derived from the statement of financial position included in the Group's consolidated financial statements for the year ended 31 December 2009.

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED 30 JUNE 2010 (UNAUDITED)

The financial information for the six months ended 30 June 2009 has not previously been published and therefore has not been audited or reviewed.

These interim condensed consolidated financial statements do not include all of the information and disclosures required in the annual consolidated financial statements and should be read in conjunction with the Group's annual consolidated financial statements for the year ended 31 December 2009, which have been prepared in accordance with IFRS.

The same accounting policies, presentation and methods of computation have been followed in these interim condensed consolidated financial statements as were applied in the Group's financial statements for the year ended 31 December 2009, except as described below.

Foreign currency exchange rates

The individual financial statements of the Group's subsidiaries are prepared in their functional currency.

Exchange rates used in the preparation of the interim condensed consolidated financial statements were as follows:

	<u>30 June 2010</u>	<u>30 June 2009</u>	<u>31 December 2009</u>
<i>KZT/USD</i>			
Period-end rates	147.46	150.41	148.36
Average for the period	147.24	144.69	147.51
<i>Romanian Lei/USD</i>			
Period-end rates	3.56	2.98	2.94
Average for the period	3.13	3.17	3.05
<i>Kyrgyz Som/USD</i>			
Period-end rates	46.39	43.28	44.09
Average for the period	45.15	42.02	42.99

Critical accounting judgments, estimates and assumptions

The critical accounting judgments, estimates and assumptions made by management of the Group and applied in the accompanying unaudited interim condensed consolidated financial statements for the six months ended 30 June 2010 are consistent with those applied in the preparation of annual consolidated financial statements of the Group for the year ended 31 December 2009.

Adoption of new and revised Standards and Interpretations

In the preparation of these interim condensed consolidated financial statements the Group has adopted all new International Financial Reporting Standards and Interpretations issued by International Financial Reporting Committee ("IFRIC") that are mandatory for adoption in annual periods beginnings on or after 1 January 2010.

The principal changes arising from adoption of these Standards and Interpretations are as follows:

IAS 27 Consolidated and Separate Financial Statements (as revised in 2008 and effective 1 July 2009)

The revisions to IAS 27 principally affect the accounting for non-controlling interests. Under the revised Standard total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

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In the current period, these changes have affected the accounting for non-controlling interests, resulting in a decrease of non-controlling interests in the amount of USD 1,339 thousand as a result of allocating losses to the non-controlling interests.

Adoption of the revised Standard had no effect neither on the financial position nor the performance of the Group.

Standards and interpretations adopted with no effect on the financial statements

The revisions and amendments to the following Standards and Interpretations presented below did not have any impact on the accounting policies, financial position or performance of the Group:

- IFRS 2 *Share-based Payments*;
- IFRS 3 *Business combinations*;
- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;
- IFRS 8 *Operating Segments*;
- IAS 1 *Presentation of Financial Statements*;
- IAS 7 *Statement of Cash Flows*;
- IAS 17 *Leases*;
- IAS 28 *Investments in Associates*;
- IAS 31 *Investments in Joint Ventures*;
- IAS 36 *Impairment of Assets*;
- IAS 38 *Intangible Assets*;
- IAS 39 *Financial Instruments: Recognition and Measurement*.

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED 30 JUNE 2010 (UNAUDITED) (in thousands of US Dollars)

2. OTHER EXPENSES, NET

	Six months ended 30 June 2010	Six months ended 30 June 2009
Non-recoverable value added tax on construction, repair, maintenance and exploration works	9,625	5,219
Bank guarantee provision	-	11,650
Loss on revaluation of property, plant and equipment	-	11,079
Other	(310)	1,247
Total	9,315	29,195

3. PROPERTY, PLANT AND EQUIPMENT

	Exploration and evaluation assets	Mining assets	Non-mining assets	Capital construction- in-progress	Total
Cost					
Balance at 31 December 2009	3,872	160,693	2,984	49,552	217,101
Additions	6,030	5,610	4	7,774	19,418
Transfers	-	684	-	(684)	-
Disposals	-	(200)	-	-	(200)
Effect of translation to presentation currency	15	300	18	(913)	(580)
Balance at 30 June 2010	9,917	167,087	3,006	55,729	235,739
Accumulated amortisation, depreciation and impairment					
Balance at 31 December 2009	-	(19,843)	(207)	-	(20,050)
Charge for the period	-	(11,582)	(51)	-	(11,633)
Disposals	-	31	-	-	31
Effect of translation to presentation currency	-	4	(2)	-	2
Balance at 30 June 2010	-	(31,390)	(260)	-	(31,650)
Net book value					
31 December 2009	3,872	140,850	2,777	49,552	197,051
30 June 2010	9,917	135,697	2,746	55,729	204,089

Amortisation and depreciation capitalised during the six months ended 30 June 2010 amounted to USD 483 thousand.

At 30 June 2010, property, plant and equipment with a carrying value of USD 11,803 thousand were pledged to secure borrowings of the Group (refer to note 5).

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED 30 JUNE 2010 (UNAUDITED) (in thousands of US Dollars)

4. INVENTORIES

	<u>30 June 2010</u>	<u>31 December 2009</u>
Inventories expected to be recovered after twelve months		
Stockpiles	3,189	2,867
Total	<u>3,189</u>	<u>2,867</u>
Inventories expected to be recovered in the next twelve months		
Gold-in-process at net production cost	8,388	5,462
Finished goods at net production cost	6,240	4,926
Total metal inventories	14,628	10,388
Stores and materials at cost	6,399	4,954
Less: allowance for obsolescence	(1,388)	(1,077)
	<u>19,639</u>	<u>14,265</u>
Total	<u>22,828</u>	<u>17,132</u>

The Group consumed USD 7,729 thousand of stores and materials during the six months ended 30 June 2010, which have been recognised as cost of gold sales (six months ended 30 June 2009: USD 7,190 thousand).

5. BORROWINGS

		<u>30 June 2010</u>			<u>31 December 2009</u>	
		<u>Currency</u>	<u>Rate, %</u>	<u>Outstand- ing balance</u>	<u>Rate, %</u>	<u>Outstand- ing balance</u>
Guaranteed senior notes	(i)	USD	9.375	200,000	9.375	200,000
Loan received from Jenington	(ii)	USD	9.27	49,960	n/a	-
Convertible loan received from Jenington	(ii)	USD	LIBOR+6	49,310	LIBOR+6	47,892
Convertible loans received from Gold Lion Holdings Limited	(iii)	USD	10.0	21,913	10.0	19,783
Secured bank loan	(iv)	USD	13.75	2,728	13.75	4,751
Unsecured bank loan	(v)	USD	11.0	1,744	11.0	4,348
Secured bank loan	(iv)	KZT	n/a	-	16.0	1,854
Total				325,655		278,628
Less: current portion due within twelve months				(303,742)		(257,816)
Long-term borrowings				<u>21,913</u>		<u>20,812</u>

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NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED 30 JUNE 2010 (UNAUDITED) (in thousands of US Dollars)

Summary of borrowing agreements

(i) Guaranteed senior notes

In November 2006, the Company issued USD 200,000 thousand 9.375% senior notes (the “Notes”). The Notes were issued at par with an interest payable semi-annually in arrear on 6 May and 6 November of each year, with the principal due on 6 November 2013. At the date of issuance the Notes were unconditionally and irrevocably guaranteed by JSC “MMC Kazakhaltyn” and its subsidiaries. On 30 July 2009, in connection with the acquisition by Jenington of 50.2% of issued shares of KazakhGold Group Limited, Polyus Gold became an additional limited liability guarantor of the Notes.

The Group is obliged to comply with a number of restrictive financial and other covenants, including maintaining of certain financial ratios. At 30 June 2010 and 31 December 2009, the Group is not in compliance with the covenants, and accordingly, the Notes are classified as a current liability. On 27 July 2010, the Company received the bondholders’ waiver of the breaches existed at 30 June 2010 under the terms and conditions of the Notes.

(ii) Loans received from Jenington

On 14 August 2009, the Company signed a USD 50,000 thousand unsecured loan agreement with Jenington, a related party. The loan bears interest at a floating rate of LIBOR+6% per annum. The principal amount together with accrued interest is payable within three months of the Company completing an anticipated capital raising of USD 100 million. The principal amount of the loan together with accrued interest can be converted by Jenington into ordinary shares of the Company at a rate of USD 1.5 per one share at any point during the life of the loan. Conversion right may be exercised by Jenington at any date following the loan agreement date and is subject to several restrictions, including regulatory approval from the Government of the Republic of Kazakhstan. The Company expects Jenington to convert the loan into Company’s ordinary shares.

The net proceeds received under the convertible loan agreement have been split between a liability component and an equity component, representing the residual attributable to the option (option premium) to convert the liability into equity of the Group, as follows:

Proceeds from issue	49,310
Fair value of liability component at date of issue	<u>(47,083)</u>
Equity component	<u>2,227</u>

The interest charged for the period is calculated by applying an effective interest rate of 14.5%.

On 4 February 2010, the Company signed a USD 50,000 thousand unsecured loan agreement with Jenington, a related party. The loan bears interest at a rate of 9.27% per annum. The principal amount together with accrued interest is payable within three months of the Company completing an anticipated capital raising of USD 100 million, but in any event no later than in nine months from the date of the loan agreement. The Company has an option to convert the loan and accrued interest into its shares or GDRs at the price equal to the average of the closing prices of the GDRs on London Stock Exchange for the period of 20 trading days ending on a trading day immediately preceding the date on which the conversion notice is provided to Jenington. Conversion right may be exercised at any date following the loan agreement date and is subject to several restrictions, including regulatory approval from the Government of the Republic of Kazakhstan. The USD 100 million equity capital raising was completed on 1 July 2010, and as a result this loan together with accrued interest was fully repaid in July 2010.

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(iii) Loans received from Gold Lion Holdings Limited

On 11 June 2009, the Company signed two loan agreements with Gold Lion Holdings Limited, a related party. The loans bear interest at a rate of 10% per annum. Principal amounts of USD 21,650 thousand and USD 9,375 thousand together with accrued interest are payable on 6 November 2014. Until their maturity date, these loans are convertible wholly or in part into the Company's ordinary shares at a rate of USD 1.5 per one share. Conversion is subject to several restrictions, including the Republic of Kazakhstan regulatory approval and approval from the Company. In June 2009, Gold Lion Holdings Limited granted a call option to Jenington and any other direct or indirect subsidiary of Polyus Gold to acquire all rights and interests under these loan agreements, including the conversion right.

The net proceeds received under the convertible loan agreements have been split between a liability component and an equity component, representing the residual attributable to the option to convert the liability into equity of the Group, as follows:

Proceeds from issue	31,025
Fair value of liability component at date of issue	<u>(17,654)</u>
Equity component	<u>13,371</u>

The interest charged for the period is calculated by applying an effective interest rate of 22.1%.

(iv) Secured bank loans

In 2009, a subsidiary of the Group obtained a USD 4,751 thousand secured loan denominated in USD from JSC SB "Sberbank" at a fixed rate of 13.75% per annum. The loan is to be repaid on 5 December 2010. Interest is payable monthly.

In 2009, a subsidiary of the Group obtained a USD 1,854 thousand secured loan denominated in KZT from JSC "Kazkommertsbank" at a fixed rate of 16% per annum. The loan was fully repaid in February 2010.

(v) Unsecured bank loan

In 2009, a subsidiary of the Group obtained a USD 4,348 thousand unsecured loan denominated in USD from JSC SB "HSBC Bank Kazakhstan" at a fixed rate of 11% per annum. The loan is to be repaid on 16 October 2010. Interest is payable monthly.

Pledges

Property, plant and equipment with book value of USD 11,803 thousand were pledged to secure borrowings.

6. RELATED PARTIES

Related parties include shareholders, entities under common ownership and control with the Group and companies presumed by management to be under control of members of the Company's Board of Directors. During the six months ended 30 June 2010 and 2009, the Company and its subsidiaries entered into transactions with related parties in relation to the provision of financing agreements from its parent entities or entities under common ownership.

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As a result of change of shareholders of the Company, OJSC “Polyus Gold” and its subsidiaries became related parties to the Group from 30 July 2009.

Outstanding balances with related parties as at 30 June 2010 and 31 December 2009 were as following:

	<u>30 June 2010</u>	<u>31 December 2009</u>
Jenington		
Borrowings	99,270	47,892
Interest payable	3,486	644
Gold Lion Holdings Limited		
Borrowings	<u>21,913</u>	<u>19,783</u>
Total	<u><u>124,669</u></u>	<u><u>68,319</u></u>

The above amounts include USD 49,310 thousand together with accrued interest that the holder can choose to convert into shares at a rate of USD 1.5 per one share. However, the conversion is subject to regulatory approval from the Government of the Republic of Kazakhstan and given the situation described in note 1 such approval may not be received.

During the six months ended 30 June 2010 and 30 June 2009, Group entered into the following transactions with related parties:

	<u>Six months ended 30 June 2010</u>	<u>Six months ended 30 June 2009</u>
Jenington		
Loans received	49,960	-
Gold Lion Holdings Limited		
Loans received	-	31,025

Loans were provided from related parties at the rates from LIBOR+6% to 10%.

Compensation of key management personnel for the six months ended 30 June 2010 amounted to USD 689 thousand (six months ended 30 June 2009: USD 2,086 thousand).

7. CONTINGENCIES

Litigation

The Group has a number of insignificant claims and litigation relating to sales and purchases of goods and services from suppliers. Management believes that none of these claims, individually or in aggregate, will have a material adverse impact on the Group. Refer to note 1 for description of the claims and litigations arisen after the reporting date with former shareholders of the Company and with the Government of the Republic of Kazakhstan.

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Taxation contingencies in the Republic of Kazakhstan

The taxation system in the Republic of Kazakhstan is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by various levels of authorities, which have the authority to impose severe fines, penalties and interest charges. A tax year generally remains open for review by the tax authorities for ten subsequent calendar years under newly amended tax law but under certain circumstances a tax year may remain open longer.

These circumstances may create tax risks in the Republic of Kazakhstan that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these interim condensed consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

8. PRINCIPAL RISKS AND UNCERTAINTIES

Republic of Kazakhstan

Although in recent years there has been a general improvement in economic conditions in the Republic of Kazakhstan, the country continues to display certain characteristics of an emerging market. These include, but are not limited to, currency controls and convertibility restrictions, relatively high level of inflation and continuing efforts by the Government to implement structural reforms.

As a result, laws and regulations affecting businesses in the Republic of Kazakhstan continue to change rapidly, and the application of such laws and regulations is unpredictable. Tax, currency and customs legislation within the Republic of Kazakhstan is subject to varying interpretations, and other legal and fiscal impediments contribute to the challenges faced by entities currently operating in the Republic of Kazakhstan. The future economic direction of the Republic of Kazakhstan is largely dependent upon the effectiveness of economic, fiscal and monetary measures undertaken by the Government, together with legal, regulatory, and political developments.