

## DIRECTORS' RESPONSIBILITY STATEMENT

Mr Evgueni I. Ivanov, Chairman and CEO of KazakhGold Group Limited confirms on behalf of the Board of Directors that:

(a) the consolidated financial statements for the year ended 31 December 2010 and 2009, prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, give a true and fair view of the assets, liabilities, financial position and profit or loss of KazakhGold Group Limited and its consolidated subsidiaries; and

(b) the management report for the year 2010 includes a fair review of the development and performance of the business and the position of KazakhGold Group Limited, together with a description of the principal risks and uncertainties that it faces.

Neither KazakhGold Group Limited nor the directors accept any liability to any person in relation to the management report except to the extent that such liability could arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with Section 90A of the Financial Services and Markets Act 2000.

EVGUENI I. IVANOV  
Chairman and CEO

26 April 2011

### **Management report Management's discussion and analysis of financial condition and results of operations for the year ended 31 December 2010**

This Management report should be read in conjunction with KazakhGold's consolidated financial statements and the related notes thereto.

The KazakhGold Group is a leading gold miner in the Republic of Kazakhstan with a broad gold reserves and resources base. The KazakhGold Group's operating mines are located in Northern and Eastern Kazakhstan, and it also has development properties in Eastern Kazakhstan and Romania, as well as potential development opportunities in Kyrgyzstan. Global Depositary Receipts representing the shares of KazakhGold Group Limited are traded on the main market of the London Stock Exchange under the symbol of KZG.

On 30 July 2009 as a result of the Partial Offer<sup>1</sup>, Jenington International, an indirect wholly owned subsidiary of Polyus Gold, the leading Russian gold producer and one of the largest gold mining companies globally, acquired 50.15% of KazakhGold Group Limited. On 1 July 2010, following an equity placing, KazakhGold issued 66,666,667 its ordinary shares, resulting in gross proceeds of USD 100 million. Polyus Gold, through its subsidiary Jenington, subscribed for 51,194,922 of these shares, increasing its ownership in KazakhGold to 65% of its issued share capital.

This report represents the management's discussion of KazakhGold's operating and financial results, including:

- material recent developments;
- key performance indicators;
- results of operations for the year ended 31 December 2010 and 31 December 2009;
- financial position as at 31 December 2010 and 31 December 2009; and
- the Company's liquidity, solvency and capital resources;

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<sup>1</sup> The Partial Offer to acquire 50.1% of the issued and to be issued share capital of KazakhGold Group Limited was made by Jenington International Inc., an indirect wholly-owned subsidiary of OJSC Polyus Gold, to all shareholders of the Group in July 2009. Following the completion of the Partial Offer Jenington became owner of 50.15% of the issued share capital of the Group.

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## **1. Material recent developments**

Since the appointment following the completion of the Partial Offer, the new management team undertook a number of steps to improve the operational and financial condition of KazakhGold, including seeking additional cash injections and initiating preparation of a new development strategy. Prior to completion of the Partial Offer, a lack of working capital and protracted underinvestment led to serious problems at all production units. Regular maintenance works had not been performed on either mining or processing equipment, resulting in an increasing number of emergency shutdowns and a significant amount of downtime.

Since completion of the Partial Offer by Jenington International in August 2009, the new controlling shareholder has invested significant amounts of funds in KazakhGold for the maintenance and restoration of existing facilities. In August 2009 and February 2010, KazakhGold entered into two USD 50 million loan agreements with Jenington to provide it with funds for working capital purposes and to fund the USD 8.4 million consent fee payable to the bondholders in connection with a consent solicitation carried out to permit the Partial Offer. On 1 July 2010, KazakhGold also completed a USD 100 million placing. A total of 51,194,922 Shares and 15,471,745 GDRs (each representing one Share) were placed at a price of USD 1.50 per share. Jenington subscribed for 51,194,922 Shares and thereby contributed an additional USD 76.8 million to KazakhGold, out of which USD 51.3 million was used to repay the February 2010 loan, together with the accrued interest. In total, since August 2009 until the end of 2010, USD 140.3 million was invested into the company. In May 2010, a new long-term strategy to 2020 was approved by the Board.

On 30 June 2010, the Board of KazakhGold announced the Proposed Combination of KazakhGold and Polyus Gold, which, if completed, would have resulted in KazakhGold acquiring substantially all of the issued share capital of Polyus Gold. The Proposed Combination was to be carried out through a series of transactions designed to create a single holding company which would combine the businesses of both KazakhGold and Polyus Gold, unifying the shareholder bases of the companies under a single listing on the London Stock Exchange.

On 12 July 2010, KazakhGold announced that its subsidiaries in Kazakhstan had received a letter from the Ministry of Industry and New Technologies of the Republic of Kazakhstan ("MINT") indicating that the prior decisions of the competent authorities in Kazakhstan relating to the waivers of the state's pre-emptive right to acquire KazakhGold securities had been annulled. The decision appeared to be based on the waiver obtained by the former directors of KazakhGold for the partial offer by Jenington, which was completed in August 2009, but also covered the waiver subsequently obtained in June 2010 for the proposed business combination between Polyus Gold and KazakhGold announced on 30 June 2010 and the USD 100 million equity placing completed by KazakhGold on 1 July 2010.

On 27 July 2010, the Proposed Combination was approved by an extraordinary general meeting of shareholders. The meeting also extended the deadline for acceptances of the Private Exchange Offer to 17 September 2010, in order to provide KazakhGold a further period for consultation with the Kazakh authorities in relation to issues raised by them in connection with the Proposed Combination, including the announcement by MINT of the annulment of the waivers previously granted to KazakhGold with respect to the state's pre-emptive rights under the Kazakh subsoil laws, with a view to resolving these issues.

On 28 July 2010, KazakhGold announced that the consent solicitation of holders of its USD 200,000,000 9.375 per cent. Senior Notes due 2013 (the "Senior Notes") was successfully completed, and the resolutions consenting to various actions in connection with the Proposed Combination and certain other matters were passed.

On 26 October 2010, KazakhGold Group and OJSC Polyus Gold announced that the Private Exchange Offer under the terms announced on 30 June 2010 had been terminated, due to an inability to reach a resolution of the above mentioned issues by the 29 October deadline.

On 8 December 2010, KazakhGold entered into a Principal Agreement ("Agreement") with AltynGroup, a limited liability partnership controlled by the Assaubayev family, to sell its operating subsidiaries in Kazakhstan, Romania and Kyrgyzstan. According to the Agreement, the Assaubayev family agreed to pay USD 509 million in two tranches.

On 14 March 2011, KazakhGold Group Limited announced that it had terminated the Principal Agreement with Altyn Group, as the first tranche completion was not achieved by the cut-off date.

On 8 April 2011, KazakhGold and AltynGroup signed a Restated and Amended Principal Agreement (RAPA) for the sale of KazakhGold's operating assets, as well as a Settlement Deed in respect of the claims initiated in relation to the Assaubayev family. Under RAPA, the sale of KazakhGold's assets shall be implemented in two tranches. In the first tranche, KazakhGold will transfer to AltynGroup 51% stakes in

operating subsidiaries for a total amount of USD 259,590,000, part of that consideration to be satisfied by cancellation of its KazakhGold's loan (plus interest accrued thereon) to Gold Lion (the entity controlled by Assaubayev family through which it holds its KazakhGold stakes).

On or prior the First tranche completion, AltynGroup will provide an irrevocable unconditional guarantee or stand-by letter of credit in respect of 51% of all sums payable under the Senior Notes; such guarantee shall be increased proportionally to the number of shares acquired further by AltynGroup.

In case the first tranche is not implemented by 12 September 2011, the letter of credit proceeds will be applied to the AltynGroup's acquisition of shares of KazakhGold, the quantity to be calculated using a formula defined by the agreement. In that case, in accordance with preliminary estimation, AltynGroup's ownership of KazakhGold will amount to 15.89%.

Under the second tranche AltynGroup shall either acquire the remaining 49% stake in the operating subsidiaries, or 100% of the off-shore companies holding such operating subsidiaries for the total consideration of USD 249,410,000. Prior to or at First tranche completion, AltynGroup is required to provide KazakhGold with guarantees of payment for the Second tranche.

## 2. KazakhGold Group's operating results

### 2.1 External market factors affecting the financial results of the KazakhGold Group

The results of the KazakhGold Group are significantly affected by the price of commodities, such as gold, oil and steel, as well as movements in the national currency exchange rates.

The market price of gold is the most significant factor affecting the profitability and operating cash flow generation of the Group. The global gold price is subject to volatile movements over short periods of time. In 2010, gold price volatility remained high, with the price ranging from the lowest level of USD 1,058 per troy ounce (London p.m. fixing) in February to the highest of USD 1,421 per ounce in November. In 2010, the average gold p.m. fixing price in London was USD 1,224.5 per ounce, an increase of 26% over the 2009 average price of USD 972.4 per ounce. For the whole year, the global price of gold increased by 25% from USD 1,121.5 per ounce on 4 January, to USD 1,405.5 per ounce on 30 December, the first and the last business days in 2010, respectively.

The results of the KazakhGold Group are also affected to a significant extent by currency exchange rates. The KazakhGold Group's revenue from gold sales is denominated in USD, whereas most of the operating expenses of KazakhGold are denominated in the Kazakh tenge. During 2010, the KZT exchange rate did not change materially. The average rate for 2010 was KZT 147.35 per USD (2009: 147.50). By the end of the year, the KZT slightly appreciated, closing at KZT 147.40 per USD (2009: 148.36).

A significant portion of costs included in the cost of gold sales of the KazakhGold Group are also directly or indirectly impacted by the prices of oil and steel. Changes in oil prices impact the prices of heating oil, diesel fuel, gasoline and lubricants for mining and construction equipment. Steel forms the basis for the price of all rolled metal products, pipes, machinery and vehicles. Global prices for commodities increased in 2010, creating significant cost pressure for the KazakhGold Group. Oil prices showed a 29% year-on-year increase, with steel prices growing by 10%. Average rates for key external market factors are:

<b>Average price/ rate</b>	<b>2010</b>	<b>2009</b>
Average London p.m. gold fixing price (USD per troy ounce) <sup>(1)</sup>	1,224.5	972.4
Oil (Brent) (USD per barrel) <sup>(2)</sup> .....	80.3	62.4
Steel (hot rolled) (USD per tonne) <sup>(3)</sup> .....	641	582
Average USD/KZT rate <sup>(5)</sup> .....	147.35	147.51
Period end USD/KZT rate .....	147.40	148.36

1. Source: London Bullion Market Association.

2. Source: Bloomberg.

3. Source: Steel Business Briefing.

4. Source: The Central Bank of Russia.

5. Source: The National Bank of Kazakhstan.

## 2.2. Discussion of results of operations for the year ended 31 December 2010 and 2009.

The following table sets forth a summary of results of the operations of the KazakhGold Group for the year ended 31 December 2010 and 2009.

(US dollars in thousands, except for per share amount)	Year ended 31 December		Change
	2010	2009	%
Gold sales	114,448	58,434	95.9
Other sales	1,246	1,943	(35.9)
<b>Total revenue</b>	<b>115,694</b>	<b>60,377</b>	<b>91.6</b>
Cost of gold sales	(76,997)	(57,296)	34.4
Cost of other sales	(3,306)	(2,846)	16.2
<b>Gross profit/(loss)</b>	<b>35,391</b>	<b>235</b>	<b>14,960.0</b>
<b>Gross profit/(loss) on gold sales</b>	<b>37,451</b>	<b>1,138</b>	3,191.0
<b>Gross profit margin</b>	<b>31%</b>	<b>0.4%</b>	-
Selling, general and administrative expenses	(24,260)	(39,746)	(39.0)
Other expenses, net	(35,230)	(32,621)	8.0
Finance costs	(32,929)	(31,841)	3.4
Foreign exchange (loss)/gain, net	1,086	(45,927)	(102.4)
<b>Loss before income tax</b>	<b>(55,942)</b>	<b>(149 900)</b>	(62.7)
<b>Pre-tax margin</b>	<b>(48%)</b>	<b>(248%)</b>	-
Income tax (expense)/ benefit	(1,329)	6,161	(121.6)
<b>Loss for the year</b>	<b>(57,271)</b>	<b>(143,739)</b>	(60.2)
Net loss attributable to minority interest	(1,006)	(840)	19.8
<b>Net profit/(loss) attributable to shareholders of the parent company</b>	<b>(56,265)</b>	<b>(142,899)</b>	(60.6)
<b>Net profit margin</b>	<b>(49%)</b>	<b>(238%)</b>	-
<b>Loss per share – basic and diluted (USD)</b>	<b>(0.66)</b>	<b>(2.70)</b>	(75.6)

## 2.3. Gold sales

The following tables show gold sales for the year ended 31 December 2010 and 2009:

	year ended 31 December		Change
	2010	2009	%
<b>Gold sales (USD thousand)</b>	<b>114,448</b>	<b>58,434</b>	95.9
<b>Gold sales (thousand troy ounces)</b>	<b>103.31</b>	<b>69.34</b>	49.0
<b>Weighted-average gold selling price (USD per troy ounce)</b>	<b>1,107.8</b>	<b>842.7</b>	31.5
<b>Average p.m. fixing price in London (USD per troy ounce)<sup>(1)</sup></b>	<b>1,224.5</b>	<b>972.4</b>	25.9
<b>Excess/ (deficit) of average selling price over/(under) average evening fixing price (USD per troy ounce)</b>	<b>(117)</b>	<b>(130)</b>	(10.0)

1) Source: London Bullion Market Association

Gold sales revenue in 2010 almost doubled year-on-year and amounted to USD 114,448 thousand. The growth was driven by higher realized gold prices as well as the substantial increase in sales volumes. In the reporting year, KazakhGold Group sold 103.31 thousand troy ounces of gold in the form of sludge,

flotation and gravitation concentrates and other semi-products, compared to 69.34 thousand ounces in the comparative period, representing almost a 50% year-on-year increase.

In 2010, the Group produced 110.5 thousand ounces of gold in semi-products, compared to 72.7 thousand ounces produced in the previous year. The growth in production was a result of the modernization programme at all the Group's facilities that began after the completion of the Partial Offer when a new management team was appointed.

In the reporting year, the gold price rally continued, pushing the average London fixing to USD 1,224.5 per ounce. KazakhGold sells its metal in semi-finished products, which are sold at a discount to the market price. The average weighted gold selling price in the reporting year amounted to USD 1,107.8 per ounce, compared to USD 842.7 per ounce in 2009. However, in the reporting period the weighted average gold selling price showed a 31.46% year-on-year increase, compared to a 25.93% increase in the London fixing. The difference resulted from the modernization and facilities development program being currently implemented and which was aimed, among other things, at increasing the share of higher-margin products in the production mix, bringing the selling price closer to the market price. In particular, the Group's production facility at Akzhal deposit was launched in the reporting period, producing dore gold.

The table below shows a breakdown of the KazakhGold Group's gold revenue by product category.

USD '000	Year ended 31 December		Change, %
	2010	2009	
<b>Product</b>			
Cathodic gold	53,653	27,236	99.0
Free gold	12,187	6,109	99.5
Other	38,918	25,089	55.1
Dore gold	9,690		
<b>Total</b>	<b>114,448</b>	<b>58,434</b>	<b>95.9</b>

The table below shows a breakdown of the KazakhGold Group's revenue by customer.

Customer	Type of Product	Location of Customer	2010	2009
			Revenues (USD thousand)	Revenues (USD thousand)
CJSC Karabashmed	Gravity and flotation concentrates, quartzite ore	Russia	38,485	22,915
Metalor Technologies	Cathodic, free gold and dore gold	Switzerland	75,530	34,487
Other <sup>(1)</sup>	Gravity and flotation concentrates, quartzite ore		433	1,032
<b>Total:</b>			<b>114,448</b>	<b>58,434</b>

1. Includes Alashankou Yaxin Commerce and Trade Company and Nongjiushi Zhongye Trade Development Company.

The KazakhGold Group currently exports all of its products, with most of its sales to Switzerland and Russia. The Group sells all of its cathodic and free gold pursuant to arrangements with Metalor S.A., a specialist trader in gold and precious metals processing based in Neuchatel in Switzerland. In the reporting period, dore gold produced at Akzhal was also sold to Metalor. Under the terms of these arrangements, Metalor pays the Group for each ounce of gold contained in the supplied products at a discount calculated based on the cost of refining, the gold price fixed by LBMA and other factors. Metalor bears the cost of insurance from the time the products are transferred for international transportation by air. On 27 October 2010, the contract with Metalor S.A. was extended until 31 December 2011. In addition, substantial volumes of gold, mainly in gravity and flotation concentrates, as well as quartzite ore is sold to CJSC Karabashmed in Russia. In April 2011, the contract with Karabashmed was extended until 30 April 2012.

## 2.4. Cost of gold sales

The below table gives the breakdown of the Group's cost of gold sales in the reporting period.

USD'000	Year ended 31 December		Change, %
	2010	2009	
<b>Cash operating costs</b>	<b>66,970</b>	<b>46,559</b>	43.8
Labour	22,669	20,643	9.8
Consumables and spares, out of which:	20,820	11,683	78.2
<i>Materials and spares</i>	18,419	10,609	73.6
<i>Fuel</i>	2,401	1,074	123.6
Utilities, out of which:	6,880	5,052	36.2
<i>Power</i>	6,551	4,908	33.4
<i>Other</i>	329	144	128.0
Tax on mining	9,223	4,726	95.1
Sundry	7,378	4,456	65.5
Amortisation and depreciation of operating assets	16,121	15,787	2.1
Increase in provision for land restoration	-	(925)	-
(Increase)/decrease in metal inventories	(6,093)	(4,125)	47.7
<b>Cost of gold sales</b>	<b>76,997</b>	<b>57,296</b>	34.4

The presentation of cash operating costs is more detailed than that presented in the financial statements. The amounts are derived from management accounts and agree in total with the amounts presented in the financial statements.

In the reporting year, the cost of gold sales amounted to USD 76,997 thousand, compared to USD 57,296 thousand in the previous year. The 34.39% year-on-year increase, compared to the 48.99% year-on-year increase in ounces sold implies a 9.8% decrease of costs of sales per ounce, which was the result of measures undertaken since the completion of the Partial Offer aimed at raising operating efficiency.

The increase in labour costs for operating personnel resulted from increased salaries and new employees hired. KazakhGold is the major employer in the towns where its mines are located and a significant number of employees work under trade union agreements. KazakhGold maintains a close relationship with local trade unions, but believes that its staff levels, relative to current production volumes, are high. Kazakhgold believes that upon modernisation of operating facilities and the associated increase in production, the staff levels will gradually become more commensurate with the levels of its gold output.

The cost of materials and spares consumed in the reporting year accounted for 27.5% of the Group's cash operating costs. In 2010, expenses on materials and spares amounted to USD 18,419 thousand, compared to USD 10,609 thousand in 2009. The growth mainly comes from the increased gold production, as well as increases in prices for most consumables.

The 123.61% year-on-year increase in expenses on fuel was a result of increased volumes of diesel fuel purchased due to the growth in production, combined with increased prices for fuel, which resulted from growth in crude oil prices.

In the reporting period, the volume of drilling-and-blasting works increased, which led to an increase in the volume of explosives consumption. The volume of ore mined increased 130%, thus diesel fuel consumption increased, ore processing grew 93% year-on-year, increasing purchases of grinding balls by 69%.

The following table sets forth the principal consumables and spares procured by the Group in 2010 and 2009:

Item	2010		2009	
	Volume, tonnes	Cost, USD'000	Volume, tonnes	Cost, USD'000
Spare parts for tipper trucks and digging machines	n/a	268	n/a	n/a
Grinding balls	1,720	1,509	1,018	796
Pipes for current operations	179	153	n/a	n/a
Spare parts for road-building machines	n/a	4	n/a	n/a
Rolled metal products for current operations	286	444	n/a	n/a
Summer diesel fuel	1,784	1,035	1,384	946
Winter diesel fuel	1,058	761	849	396
Ai-80 gasoline	361	221	337	172
Ai-92 gasoline	67	47	71	42
Explosives	646	1,010	397	593
Cyanides	725	2,123	610	1,897

The 95.17% increase in tax on mining is proportionate to the increase in gold sales revenue. Mining tax in the Republic of Kazakhstan is calculated with reference to the value of the reserves of commercially useful minerals which are contained in the mineral raw materials extracted. The value of the reserves of commercially useful minerals contained in mineral raw materials is determined on the basis of the average exchange price for such commercial minerals for the tax period. The average exchange price is the arithmetic mean of the daily average quotations for each commercial mineral recorded on the London Metal Exchange. The mining tax rate for gold from 1 January 2009 is 5%.

The major portion of sundry costs in 2010 comprised of expenses on security. The latter showed a substantial increase in the reporting year and amounted to USD 4,169 thousand, compared to USD 1,766 thousand in 2009. Increased spending on security was a result of the new management's efforts to strengthen control over operations.

In the reporting year, amortisation included in cost of sales increased by 2.12% to USD 16,121 thousand. The increase was due to additions to the property, plant and equipment resulting from the investments into the production facilities made since the completion of the Partial Offer.

## 2.5. Selling, general and administrative expenses

The table below gives a breakdown of KazakhGold Group's selling, general and administrative expenses.

USD '000	Year ended 31 December		
	2010	2009	Change, %
Salaries	8,157	9,138	(10.7)
Taxes other than mining and income taxes	3,521	1,613	118.3
Professional services	8,719	12,342	(29.4)
Depreciation	457	414	10.4
Other	3,406	16,239	(79.0)
<b>Total</b>	<b>24,260</b>	<b>39,746</b>	<b>(39.0)</b>

The presentation of selling, general and administrative expenses is more detailed than that presented in the financial statements. The amounts are derived from management accounts and agree in total with the amounts presented in the financial statements.

Selling, general and administrative expenses in the reporting year decreased substantially and amounted to USD 24,260 thousand, compared to USD 39,746 thousand in 2009.

In 2010, salaries included in the selling, general and administrative expenses decreased significantly and amounted to USD 8,157 thousand, compared to USD 9,138 thousand in the previous year. The decrease

reflected the cost-cutting programme implemented by the management team of the Group, which was appointed following the completion of the Partial Offer.

Taxes, other than mining and income taxes, in the reporting period showed a 118.29% year-on-year increase and amounted to USD 3,521 thousand. The major portion of this item is comprised of property tax expense, which, in the reporting year, amounted to USD 1,914 thousand. Also, in the reporting period, USD 1,062 thousand of tax penalties were recorded, mainly relating to VAT expenses.

One of the largest items of the Group's selling, general and administrative expenses in the reporting period comprised of expenses for professional services. This item included expenses for legal, audit and consulting services, including those relating to the investigation of activities of the previous management, preparation for the proceedings against the Assaubayev family, and the July 2010 USD 100 million equity placement, as well as the Proposed Combination.

In 2009, expenses on professional services included those related to the preparation for the Partial Offer.

## 2.6. Other expenses, net

USD '000	Year ended 31 December		Change, %
	2010	2009	
Non-recoverable value added tax on construction, repair, maintenance and exploration works	8,600	5,219	64.8
Bank guarantee provision	-	11,650	(100.0)
Loss on revaluation of property, plant & equipment	-	11,079	(100.0)
Impairment of property, plant and equipment	26,544	-	139.6
Other	86	4,673	(98.2)
<b>Total</b>	<b>35,230</b>	<b>32,621</b>	<b>8.0</b>

Other expenses in the reporting year primarily related to the effects of new management's efforts to address many of the issues identified upon the takeover, relating to the activities of the former management. Particularly, in the reporting period, KazakhGold accrued USD 8,600 thousand of VAT, which it believes was previously illegally refunded out of the state budget by the former management of the Company during 2007-2009 based on sham contracts.

The impairment of property, plant and equipment in the reporting year amounted to USD 26,544 thousand and was a result of the continued efforts of the new management to streamline control and management systems of the Company. In particular, further reassessments of mining assets and capital construction in progress were made following the introduction of a number of new upgrades in the Group's management and accounting systems.

## 2.7. Finance costs and foreign exchange gain/(loss)

USD '000	Year ended 31 December		Change, %
	2010	2009	
Finance costs	(32,929)	(31,841)	3.4
Foreign exchange (loss)/gain	1,086	(45,927)	(102.4)

In the reporting period, finance costs amounted to USD 32,929 thousand. The major portion of that was interest on loans and borrowings amounting to USD 26,951 thousand. Out of that amount, interest accrued on the Senior Notes amounted to USD 18,750 thousand. The remaining portion of interest on loans and borrowing was related to interest payments in respect of the loan from Gold Lion, amounting to USD 3,103 thousand, and in respect of the loans from Jenington, amounting to USD 5,098 thousand (see note 17 of the consolidated financial statements for the year ended 31 December 2010).

In the reporting year, currency exchange gain amounted to USD 1,068 thousand, compared to currency exchange loss of USD 45,927 thousand in 2009. The currency exchange gain was a result of period-end KZT/USD exchange rate increase, the major portion of loans and borrowings being USD denominated.

The USD 45,927 thousand foreign exchange loss in the year 2009 was a result of KZT devaluation by the National Bank of Kazakhstan in February 2009.

## 2.8. Income tax

In 2010, the Group accrued USD 1,329 thousand of income tax expense, compared to USD 6,161 thousand of income tax benefit in the previous year. In 2010, TOO Gornyyak, a subsidiary of the Group, developing Akzhal deposit, started production activities and received taxable profit, that is why income tax expense was accrued, in spite of loss before income tax at corporate level.

## 2.9. Other sales and cost of other sales

In 2010, other sales amounted to USD 1,246 thousand, compared to USD 1,943 thousand in 2009. The cost of other sales amounted to USD 3,306 thousand compared to USD 2,846 thousand in the previous year. Other sales included revenues from hotels and ancillary services. The cost of other sales included non-mining operating expenses, such as hotel operations, and other ancillary services.

## 3. Non-GAAP financial measures

In its analysis of the Group's results, KazakhGold uses key performance indicators which are not measures determined in accordance with IFRS.

### 3.1. EBITDA

"EBITDA" is defined by the KazakhGold Group as profit before finance costs, income tax, depreciation and amortisation of operating assets and is further adjusted by certain items included in the table below. In management view, KazakhGold has made these adjustments in calculating EBITDA to provide a clearer view of the performance of its underlying business operations and to generate a metric that it believes will give greater comparability over time with peers in its industry. KazakhGold believes that EBITDA is a meaningful indicator of its profitability and performance. This measure should not be considered as an alternative to profit for the period and operating cash flows based on IFRS and should not necessarily be construed as a comprehensive indicator of the Group's measure of profitability or liquidity.

The following table sets forth the Group's EBITDA for the years 2010 and 2009:

USD'000	Year ended 31 December	
	2010	2009
<b>Loss for the period</b>	<b>(57,271)</b>	<b>(143,739)</b>
- Income tax expense/(benefit)	1,329	(6,161)
+ Finance costs	32,929	31,841
+ Depreciation and amortization for the period	18,116	17,659
- Foreign exchange (gain)/ loss	(1,086)	45,927
Loss on PPE disposal	568	1,859
Loss on revaluation of property, plan and equipment	-	11,079
Impairment of property, plant and equipment	26,544	-
<b>EBITDA</b>	<b>21 129</b>	<b>(41 535)</b>

The Group's EBITDA for the year 2010 amounted to USD 21 129 thousand, compared to negative EBITDA of USD 41 535 thousand in the previous year. The substantial improvement of EBITDA resulted from increased sales volumes, improved gold selling prices and improved cost control.

### 3.2. Total cash costs

KazakhGold Group presents the financial items “total cash costs” (“TCC”) and “total cash costs per troy ounce”. The measures are calculated and presented by management as TCC presentation is a common industry practice, although its calculations of these items may differ from those of its industry peers. These items are not IFRS measures. An investor should not consider these items in isolation or as alternatives to cost of sales, profit for the period attributable to shareholders of the parent company, net cash generated from operating activities or any other measure of financial performance presented in accordance with IFRS. The calculation of total cash costs may vary significantly among gold mining companies, and by themselves do not necessarily provide a basis for comparison with other gold mining companies.

Total cash costs are defined by the Group as cost of gold sales reduced by depreciation and amortisation of operating assets and provision for annual vacation payment. Total cash costs per troy ounce are the attributable total cash costs divided by the attributable troy ounce of gold sold.

The following table shows the Group’s TCC for the years 2010 and 2009:

USD'000	Year ended 31 December		Change, %
	2010	2009	
<b>Cost of gold sold</b>	<b>76,997</b>	<b>57,296</b>	34.4
- property, plant and equipment depreciation	(16,121)	(15,787)	2.1
- vacation provision	(462)	(1,215)	(62.0)
TCC (USD thousand)	60,414	40,294	49.9
Gold sales (thousand troy ounces)	103	69	49.0
<b>TCC, USD/ounce</b>	<b>585</b>	<b>581</b>	0.6

In 2010, TCC amounted to USD 585 per ounce of gold sold, compared to USD 581 in the previous year with this insignificant increase related only to the KZT appreciation against USD. The Group is continuing to focus on raising the operational efficiency of its producing enterprises aimed, particularly, at curbing costs.

## 4. Review of financial sustainability and solvency

As at 31 December 2010, the Group had a working capital deficiency of USD 233,169 thousand. The deficit mainly resulted from the full amount owed on the senior notes in the amount of USD 200,000 thousand with original maturity in 2013 and short-term borrowing outstanding with Polyus Gold of USD 49 million. The Senior Notes include various restrictive covenants including limitations on additional indebtedness, and meeting certain financial reporting timelines. At 31 December 2010, the Group was not in compliance with certain of these covenants, and as a consequence, the Group classified the Senior Notes Senior Notes as current liability.

### 4.1. Analysis of items of statement of financial position

KazakhGold’s consolidated statement of financial position as at 31 December 2010, compared to 31 December 2009, was as follows:

USD'000	Year ended 31 December		Change, %
	2010	2009	
<b>ASSETS</b>			
<b>Non-current assets</b>	<b>193,979</b>	<b>199,918</b>	<b>(3.0)</b>
Property, plant and equipment	190,151	197,051	(3.5)
Inventories	2,245	2,867	(21.7)
Other non-current assets	1,583	-	n/a
<b>Current assets</b>	<b>47,747</b>	<b>25,835</b>	<b>84.8</b>
Inventories	27,891	14,265	95.5
Reimbursable value added tax	4,538	-	n/a
Trade and other receivables	1,812	2,124	(14.7)

Advances paid to suppliers	2,560	1,905	34.4
Income tax prepaid	1,765	3,057	(42.3)
Cash and cash equivalents	8,162	3,531	131.2
Other current assets	1,019	953	6.9
<b>TOTAL ASSETS</b>	<b>241,726</b>	<b>225,753</b>	<b>7.1</b>
<b>NEGATIVE EQUITY AND LIABILITIES</b>			
<b>Share capital and reserves</b>	<b>(88,561)</b>	<b>(127,170)</b>	<b>(30.4)</b>
Share capital	332,392	233,645	42.3
Revaluation surplus	7,787	7,787	-
Option premium on convertible debt	15,598	15,598	-
Translation reserve	22,533	25,401	(11.3)
Accumulated losses	(465,866)	(409,601)	13.7
<b>Negative equity attributable to shareholders of the parent company</b>	<b>(87,556)</b>	<b>(127,170)</b>	<b>(31.2)</b>
Non-controlling interests	(1,005)	-	n/a
<b>Non-current liabilities</b>	<b>49,371</b>	<b>49,694</b>	<b>(0.7)</b>
Borrowings	24,155	20,812	16.1
Environmental obligations	20,758	13,356	55.4
Other non-current liabilities	4,458	15,526	(71.3)
<b>Current liabilities</b>	<b>280,916</b>	<b>303,229</b>	<b>(7.4)</b>
Borrowings	249,310	257,816	(3.3)
Trade, other payables and accrued expenses	27,507	20,668	3.1
Income tax payable	1,332	-	-
Other taxes payable	2,767	24,745	(88.8)
<b>TOTAL LIABILITIES</b>	<b>330,287</b>	<b>352,923</b>	<b>(6.4)</b>
<b>TOTAL NEGATIVE EQUITY AND LIABILITIES</b>	<b>241,726</b>	<b>225,753</b>	<b>7.1</b>

#### 4.1.1. Assets

##### *Non-current assets*

The table below sets forth the components of the KazakhGold Group's property, plant and equipment as at 31 December 2010 and 31 December 2009:

USD'000	As at 31 December,		Change, %
	2010	2009	
Exploration and evaluation assets	12,541	3,872	223.9
Mining assets	122,372	140,850	(13.1)
Non-mining assets	2,571	2,777	(7.4)
Capital construction-in-progress	52,667	49,552	6.3
<b>Total property, plant and equipment</b>	<b>190,151</b>	<b>197,051</b>	<b>(3.5)</b>

KazakhGold's property, plant and equipment as at 31 December 2010 amounted to USD 190,151 thousand, compared to USD 197,051 thousand as at 31 December 2009. The decrease resulted from impairment of mining assets in the amount of USD 19,835 thousand and impairment of capital construction in progress in the amount of USD 6,709, both relating to the reassessment of the fixed assets made in the reporting year following certain improvements of management and accounting systems of the Group. This was partly offset by additions to fixed assets which resulted from investments made into the modernization and expansion of the Group's production facilities, as well as to exploration works.

In May 2010, the new long-term strategy to develop the Company's assets was approved by the Board. The strategy consisted of the large-scale exploration campaign aimed at substantially increasing reserves, as well as the modernization and expansion programme to upgrade the existing facilities and construct new mining and processing capacities at existing operating sites. Upgrading works at all sites commenced in August 2009, following completion of the Partial Offer, and were intensified after the development strategy was approved. Due to the conflict with the previous owners that arose during the summer (see Section 1. of this report Material recent developments), management had to significantly curb its investment programme. In particular, spending on exploration was substantially cut. The Group remained focused mainly on the modernization of the existing facilities during the period.

Capital expenditure in 2010 amounted to USD 33,548 thousand, compared to USD 7,372 thousand in 2009 (see 4.3 of this Report).

#### *Current assets*

As at 31 December 2010, current assets amounted to USD 47,747 thousand, compared to USD 25,835 thousand as at 31 December 2009. The increase in current assets resulted from capital injections into the working capital of the Company that continued in the reporting period. Inventories showed a 95.5% year-on-year increase, due to substantial increase of gold-in-process and finished goods at warehouses. The increase resulted from improved operating efficiencies of the Group's production facilities resulting from the modernization program that began after the Partial Offer was completed in August 2009.

#### **4.1.2. Equity and liabilities**

##### *Capital and reserves*

As at 31 December 2010, the Group had negative capital and reserves amounting to USD 88,561 thousand, compared to negative capital and reserves of USD 127,170 thousand as at 31 December 2009. The decrease in negative capital and reserves resulted from the share placement for USD 100 million, which was partly offset by loss for the year ended 31 December 2011.

##### *Non-current liabilities*

As at 31 December 2010, the KazakhGold Group's non-current liabilities amounted to USD 49,371 thousand, compared to USD 49,694 thousand as at 31 December 2009. The most substantial item within non-current liabilities is long-term borrowings, which is comprised of a loan obtained from Gold Lion in June 2009, due on 6 November 2014. (See Note 17 of the consolidated financial statements).

Environmental obligations as at 31 December 2010 amounted to USD 20,758 thousand, compared to USD 13,356 thousand as at 31 December 2009. The increase resulted from the change in the applied discount rate.

##### *Current liabilities*

As at 31 December 2010, the KazakhGold Group's current liabilities amounted to USD 280,916 thousand, compared to USD 303,229 thousand as at 31 December 2009.

The Group's current liabilities as at 31 December 2010 were comprised of the USD 200,000 thousand Senior Notes and a short-term loan from Jenington in the amount of USD 49,310 million (see Note 17 of the consolidated financial statements). As at 31 December 2010 the Senior Notes are classified as current, as the Group was not in compliance with certain of its covenants.

As at 31 December 2009, KazakhGold also had secured and unsecured USD-denominated loans for the total amount of USD 9,099 thousand, as well as a secured KZT-denominated loan of USD 1,854 thousand. All loans except Jenington and the Senior Notes were repaid during 2010.

On 14 August 2009 and on 4 February 2010, the Group obtained two USD 50,000 thousand loans from Jenington International to finance its working capital and to fund the consent fee payable to holders of the Senior Notes in connection with the Partial Offer. The February loan was repaid in July 2010, through proceeds of the USD 100,000 thousand placing of shares, and thus is not reflected in the consolidated financial statements. The loan obtained in August 2009, as at 31 December 2010, was classified as a short-term borrowing (see Note 17 on the consolidated financial statements). Under the RAPA (see section 1 of this report), AltynGroup is required to provide funds for the repayment of the loan at completion of the first tranche.

#### 4.2. Cash flow analysis

The following table shows KazakhGold's consolidated statement of cash flows for the years ended 31 December 2010 and 31 December 2009.

<b>USD'000</b>	<b>12m 2010</b>	<b>12m 2009</b>
<b>Operating activities</b>		
<b>Profit before income tax</b>	<b>(55,942)</b>	<b>(149,900)</b>
Adjustments for:		
Amortisation and depreciation	18,116	17,659
Loss on revaluation of PPE	-	11,079
Impairment of PPE	26,544	-
Bank guarantee provision	-	11,650
Non-recoverable VAT	-	5,219
Finance costs	32,929	31,841
Loss on disposal of property, plant and equipment	574	1,859
Change in allowance for doubtful debts	(65)	3,594
Foreign exchange (gain)/loss, net	(1,086)	45,927
Other	1,996	1,881
<b>Operating profit before working capital changes</b>	<b>23,066</b>	<b>(19,191)</b>
Movements in working capital		
Inventories	(12,493)	(2,842)
Trade and other receivables	383	(229)
Advances paid to suppliers	(565)	(990)
VAT reimbursable	(5,259)	-
Other current assets	(62)	(851)
Trade payables	(536)	(10,470)
Other payables and accrued expenses	(2,063)	11,177
Other taxes payable	(20,401)	(1,672)
<b>Cash flows from operations</b>	<b>(17,930)</b>	<b>(25,068)</b>
Interest paid	(24,546)	(22,457)
Income tax paid	(1,410)	(1,462)
<b>Net cash inflow from operating activities</b>	<b>(43,886)</b>	<b>(48,987)</b>
<b>Investing activities</b>		
Purchase of property, plant and equipment	(33,548)	(7,372)
<b>Net cash inflow/(outflow) from investing activities</b>	<b>(33,548)</b>	<b>(7,372)</b>
<b>Financing activities</b>		
Proceeds from borrowings	49,960	91,288
Repayments of borrowings	(60,841)	(43,145)

Repayments of finance lease obligations	-	(501)
Repayment of bank guarantee liability	(4,967)	-
Proceeds from issuance a company Share capital	98,747	-
<b>Net cash (outflow)/inflow from financing activities</b>	<b>82,899</b>	<b>47,642</b>
Restricted cash	(862)	-
Effect of translation to presentation currency	28	(1,718)
<b>Net increase in cash and cash equivalents</b>	<b>5,465</b>	<b>(8,717)</b>
<b>Cash and cash equivalents at beginning of the year</b>	<b>3,531</b>	<b>13,966</b>
<b>Cash and cash equivalents at end of the year</b>	<b>8,162</b>	<b>3,531</b>

Net cash used in operating activities in the reporting year amounted to USD 43,886 thousand compared to USD 48,987 thousand in 2009. Investing activities substantially increased in the reporting period. Capital expenditure in 2010 amounted to USD 33,548 thousand, compared to USD 7,372 thousand in 2009.

Cash generated from financing activities amounted to USD 82,899 thousand, compared to USD 47,642 thousand in 2009. The inflow from financing activities resulted from the new share placements for USD 100 million in July 2010, as well as proceeds from borrowings, which was partly offset by repayment of borrowings (see Note 17 of the consolidated financial statements).

#### 4.3 Capital expenditures

The following table shows the KazakhGold Group's capital expenditures in 2010 and 2009:

USD'000	Year ended 31 December		Change, %
	2010	2009	
+ Purchase of property, plant and equipment	33,548	7,372	355.1
<b>Net capital expenditures</b>	<b>33,548</b>	<b>7,372</b>	<b>355.1</b>

In May 2010, the Board of KazakhGold approved a development strategy for the Kazakhstan assets of KazakhGold Group through 2020. The strategy covers the development of the mineral resources base, the modernization and expansion of the existing operating capacities and the construction of new production facilities. Under this strategy, the Group's capital expenditures in 2010 were planned at the level of USD 56 million - USD 67 million. The capital expenditure activities were intensified after the strategy was approved, but, due to the conflict with the previous owners, since August 2010 financing of those measures was substantially reduced, and the investment program for 2010 was not fully implemented.

In 2010, the Company concentrated on modernization of the existing production units, located in the Stepnogorsk region of the Akmolinsk area of Kazakhstan: Aksu, Bestobe and Zholymbet. Exploration works also remained in focus in the reporting period. The total volume of capital expenditures in 2010 amounted to USD 33,548 thousand.

In 2010, at the Aksu mine a heavy repair of three mills, including replacement of crushing cylinders, was performed. This measure allowed an increase in the volume of ore processed at the plant by 70%. At the same time, works on commissioning of the additional section of the heap leaching complex continued. As a result, the volume of ore processed at the heap leaching facility increased by 127%.

At the Bestobe a new flotation workshop was constructed and equipped with new mills, flotation equipment, concentration and slime pumps. The main building of the plant was also equipped with the new mill. These measures helped to increase volume of ore processed at the plant by 55%. On the mining side, additional horizons were brought into operations (zone Dalnaya at the level 160 meters, level of 655 meters of Centralnaya area), increasing the volume of underground mining by 1.7 times.

At the Zholymbet mine, new mills were launched into operations, as well as a new jaw crusher and cone-type crusher, which resulted in a further increase of the ore processed by 23%. Also the capital repair of the Centralnaya shaft had been performed, including the replacement of the depreciated armors and commissioning of the compressor station, which delivers compressed air to the shaft.

In the reporting period, the Company's capital expenditure program included exploration activities at the following deposits in Kazakhstan: Aksu, Bestobe, Zholymbet, Akzhal, Southern Karaultube, the Quartzite Hills and Kaskabulak. Total volume of exploratory drilling (including core drilling and reverse circulation drilling) at all the deposits amounted to 31.8 thousand meters, compared to 8.1 thousand meters in the previous year.

## **5. Description of principal risks**

### **Going concern risk**

Subsequent to the completion of the Partial Offer, management has focused on cost reduction and investing in mining infrastructure as a means of facilitating increases in production. As a result of these actions, combined with the increase in gold prices, the Group's operating and financial performance has been substantially improved. Nevertheless, despite the improvement in operations, the Group continued to incur losses in the reporting year, has negative working capital and cash outflows from operations.

At 31 December 2010 the Group has the following borrowings (see Note 7 of the consolidated financial statements):

Senior Notes in the amount of USD 200,000 thousand (the "Notes") guaranteed by Polyus Gold;

A loan from Jenington of USD 49,310 thousand); and

A loan from Gold Lion Holdings Limited ("Gold Lion") of 24,155 thousand, a former related party.

Pursuant to the agreement relating to the Notes, the Group is obligated to comply with a number of restrictive covenants, including limitations on obtaining additional indebtedness, and meeting certain financial reporting timelines. At December 31, 2010 and 2009, the Group was not in compliance with certain of these covenants and as a consequence, the Group classified the Notes as a current liability. In addition, the loan from Jenington is also due in 2011. The Group's working capital deficit has primarily resulted as a consequence of this breach of covenants.

In addition to the Group's financial difficulties as described above, there is currently 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, Polyus Gold filed a lawsuit with the High Court in London against the former controlling shareholders.

Subsequent to that date, the Government of the Republic of Kazakhstan (the "Government") has taken various actions against the current management and directors that have had both a direct and an indirect impact on the Group's operations. (see Note 1 of the consolidated financial statements)

To resolve the existing disputes between the shareholders mentioned above, with regards to misappropriation of funds identified in 2008-2009 and as a step toward the RTO deal announced at the middle of the year 2010, in December 2010 KazakhGold Group Limited entered into a principal agreement for the sale of its operating subsidiaries and related matters with AltynGroup Kazakhstan LLP, a limited liability partnership controlled by members of the Assaubayev family. The deal was later canceled and then renewed on 8 April 2011 (see section 1 of this report). The transaction is subject to a number of conditions, including settlement of all outstanding claims and actions between the parties, and the receipt of all necessary waivers and consents from the Kazakhstan Government, receipt of financing by AltynGroup to complete the transactions and the entry into definitive agreements, as well as the receipt of all necessary waivers and approvals for a possible business combination between KazakhGold and Polyus Gold.

The deal is exposed to a number of uncertainties and risks such as (i) a material breach by AltynGroup of the terms of the Agreement; (ii) failure by AltynGroup to obtain the required waivers and consents in Kazakhstan; or (iii) failure by AltynGroup to obtain the debt and equity financing required for tranches closing. Therefore there can be no assurance that the conditions to the Transaction will be satisfied, or that the Transaction will be completed.

All the above-mentioned factors may have a material impact on the Group's future operations and may cast a doubt about the Group's ability to continue as a going concern. For more details see Note 1 of the consolidated financial statements.

### **Other risk factors**

In addition to going concern risk, the Group is exposed to a number of risks relating to doing business in gold mining sector in countries where the Group's operations or projects are located. Those risk factors are described below.

### **Financial risk factors**

The Group's multi-national operations expose it to a variety of financial risks: foreign currency risk, fair value and cash flow interest rate risk, other price risk, liquidity risk and credit risk. The policy for managing these risks is set by the Board and all such risks are managed at a Group level within the organization.

The Group has a general policy of not hedging against foreign currency risk. In managing interest rate and currency risks, the Group aims to reduce the impact of short-term fluctuations on the Group's earnings. Over the longer-term, however, changes in foreign exchange rates could have an impact on consolidated earnings.

#### *Market risk*

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in interest rates (interest rate risk), foreign exchange rates (currency risk) or other market factors (other price risk).

##### *(a) Price risk*

The Group is exposed to market price risk from its current activities.

The gold market is cyclical and sensitive to any economic changes. The price of gold is subject to substantial fluctuations and is affected by a number of factors which are beyond the control of the Group. A substantial continued price reduction may result in a reduction in profitability of gold exploration and extraction activities.

The Group manages this risk centrally, with reference to annual budgets and periodic forecasts including sensitivity analyses of projected production rates and gold market prices.

##### *(b) Liquidity risk*

The liquidity risk of the Group is managed centrally. New borrowings are taken on where additional funds are required. During the period under review, all of the Group's new borrowing were from its parent, Jenington International. Surplus funds not allocated to future investment and working capital requirements are used to repay existing loans and bonds. The bulk of the Group's cash balances are held in USD denominated floating rate deposits as required to fund its short-term requirements.

##### *(c) Credit risk*

The Group is exposed to credit risk arising from credit sales of its products to customers. It is the Board's policy to assess the credit risk of all new customers before entering into contracts and also, where possible, to trade only with established entities. During 2010, the Group had two principal customers, who together account for 90% of its sales.

##### *(d) Foreign exchange risk*

Foreign exchangerisk arises due to the Group's primary revenues being in US dollars, which is also the presentation currency whilst the Group's principal operating costs are denominated in Kazakhstan Tenge, which is the principal functional currency of the Group's operating subsidiaries.

The effect of a strengthening of the Kazak Tenge against the US dollar at the balance sheet date could result in an increase in post-tax losses for the year and decrease net assets, all other variables held constant.

### **Operational risks**

***The reserves volume and grade of the ore the KazakhGold Group processes may not conform to current expectations and could be significantly corrected.***

The activity of the Group heavily relies upon existing reserves and resources. Evaluation of mineral resources of all mining companies, may, by its nature, be inaccurate and to some extent depends on the statistical findings on the basis of limited drilling and other analyses, which could be inconsistent. The gold price changes may also significantly impact the assessment and classification of ores. A failure to confirm the quantity and quality of the mined ore deposits may reduce the efficiency of production through boosting the cost of mining and increasing the labor intensity. **The KazakhGold Group is subject to mining risks.**

Gold exploration and the development of mines involve a high degree of risk and uncertainty.

There are increased risks of flooding, pit slope and rim slide, accidents caused by the use of the mining transport equipment and preparation and performance of explosion works in the pit, reduction of gold production due to adverse weather conditions and problems in the power supply facilities and recovery plants.

These risks could result in suspended ore production and recovery, increased costs, health, safety and environmental issues and affect the Group's production activities.

The Group aims to mitigate the risks associated with unplanned production interruptions through various processes, including probability analysis and effective risk management. Such risk management includes identification of probability and consequences of potential threats and adoption of appropriate risk response measures to prevent accidents and emergencies.

#### **Regulation and country risks**

Emerging markets such as Kazakhstan, Kirgizstan and Romania are subject to greater risks than more developed markets, including significant legal, economic and political risks.

##### *• Taxation contingencies*

The Group is subject to uncertainties relating to the determination of its tax liabilities. The tax system and tax legislation in Kazakhstan have been in force for only a relatively short time and are subject to frequent changes and varying interpretations. Management's interpretations of such legislation in applying it to business transactions of the Group may be challenged by the relevant tax authorities and, as a result, the Group may be assessed on additional tax payments including fines, penalties and interest charges, which could have a material adverse effect on the Group's financial position and results of operations. Such uncertainties may in particular relate to the valuation of the taxable base for excess profits tax purposes.

##### *• Insurance*

The insurance industry in Kazakhstan is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. The Group does not have third party liability coverage in respect of property or environmental damage arising from accidents on Group property or relating to the Group's operations. There is a risk that the loss or destruction of certain assets could have a material adverse effect on the Group's operations and financial position.

##### *• Environmental contingencies*

Environmental regulations in Kazakhstan are continually evolving. The outcome of the environmental regulations under proposed or future environmental legislation cannot be estimated at present. As obligations are determined, they will be provided for in accordance with the Group's accounting policies. The Directors believe that there are no significant liabilities that can be identified under current legislation not accrued for in the Group's consolidated financial statements. A provision has been made for costs associated with restoration and abandonment of mine sites upon depletion of deposits.

##### *• Use of sub-soil rights*

In Kazakhstan, all sub-soil reserves belong to the State, with the Ministry of Energy and Mineral Resources granting exploration and production rights to third party bodies. Sub-soil rights are not granted in perpetuity and any renewal must be agreed before the expiration of the relevant current contract or license. These rights may be terminated by the Ministry if the Group does not satisfy its contractual obligations in respect of the individual contract or license granted. The Group believes that it is in substantial compliance with the terms of its sub-soil agreements.

- Kazakhstan currency control regulations may hinder the KazakhGold Group's ability to conduct business.

- Kazakh competition regulations and procedures are subject to uncertainties.

If transactions that KazakhGold and its subsidiaries have entered into are challenged for non-compliance with applicable Kazakh legal requirements, the transactions could be invalidated or liabilities imposed on the KazakhGold Group.

- The Kazakh state may be entitled to exercise pre-emptive rights over assets acquired by the KazakhGold Group, transfers of shares in KazakhGold's subsidiaries and the issuance of new depository receipts over its shares.

Additional risks and uncertainties that KazakhGold is not aware of or that KazakhGold currently believes are immaterial may also adversely affect the KazakhGold Group's business, operating results and financial condition.

#### **6. Main features of the internal control and risk management systems in relation to the financial reporting process**

Group management is responsible for establishing and maintaining adequate risk management and internal control over financial reporting for the Group. Internal control over financial reporting is a process to

provide reasonable assurance regarding the reliability of the Group's financial reporting for external purposes in accordance with international accounting principles.

Internal control includes maintaining records that, in reasonable detail, accurately and fairly reflect the Group's transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of the Group's financial statements; providing reasonable assurance that receipts and expenditures of Group assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use, or disposition of Group assets that could have a material effect on its financial statements would be prevented or detected on a timely basis.

One of the instruments of the Group's internal control is the Audit Committee (see section 7. Corporate governance).

Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of the Group's financial statements would be prevented or detected.

While preparing and improving its internal control and risk management systems over financial reporting, the Group relies, among others, on recommendations and integrated framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this evaluation, management concluded that the Group's internal control over financial reporting as of December 31, 2010 was effective.

## **7. Corporate governance report**

### **7.1. Board of Directors**

#### **Mr. Evgeny I. Ivanov**

Mr. Ivanov has been a member of KazakhGold's Board of Directors and Chairman of KazakhGold since August 2009. Mr. Ivanov has held the following other posts:

- From 2005 to 2007 – Member of the Board of Directors of ROSBANK.
- Since 2004 – Member of the Board of Directors of CJSC Polyus, from 2004 to 2007 and from February 2008 to October 2008, President of CJSC Polyus and, from 28 December 2007 to 10 February 2008 and from October 2008 to December 2010, General Director of CJSC Polyus.
- From 2005 to 2007 since 2008 – Member of the Board of Directors of OJSC Matrosov Mine.
- Since 2005 – Member and Chairman of the Board of Directors of JSC Lenzoloto.
- From 2005 to 2007 – Member of the Board of Directors of OJSC Aldanzoloto.
- From 2005 to 2008 – Chairman of the Board of Directors of OJSC YMC.
- From 2005 to 2007 – Member of the Board of Directors of OJSC SVMC.
- From 2005 to 2008 – Vice-Chairman of the Board of Directors of ROSBANK (Switzerland) S.A.
- Since 2006 – Chairman of the Board of Directors of CJSC ZDK Lenzoloto.
- From 2006 to 2007 and from October 2008 to December 2010 – General Director of Polyus Gold.
- From February 2008 to October 2008, President of CJSC Polyus.
- From 2007 to 2009 – General Director and Member of the Board of Directors of OJSC Polyus

Exploration.

- Since 2008 – Chairman of the Board of Directors of East Yakutia Development Corporation.
- Since 2008 – Member of the Board of Directors of LZRK LLC and, since April 2010, Chairman of the Board.
- Mr. Ivanov graduated from the State Finance Academy in International Economic Relations.

#### **Mr. German R. Pikhoya**

Mr. Pikhoya has been a member of KazakhGold's Board of Directors since August 2009. Mr. Pikhoya has held the following other posts:

- From 1994 to 1995 – Project Manager at MOSEXPO company.
- From 1994 to 1998 – General Director of Eurogold Financial and Industrial Group Managing Company.
- From 1995 to 1997 – General Director of Palamos company.
- From 1998 to 2002 – Deputy Head of representative office in Russia and New Business Development Manager for Placer Dome International Ltd.
- From 2002 to 2004 – Deputy General Director for Corporate Development of CJSC Polyus.
- From 2004 to 2007 – Vice-President for Corporate Development of CJSC Polyus.
- From 2007 to 2008 – Deputy General Director for Strategy and Corporate Development of OJSC Polyus Gold.
- Since January 2009 – Deputy General Director for Strategy and Corporate Development of CJSC Polyus.

Mr. Pikhoya graduated from the Urals State University with an honours degree in history. Mr. Pikhoya conducted post-graduate research at Bowdoin College in the United States. Mr. Pikhoya graduated from the Russian State Service Academy with a degree in economics.

**Mr. Alexey L. Teksler**

Mr. Teksler has been a member of the Board of the KazakhGold Group Ltd since March 2010. Since August 2009, Mr. Teksler has been Chief Operating Officer and a member of the Board of Directors of the KazakhGold Group's main operating subsidiary, Kazakhaltyn. Mr. Teksler has held the following other posts:

- From 2001 to 2007 – Chief Accountant, Deputy Director of the Polar Division of Norilsk Nickel, Head of Multibranch Supporting Department.
- From 2007 to 2008 – General Director of Norilsk Supporting Complex LLC.
- From 2008 to June 2009 – Head of Norilsk City Authority.

Mr. Teksler graduated from Norilsk Industrial Institute with a degree in Economy and Administration in Metallurgy.

**Mr. Oleg V. Ignatov**

Mr. Ignatov has been a member of KazakhGold's Board of Directors since August 2009. Mr. Ignatov has held the following other posts:

- From 1994 to 1998 – Various positions at UNEXIM Bank, including Senior Specialist, Chief Specialist of Regional Development, Head of the Department for Federal Programmes for the Management of Regional Relations, Deputy Head of Regional Development and Head of Management of Budget and Regional Programmes.
- From 1998 to 2003 – Various positions at OJSC AKB Rosbank, including Head of Regional Relations, Deputy Head for Corporate Clientele in the Regional Relations Department, Vice-President and Senior Vice-President.
- In 2002 – Deputy General Director for Finance of OJSC Chelyabenergo.
- From 2003 to 2005 – Deputy Head of Norilsk City of Krasnoyarsk region.
- From 2005 to 2008 – Deputy Director for Economy and Finance of the Zapolyarny unit of Open Joint Stock Company Mining and Metallurgical Company “Norilsk Nickel”.
- Since 2008 – Member of the Board of Directors of CJSC ZDK Lenzoloto.
- Since 2008 – Deputy General Director for Economy and Finance of CJSC Polyus and member of the Board of Directors.

Mr. Ignatov graduated from Moscow Machine-Tool Institute in 1992 with a degree in electrical engineering. In 1998 Mr. Ignatov graduated with honours from the Finance Academy of the Government of the Russian Federation with a degree in finance and credit.

**Mr. Adrian Coates**

Mr. Coates has been a member of the Board and the Chairman of the Audit Committee since March 2010. Mr. Coates has held the following other posts:

- From 1996 to 1998 – Managing Director, Metals and Mining, at UBS Investment Bank.
- From 1998 to 2008 – Global Sector Head, Resources and Energy, at HSBC.
- Since 1998 – Director of Regal Petroleum plc.
- Since 1998 – Director of A&P Coates Management Limited.

Mr. Coates has a MA degree in Economics from Cambridge University and a MBA from the London Business School.

**7.2. Accounting policies**

The Group's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standard Board.

**7.3. Share capital**

Details of the Group's authorized and issued share capital as at 31 December 2010 are disclosed in Note 16 of the consolidated financial statements.

**7.4 Substantial shareholdings**

The Group is aware of the following beneficial shareholdings, representing 10% or more of the issued ordinary share capital of the Group, as at 31 December 2010.

	Number of ordinary shares	% of issued share capital
Jenington International Inc.	77,745,417	65.00
BNY (Nominees) Limited <sup>1</sup>	31,263,377	26.14

Gold Lion Holdings Limited	10,599,539	8.86
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<sup>1</sup> BNY (Nominees) Limited holds these shares as depository, against Global Depositary Receipts issued, each representing one ordinary share with a nominal value of £0.0001.

## **7.5 Corporate governance**

### **Board**

The Board of Directors is composed of five members: the Executive Chairman (Evgeny Ivanov) and four Non-Executive Directors (German Pikhoya, Oleg Ignatov, Alexey Tekslar and Adrian Coates), including one independent director (Adrian Coates).

The Board has established the Audit Committee with formally delegated duties, responsibilities and written terms of reference. From time to time, separate committees may be set up by the Board to consider specific issues as and when the need arises.

The Board of Directors met 15 times during 2010 to discuss matters related to the Company's activity.

### **Audit Committee**

The Audit Committee assists the Board in discharging its responsibilities with regard to financial reporting, external and internal audits and controls, including reviewing the Company's annual financial statements, reviewing and monitoring the extent of the non-audit work undertaken by external auditors, advising on the appointment of external auditors and reviewing the effectiveness of the Company's internal audit activities, internal controls and risk management systems. The ultimate responsibility for reviewing and approving the annual report and accounts and the half yearly reports remains with the Board.

The membership of the Company's Audit Committee is composed of three members: Adrian Coates, German Pikhoya and Oleg Ignatov. Adrian Coates, the Committee Chairman, is considered by the Board to have recent and relevant financial experience. The Company therefore considers that it complies with the Combined Code recommendations regarding the composition of the Audit Committee.

The Audit Committee meets formally at least three times a year and otherwise as required.

In the reporting year, four meetings of the Audit Committee were held. The agenda of those meetings were the following: review of FY 2009 consolidated financial statements; review of 1H 2010 interim condensed consolidated financial statements; and remuneration of the auditor.

### **7.6. Directors and officers liability insurance**

The Group has in place a Directors and Officers insurance policy to cover relevant individuals against claims arising from their work on behalf of the company. The Board intends to keep the level of cover provided under annual or more frequent review, as appropriate.