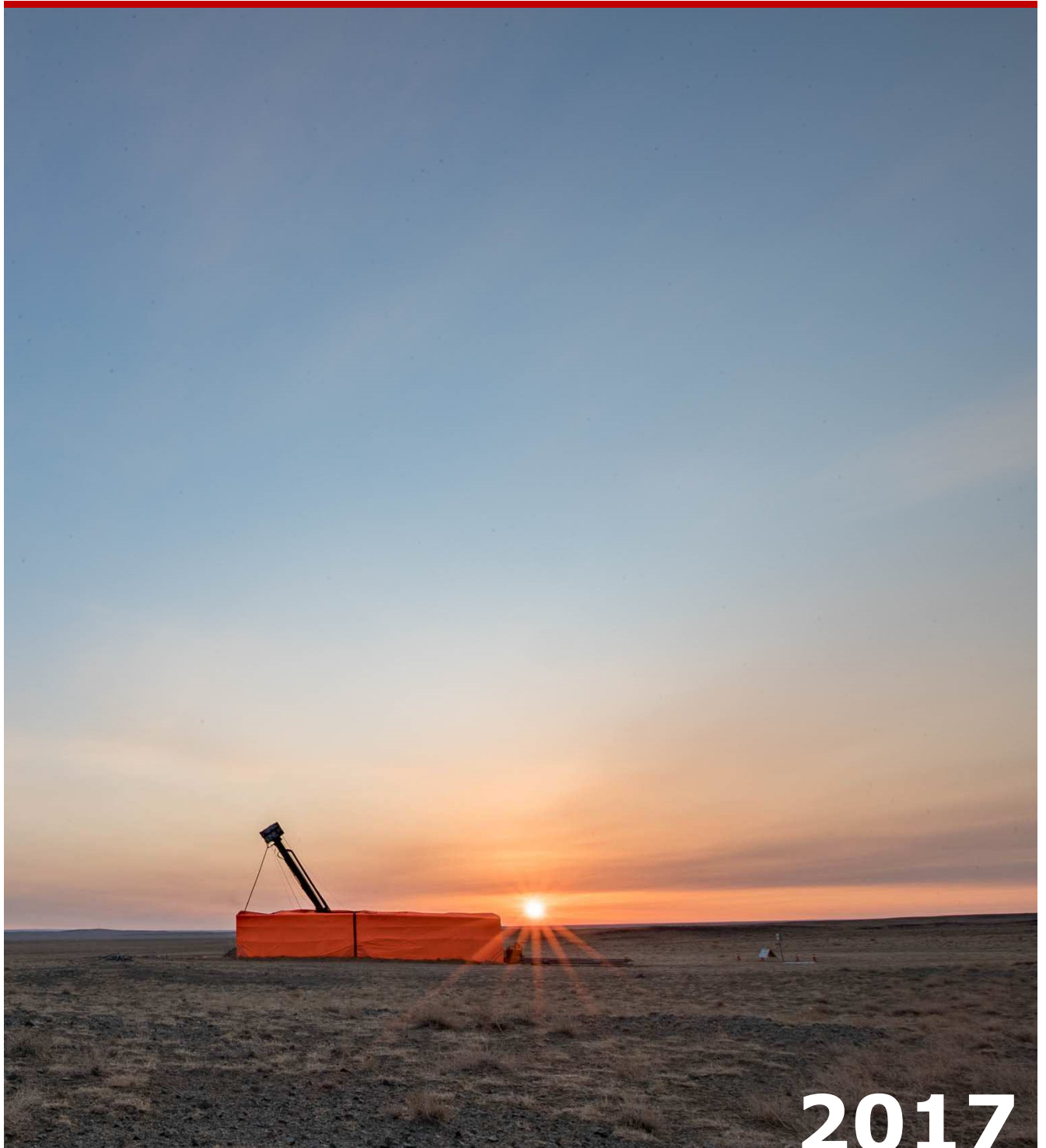




XANADU MINES



2017 ANNUAL REPORT

Xanadu Mines Limited ASX: XAM
For the year ended 31 December 2017

Corporate Directory

Directors

Kevin Tomlinson	Independent Non-Executive Chairman (appointed 29 May 2017)
Andrew Stewart	Managing Director & Chief Executive Officer
Ganbayar Lkhagvasuren	Executive Director
Hannah Badenach	Non-Executive Director
Marcus Engelbrecht	Non-Executive Director
Darryl Clark	Independent Non-Executive Director
Michele Muscillo	Independent Non-Executive Director (appointed 14 August 2017)

Company Secretary

Phil Mackey (appointed 26 May 2017)

Registered Office - Australia

c/o Company Matters Pty Limited
Level 12, 680 George Street
Sydney NSW 2000
Tel: +61 2 8280 7497
Fax: +61 2 9287 0350

Registered Office - Mongolia

Suite 23, Building 9B
Olympic Street, Khoroo 1, Sukhbaatar District
Ulaanbaatar 14240
Tel: +976 11 7012 0211

Share Registry

Computershare Investor Services Pty Limited
Level 3, 60 Carrington Street
Sydney, NSW 2000
Tel: +61 1300 855 080

Auditor

Ernst & Young
200 George Street
Sydney, NSW 2000

Stock Exchange Listing



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

ABN 92 114 249 026

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Letter from the Chairman

Dear Shareholder

It gives me great pleasure to address you for the first time in the capacity of chairman of Xanadu Mines.

Since taking on the role in late May 2017, I have been thoroughly impressed by the work being conducted by Managing Director Andrew Stewart and his team in Mongolia's highly prospective South Gobi copper-gold belt and I think you will all share my view that it has been another year of extremely positive progress for the Company.

Under Andrew's leadership, Xanadu has been both busy and productive on the exploration front and at the time of writing, the Company is adding more drill rigs to accelerate the evaluation of our Kharmagtai and Red Mountain projects and further explore areas that have returned significant intersections to date.

We are in the very early stages of a new bull market for copper. It's important to note that this bull market will be different to previous bull markets in that it will be driven by supply destruction, not demand creation. Having acquired Kharmagtai at the bottom of the last cycle, Xanadu is in an ideal position to benefit from the swing. Now is the time to be leveraged to discovery upside, as we are.

Xanadu's market capitalization has gone from less than \$100 million when I was appointed to the board to well over \$150 million and the Company's enterprise value has grown to be consistently over the \$100 million threshold that typically results in greater interest from institutional investors. Early last month Xanadu achieved another important milestone by being included in the S&P/ASX Indices.

In September last year, the Company successfully raised A\$15.4 million through an oversubscribed placement, with the funds earmarked for exploration activities at the Kharmagtai, Red Mountain and Yellow Mountain copper-gold projects, repayment of the Noble debt facility and general working capital.

We were delighted with the strong support received from our existing sophisticated and institutional shareholders as well as several new international institutions that have strengthened the register. The extinguishment of the Noble debt was another positive outcome that will allow Xanadu to pursue its drilling programs unencumbered.

Our flagship Kharmagtai copper-gold project, located an hour's drive north of the giant Oyu Tolgoi copper-gold deposit, continues to develop into a globally significant discovery. Drilling over the past 12 months has returned some of the best intercepts to date including 650m or greater at +1% copper equivalent. Intercepts of this length and grade compare favorably to those produced from some of the most significant copper-gold discoveries in recent history, including Oyu Tolgoi and Wafi-Golpu in Papua New Guinea.

The average copper deposit mining grade is about 0.4% Cu, so when a company has a project like Kharmagtai with copper grades greater than 1% and gold grades greater than 1 g/t, the investment community pays attention and so does the mining industry. It is fair to say that the excitement surrounding this district play has become an industry talking point and something of a beacon of hope in a sector that hasn't done much since the middle of 2004 when OT was discovered.

The drilling operations at Kharmagtai, which are increasing in their intensity, continue to extend the dimensions of the known mineralisation, while 19 further known porphyry targets in the district remain in the pipeline for future drilling.

Cost effectively exploring a landholding as large as Xanadu's in the South Gobi poses an ongoing challenge. Despite this, the Company has made significant headway over the past 12 months, in line with our clearly outlined strategy. The Board and management of Xanadu, all with substantial equity interests in the Company, remains firmly focused on enhancing shareholder value through monetising our advanced projects and continuing to discover more copper and gold.

Persistence and patience are required to unlock the value of porphyry copper-gold projects and 2017 was another year in which the understanding of our projects developed significantly, increasing the likelihood of a game-changing discovery.

Total direct exploration spend was over \$7.0 million with over 80% allocated towards Kharmagtai, the most advanced of our projects.

We continue demonstrating a deepening commitment to Mongolia and we are proud to partner with the country to explore one of the best copper and gold projects in the world that one day could supply materials essential to everyday life.

Letter from the Chairman

continued

Despite some of the headlines you may have read, we consider Mongolia a fantastic place to be operating and take comfort from the fact that it is the only country to have seen the development of a tier one copper project (Oyu Tolgoi) in the past two decades.

It is my strong opinion that Xanadu possesses all the ingredients to create significant shareholder value over coming years. It has good projects in the right location; a strong Board and management team; and a supportive shareholder base. Throw into the mix improving copper market fundamentals and major companies looking to add new, high quality projects to their portfolios and it is not hard to envisage a very bright future.

In closing, I would like to thank all of our stakeholders for their continued support for Xanadu Mines.

Yours faithfully



Kevin Tomlinson

Non-Executive Chairman

23 March 2018

Review of Operations

Xanadu Mines continued to make significant progress in its Mongolian copper and gold strategy over the 12 months ending 31 December 2017. The Company controls one of the most promising porphyry copper and gold projects in Asia with Kharmagtai, and has a portfolio of advanced district-scale exploration projects including Red Mountain and Yellow Mountain (Figure 1).

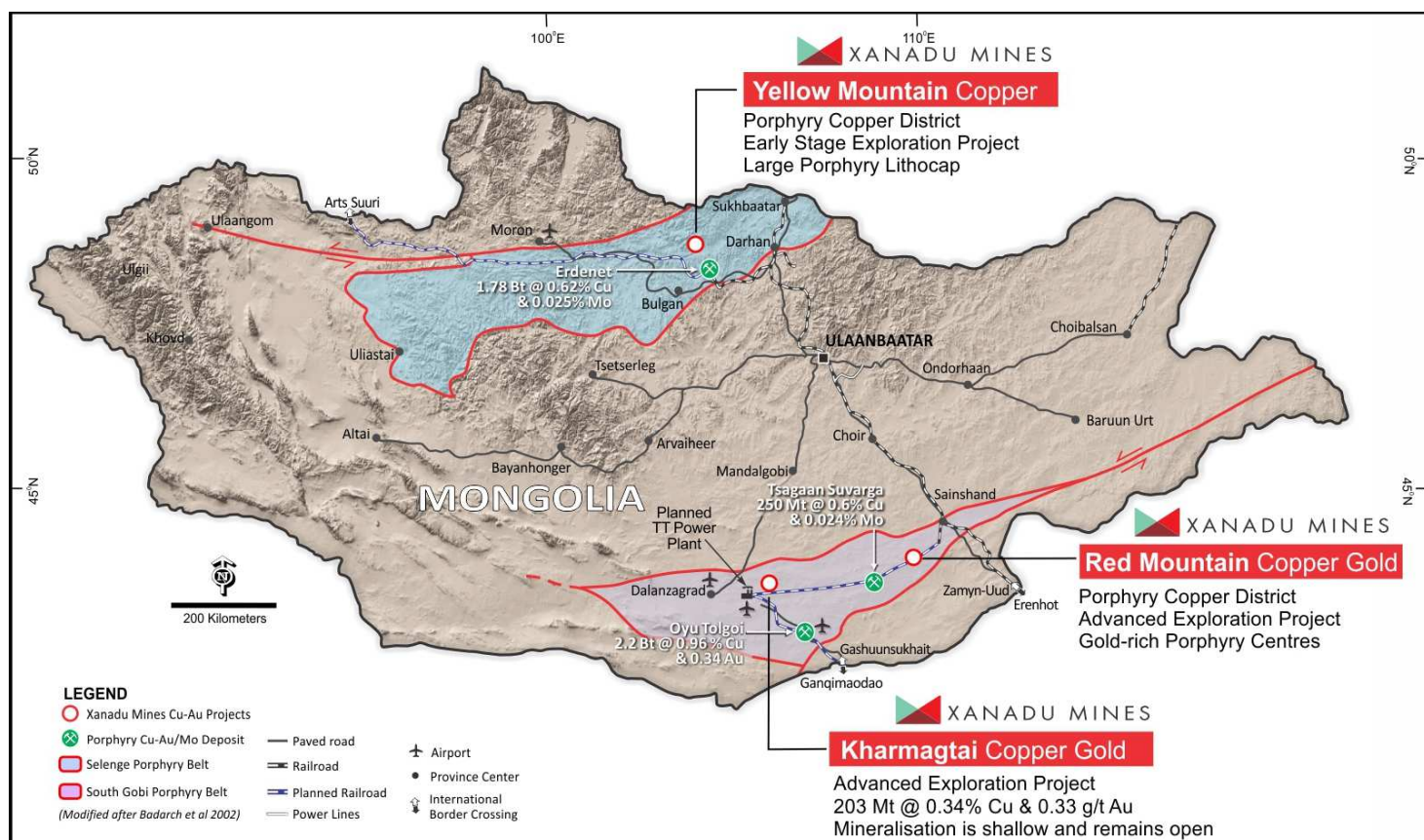


FIGURE 1: Location of Xanadu’s copper-gold projects, within Mongolia’s highly mineralised and vastly underexplored mineral belts.

The planned exploration programs, among the largest to be undertaken by a junior ASX-listed exploration company last year, targeted the discovery of additional copper-gold deposits on the Company’s South Gobi porphyry projects at Kharmagtai and Red Mountain where a total of 28,050 metres of diamond drilling, 1,831 metres reverse circulation drilling, 6,320 metres of PCD drilling and 816 metres of trenching has been completed during the calendar year.

Kharmagtai Copper-gold Project (Xanadu Earning up to 76.5%)

The flagship Kharmagtai project has continued to emerge as one of the premier undeveloped copper and gold assets globally. The project is located within the Omnogovi Province, approximately 420 kilometres southeast of Ulaanbaatar and 120 kilometres north of the Rio Tinto-controlled Oyu Tolgoi deposit. Xanadu and its joint venture partner, Mongol Metals LLC, announced the acquisition of a 90% interest in the Kharmagtai porphyry copper-gold project from Turquoise Hill Resources in February 2014. Under the Mongol Metals LLC joint venture terms, Xanadu has earned an 85% interest in the Kharmagtai project, equivalent to a 76.5% effective interest, by funding acquisition and exploration costs.

The Kharmagtai project is the engine room for Xanadu’s short term growth. Previous exploration has focused on the three outcropping porphyry deposits (Stockwork Hill, White Hill and Copper Hill) where Xanadu has already defined over 1.5 Mlb copper and over 2 million ounces of gold resource (refer to Xanadu’s ASX announcement - 19 March 2015) in the central part of Mining Licence 17387A. Apart from these three deposits the prospective rocks of the Kharmagtai Igneous Complex are covered by either younger unconsolidated gravels or are obscured by younger rocks.

Exploration in 2017 followed the dual strategy of expanding current resources and identifying new, high-grade porphyry deposits under shallow cover. This strategy has resulted in the discovery of the off-set to the Stockwork Hill Deposit, added significant extensions to the White Hill Deposit and near misses to the high-grade extensions of Copper Hill (Figure 3).

Review of Operations

continued

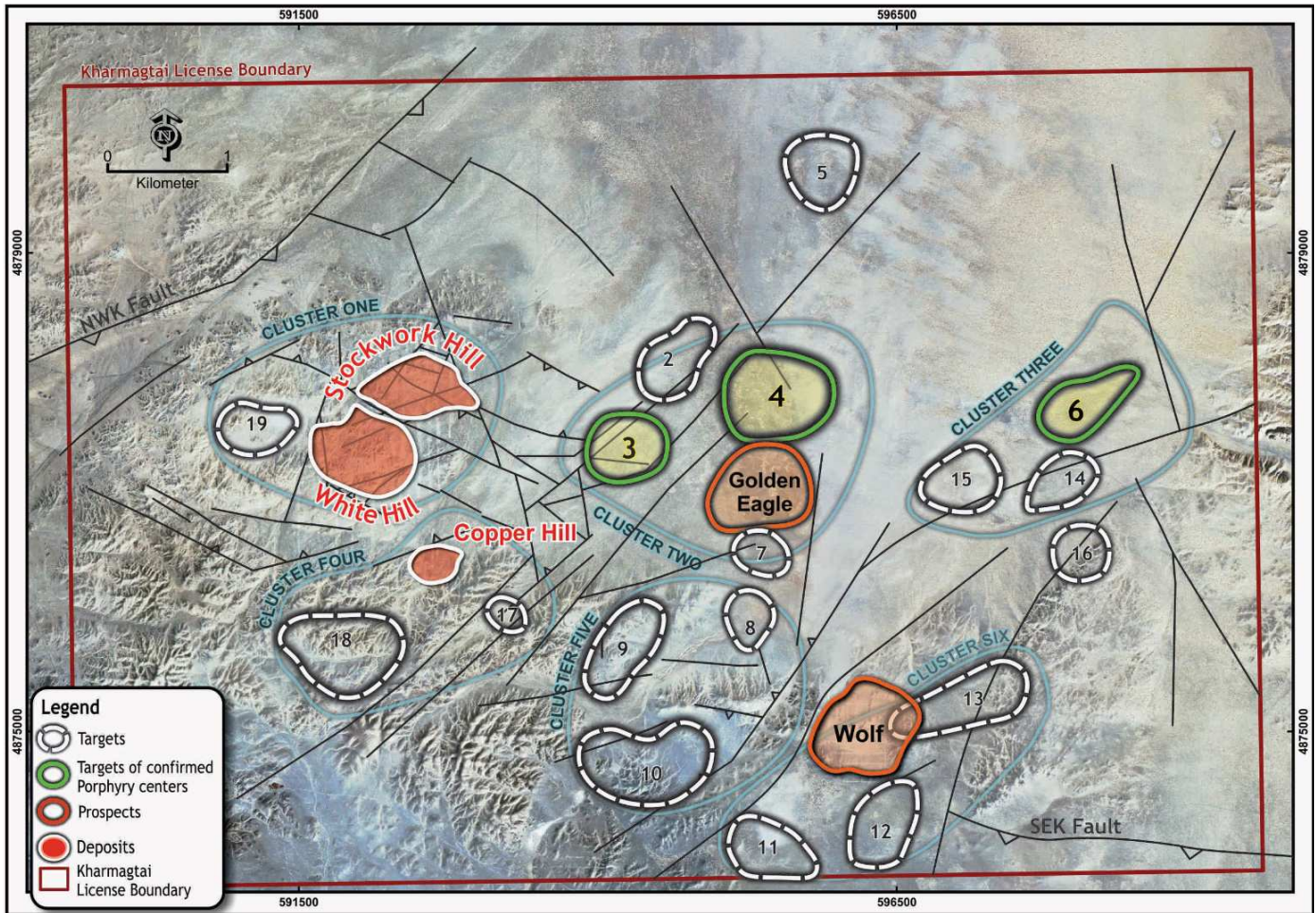


FIGURE 2: The Kharmagtai Mining Licence showing known porphyry deposits and seven new targets.

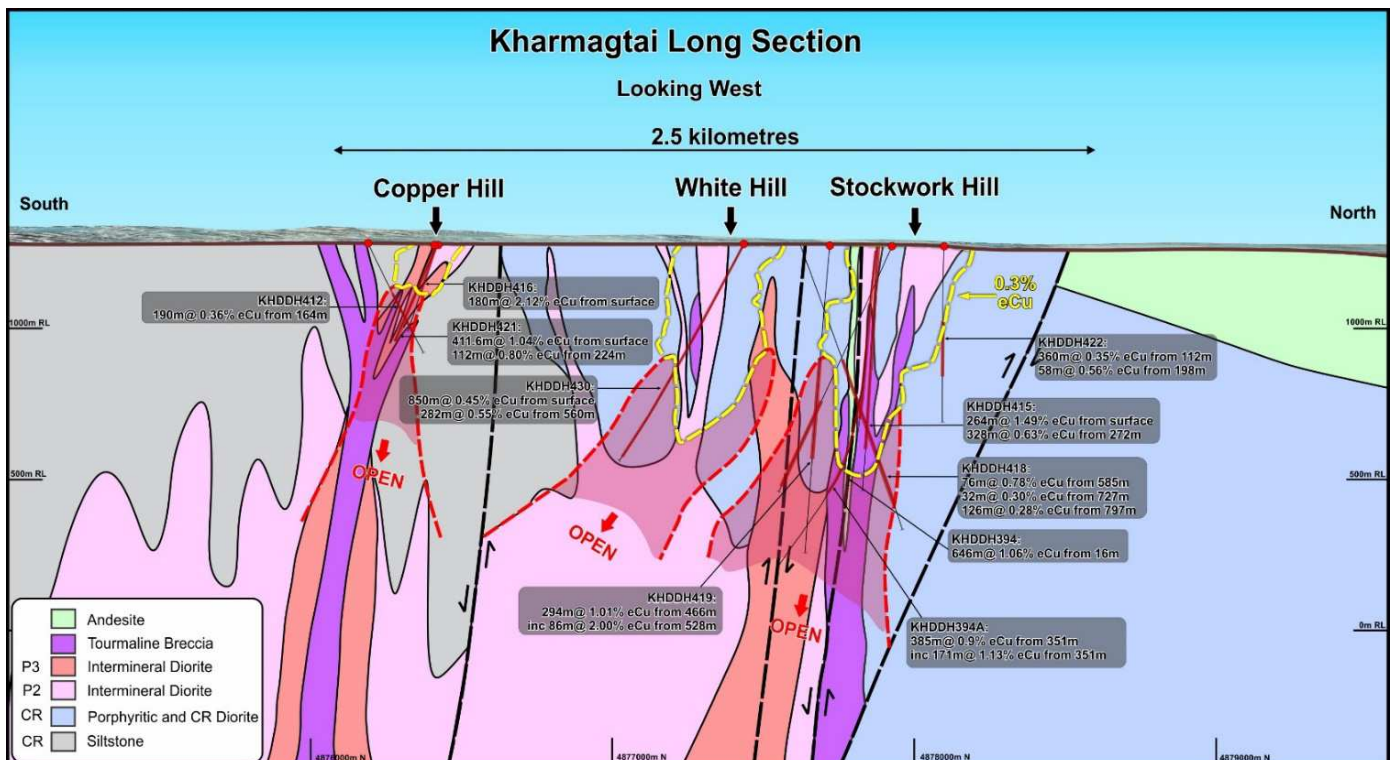


FIGURE 3: Long section through the three existing deposits at Kharmagtai showing significant extensions to these deposits.

Review of Operations

continued

At Stockwork Hill detailed structural work during 2017 identified three potential offset blocks of mineralization. These targets were drilled and the southern lobe target returned high-grade bornite bearing mineralisation. KHDDH419 returned **294m @ 0.47% Cu & 0.85g/t Au (1.01% eCu) from 466m** including **86m @ 0.78% Cu and 1.91g/t Au (2.0% eCu) from 558m**. This drill hole marks the discovery of the lower, fault offset portion of Stockwork Hill (Figure 3) outside the existing resource. Importantly, the presence of bornite and strong potassic alteration indicates drilling is nearing the higher-grade core of the Stockwork Hill porphyry system.

At White Hill detailed relogging and reinterpretation of the geology has shown that what was initially thought of as a homogenous unit of porphyry mineralization is actually numerous narrow fingers of mineralized porphyry within country rock diorite. These fingers of higher-grade porphyry are interpreted to coalesce into a large higher-grade intrusive body. Drill hole KHDDH430 was drilled to test this theory and returned **850m @ 0.32% Cu and 0.2g/t (0.45% eCu) from surface** including **282 @ 0.44% Cu and 0.16g/t Au (0.55% eCu) from 560m**. This drill hole has added over 300m of higher-grade mineralization outside the existing resource at White Hill (Figure 3).

At Copper Hill, we continued to target the off-set high-grade zone of mineralization below the current resource. This work has identified the key structures and made predictions as to the location of this high-grade zone. Drill holes KHDDH416 and KHDDH421 were drilled at Copper Hill targeting this zone. KHDDH421 returned **411.6m @ 0.54% Cu and 0.79 g/t Au (1.04% eCu) from surface**, including **134m @ 1.01% Cu and 1.84 g/t Au (2.18% eCu) from 14m**. KHDDH416 returned **180m @ 0.95% Cu and 1.84g/t Au (2.12% eCu) from surface**, including **30m @ 1.93% Cu and 4.14g/t Au (4.57% eCu) from 66m** and **30m @ 1.55% Cu and 3.45g/t Au (3.75% eCu) from 104m**. These holes show the tenor of the high-grade zone and have tagged the medium grade halo to the lower offset mineralization. Work continues to refine this target.

Numerous other targets have been tested during 2017 with a remarkable strike rate. Almost all drill holes have returned moderate to broad zones of porphyry mineralization or narrow high-grade zones of epithermal gold. At Target 19, a large area of phyllic alteration and surface geochemistry has been tested with drill hole KHDDH435, returning returned **213.4m @ 0.23% Cu and 0.17g/t Au (0.34% eCu) from 86m**, including **130.3 @ 0.29% Cu and 0.22g/t Au (0.43% eCu) from 130m**, follow up drilling continues as Target 19 appears to be a similar system to, and potentially a faulted offset to White Hill, 2km to the east.

Advanced geophysical techniques are being applied to the search for porphyries buried under shallow cover at Kharmagtai. Reprocessing of high-resolution ground magnetic data has been undertaken to identify areas where the magnetic field has been rotated. This rotation or variation in magnetic field direction is usually indicative if alteration, faulting and or mineralization (Figure 4).

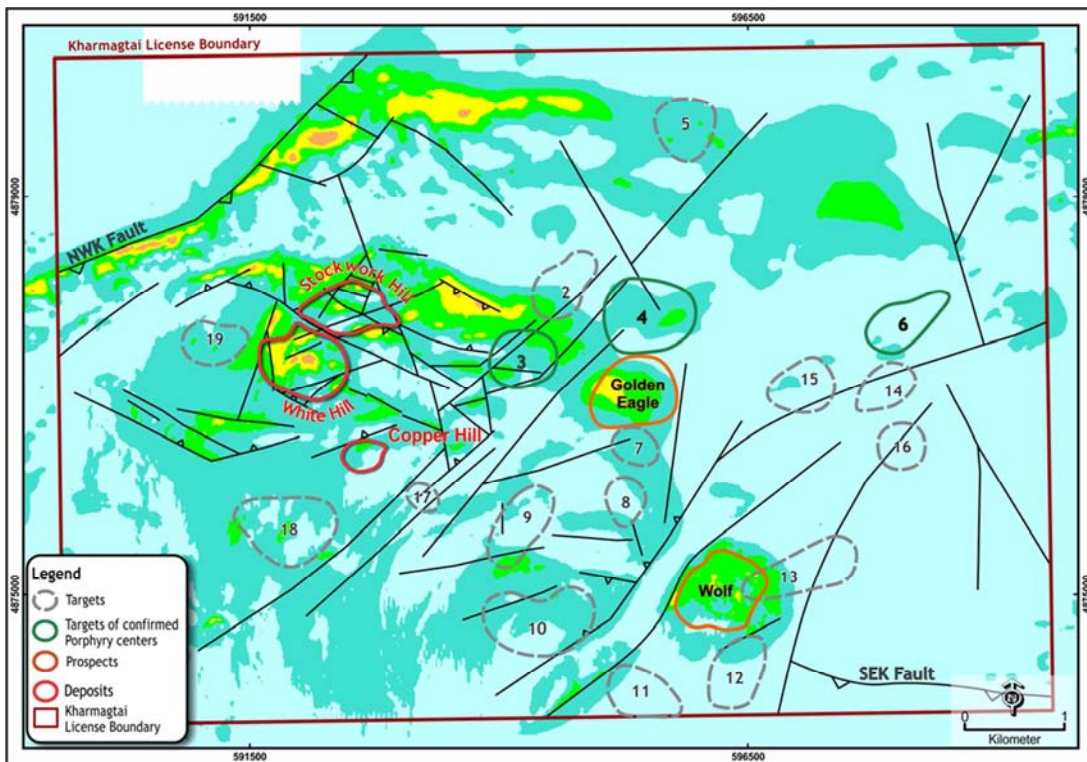


Figure 4: Sophisticated reprocessing of the existing ground magnetics focuses on areas where magnetic rotation has occurred. This rotation occurs due to faulting, mineralisation or alteration and helps highlight areas of potential mineralisation. Interestingly, all areas of existing mineralisation are represented and several areas outside known targets are highlighted for follow-up.

Review of Operations

continued

Exploration at Kharmagtai during 2018 will focus on continuing to expand the current resources and advancing the highest priority exploration targets to provide additional shallow, high-grade resources.

Red Mountain Project (Xanadu 90%)

The Red Mountain copper-gold project is located in the Dornogovi Province of southern Mongolia, approximately 70 kilometres west of the future industrial centre of Sainshand. Red Mountain is a highly prospective porphyry copper-gold project. The project comprises a large and underexplored porphyry district (covering approximately 40km²) and consists of multiple co-genetic porphyry copper-gold centres, mineralised tourmaline breccia pipes and copper-gold/base metal magnetite skarns, which occur within the central part of Mining Licence 17129A (Figure 4).

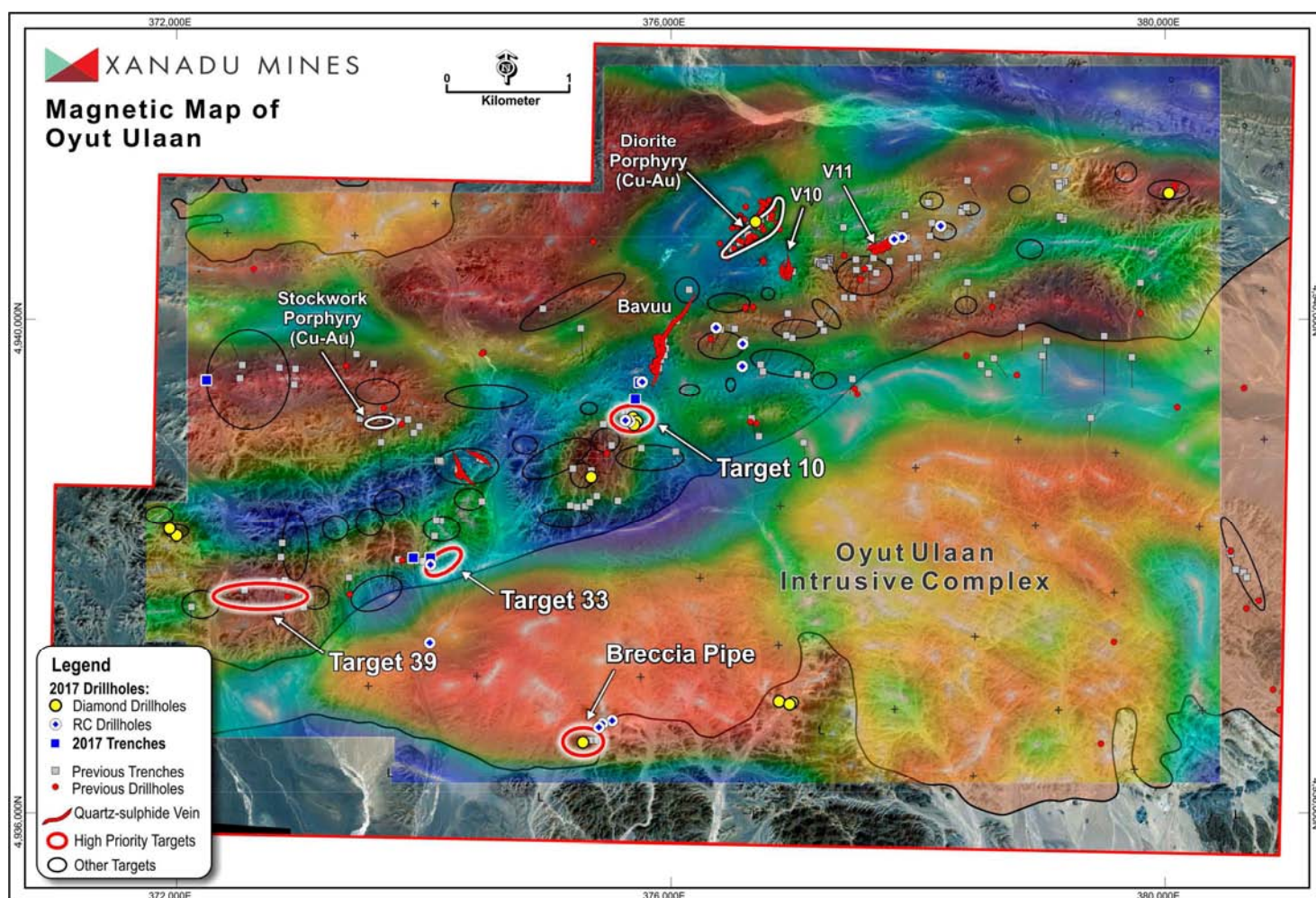


FIGURE 5: The Red Mountain Mining Licence showing known porphyry deposits and new targets.

Exploration during 2017 at Red Mountain focused on continuing to test a wide range of high-grade epithermal gold, large scale porphyry and tourmaline breccia targets. This work resulted in numerous significant gold and copper intercepts.

At Diorite Hill, drilling was conducted to test for along strike extensions of high-grade copper gold mineralization. OUDDH87 returned **184m at 0.52% Cu and 0.85g/t Au (1.06% eCu) from surface**. This work has highlighted the location of several off-setting faults and provided structural information that once combined with the ground penetrating radar and reprocessed magnetic data will provide additional high-grade porphyry targets.

At the Breccia Pipe prospect, diamond drill hole OUDDH088 was designed to test the eastern strike extension to high-grade mineralization, intersected **66m at 1.8% Cu from surface including 19m at 4.15% Cu from 20.4m**. Mineralization remains open at depth and to the southwest and northeast. Broad scale mapping and geochemistry is underway to find additional high-grade tourmaline breccia pipes and additional drilling will be conducted at Breccia Pipe prospect.

Review of Operations

continued

Drilling at Target 10, where a large-scale porphyry target has been developed returned a broad zone of moderate grade porphyry mineralization with a very high grade zone on the flanks. OUDDH089 returned **6.2m at 4.24% Cu and 1.9g/t Au (5.45% CuEq) from 128m** including **0.9m at 22.10% Cu and 8.27g/t Au (27.37% CuEq)** from on the flanks of **79.5m @ 0.26% Cu and 0.21 g/t Au from 189.5m**.

Trenching and RC drilling at Target 33 during 2017 has returned broad zones of epithermal gold. OURC043 was designed to test these gold bearing quartz veins and intersected **22m at 1.8g/t from 40m** including **10m at 3.7g/t Au from 50m** within silica and epidote altered volcanic rocks and below the weathering zone. OURC055, a follow-up hole returned **16m @ 1.13g/t Au** from surface. This target is hosted within a feldspar altered intrusive dyke that extends for several kilometers east west and is associated with strong gold anomalism from soils. Work in 2018 will include trenching along the entire length of the target with follow-up scout drilling to determine the continuity of grade and potential strike and widths.

Xanadu has also continued to define the projects potential through a combination of mapping, geophysics and trenching identifying multiple drill-ready targets. Exploration work indicates that outcropping mineralisation may represent the shallow part of a deeper, more continuous porphyry system. A tourmaline breccia complex is also present at Red Mountain with similarities to the mineralised tourmaline breccia dike complex at Kharmagtai. The Company will continue its systematic and low-cost exploration program at Red Mountain. The next phase of exploration will focus on delineating potential shallow, high-grade gold mineralisation by exploring along strike from existing intersections and testing the many geophysical and geochemical anomalies which remain within the Red Mountain licence area.

Sharchuluut Project (Xanadu 100%)

Sharchuluut Uul is an early stage project focused on what is an extensive advanced argillic (high-sulphidation porphyry lithocap) alteration above a deeper porphyry centre. Limited drilling to date has intersected broad zones of porphyry alteration. Xanadu has outlined two main target areas that are yet to be tested.

Mineral Resources Statement

The Company's Mineral Resource Statement has been compiled in accordance with the Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves (the JORC Code 2012 Edition) and Chapter 5 of the ASX Listing Rules and ASX Guidance Note 31. The Mineral Resource Estimate for the Kharmagtai deposit from 2015 amounts to 203Mt @ 0.34% Cu and 0.33g/t Au (0.55% CuEq) for a contained metal content of 1,500Mlb Cu and 2.2Moz Au. No changes were made to Kharmagtai Mineral Resources. This Mineral Resource, based on a total of 108,130 metres of drilling (83,577 metres of diamond and 24,553 metres of Reverse Circulation) and includes indicated resource categories as well as inferred classified material, is reported at a 0.3% CuEq cut-off constrained within Whittle optimised pit shells and CuEq cut-off 0.5% CuEq applied to the underground resources (Table 1). The Resource Estimate also includes a higher-grade core of 56Mt @ 0.47% Cu and 0.59g/t Au (0.85% Cu equivalent) for a contained metal content of 580Mlb Cu and 1.1Moz Au. The higher-grade core is reported at a 0.6% CuEq cut-off and split between open pit within a Whittle optimised pit shell and underground outside of the pit shell (Table 2).

Refer to ASX announcement dated 19 March 2015 "Kharmagtai Maiden JORC Resource" for full details of resource estimation methodology and attributions. Note: All figures may not sum exactly due to rounding.

The tables below set out the Company's Mineral Resources for 2015.

Table 1: Summary Mineral Resource Estimate tabulation for Kharmagtai Deposit, 28 February 2015. Reported at a 0.3% CuEq cut-off constrained within optimised pit shells, and CuEq cut-off 0.5% CuEq applied to the underground.

Deposit	Mining Method	Cut-Off CuEq (%)	Resource Category	Material (Mt)	Grade			Metal		
					Cu(%)	Au(g/t)	CuEq(%)	Cu(Mlb)	Au(Koz)	
All	OC	0.3	Indicated	23	0.41	0.55	0.76	203	401	
			Inferred	107	0.27	0.24	0.42	641	833	
	UG	0.5	Indicated	24	0.43	0.47	0.73	225	359	
			Inferred	51	0.42	0.36	0.64	463	591	
	Combined			Indicated	46	0.42	0.51	0.74	428	759
				Inferred	157	0.32	0.28	0.49	1,104	1,424

Review of Operations

continued

Notes:

- JORC 2012 categorised Mineral Resources for the Kharmagtai Copper Gold Project have been classified as indicated and inferred confidence categories on a spatial, areal and zone basis and are listed in the table below.
- A cut-off 0.3% CuEq within a Whittle Pit Shell and 0.5% CuEq below a Whittle Pit Shell.
- Numbers may not add due to rounding.

Table 2: Summary Mineral Resource Estimate tabulation for Kharmagtai Deposit, March 2015. Reported at a 0.6% CuEq cut-off constrained within an optimised pit shell.

Deposit	Mining Method	Cut-Off CuEq(%)	Resource Category	Material (Mt)	Grade			Metal		
					Cu(%)	Au(g/t)	CuEq(%)	Cu(Mlb)	Au(Koz)	
All	OC	0.6	Indicated	9	0.52	0.87	1.08	102	248	
			Inferred	1	0.38	0.82	0.92	11	34	
	UG	0.6	Indicated	20	0.46	0.57	0.83	203	368	
			Inferred	26	0.46	0.50	0.78	263	418	
	Combined			Indicated	29	0.48	0.66	0.91	305	616
				Inferred	27	0.46	0.52	0.79	274	452

Notes:

- JORC 2012 categorised Mineral Resources for the Kharmagtai Copper Gold Project have been classified as indicated and inferred confidence categories on a spatial, areal and zone basis and are listed in the table below.
- A cut-off 0.6% CuEq within a Whittle Pit Shell and 0.6% CuEq below a Whittle Pit Shell.
- Numbers may not add due to rounding.

The Mineral Resource estimate for Kharmagtai was completed by external independent consultants, Mining Associates Ltd. The Mineral Resource is reported according to the principles and guidelines of JORC 2012. It is based on a database containing 64,296 records from 265 holes, with a total of 91,837.8 metres drilled that was available as of 31 December 2014. The Mineral Resource was tested for and found to have reasonable and realistic prospects for eventual economic extraction. It represents a realistic inventory of mineralisation within a conceptual open cut and underground mine design (Tables 1 and 2). The base case CuEq cut-off grade assumptions for each deposit were determined using cut-off grades applicable to mining operations exploiting similar deposits. The CuEq cut-off applied for the open pit was 0.3% CuEq and CuEq cut-off 0.5% CuEq applied to the underground. The CuEq calculation represents the total metal value for each metal, multiplied by the conversion factor, summed and expressed in equivalent copper percentage. Grades have not been adjusted for metallurgical or refining recoveries and the copper equivalent grades are intended for summarising grade. The copper equivalent calculation is intended as an indicative value only. The following copper equivalent conversion factors and long term price assumptions have been adopted: Copper Equivalent Formula (CuEq) = Cu% + (Au (ppm) x 0.6378); Price assumptions: Cu (US\$2.60lb) and Au (US\$1,300oz) and a gold recovery factor of 70.85%.

Competent Person's Statements

The information in this report that relates to the Mineral Resource is based on information compiled by Mr Andrew J. Vigar, who is a Fellow of The Australasian Institute of Mining and Metallurgy. Mr Vigar is employed by Mining Associates Limited Hong Kong. Mr Vigar has sufficient experience which is relevant to the style of mineralisation and type of deposit under consideration and to the activity which he is undertaking to qualify as a "Competent Person" as defined in the 2012 Edition of the 'Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves'. Mr Vigar consents to the inclusion in this report of the matters based on his information in the form and context in which it appears. The information in this report that relates to Exploration Results is based on information compiled by Dr Andrew Stewart who is responsible for the exploration data, comments on exploration target sizes, QA/QC and geological interpretation and information, which is incorporated in the database that was provided to Mining Associates for undertaking the Resource estimate. Dr Stewart is an employee of Xanadu and is a Member of the Australasian Institute of Geoscientists. Dr Stewart has sufficient experience relevant to the style of mineralisation and type of deposit under consideration and to the activity he is undertaking to qualify as the "Competent Person" as defined in the 2012 Edition of the "Australasian Code for Reporting Exploration Results, Mineral Resources and Ore Reserves". Dr Stewart consents to the inclusion in the report of the matters based on his information in the form and context in which it appears.

Exploration Expenditure

The Company invested \$7.1 million (31 December 2016: \$4.8 million) in exploration activities at the Kharmagtai and Red Mountain projects. A total of 28,050 metres of diamond drilling, 1,831 metres reverse circulation drilling, 6,320 metres of PCD drilling and 816 metres of trenching were completed during the calendar year at the Kharmagtai and Red Mountain projects.

Review of Operations

continued

Capital Management

The Company had \$9.1 million cash on hand as at 31 December 2017 (31 December 2016: \$8.3 million). The Company realised net \$13.1 million (31 December 2016: \$11.5 million) in financing cash flows from a share placement.

During the year, the Company repaid the related party loan from Noble Resources International (which was denominated in USD) by way of combined cash of AUD 2.9 million and equity of AUD 1.4 million.

The primary use of funds over 2018 will be the continuation of exploration activities at the Company's Kharmagtai and Red Mountain copper-gold projects and working capital. The Company may need to raise additional capital for its exploration activities or seek joint venture partners. There is a risk that capital or joint venture partners may not be available or available on acceptable terms. Capital management is a priority of Management and the Company retains the flexibility to reduce its cost base while preserving its exploration projects if required.

Business Risks

Political and Legal Risks

The Company's mineral projects are located in Mongolia, where mineral exploration and mining activities may be affected in varying degrees by political instability, economic conditions, expropriation or nationalization of property and changes in government regulations such as foreign investment laws, tax laws, business laws, environmental laws and mining laws, affecting the Company's business in that country. Government policy may change to discourage foreign investment, nationalization of the mining industry may occur and other government limitations, restrictions or requirements may be implemented. There can be no assurance that the Company's assets will not be subject to nationalization, requisition, expropriation or confiscation, whether legitimate or not, by any authority or body.

The regulatory environment is in a state of continuing change, and new laws, regulations and requirements may be retroactive in their effect and implementation. There can be no assurance that Mongolian laws protecting foreign investments will not be amended or abolished or that existing laws will be enforced or interpreted to provide adequate protection against any or all of the risks described above.

License Risks

The Company's most significant licenses are the license covering the Kharmagtai Project and the license covering the Red Mountain Project. The Government of Mongolia could revoke either of these licenses if the Company fails to satisfy its obligations, including payment of royalties and taxes to the Government of Mongolia and the satisfaction of certain mining, environmental, health and safety requirements. A termination of the Company's mining licenses covering the Kharmagtai Project or the Red Mountain Project by the Government of Mongolia could materially and adversely affect the Company's reputation, business, prospects, financial conditions and results of operations. In addition, the Company would require additional licenses or permits to conduct the Company's mining or exploration operations in Mongolia. There can be no assurance that the Company will be able to obtain and maintain such licenses or permits on terms favorable to it, or at all, for the Company's future intended mining or exploration targets in Mongolia, or that such terms would not be subject to various changes.

Mineral Resource Assumptions Risk

The Company's mineral resource and mineral reserve estimates for the Kharmagtai Project are based on a number of assumptions. There are numerous uncertainties inherent in estimating quantities of mineral reserves and grades of mineralization, including many factors beyond the control of the Company. There can be no assurance that the mineral resources and mineral reserve estimates will be recovered in the quantities, qualities or yields presented in this prospectus or set out in the Kharmagtai Technical Report. Copper and gold mineral resource and mineral reserve estimates are inherently prone to variability. They involve expressions of judgment with regard to the presence and quality of mineralization and the ability to extract and process the mineralization economically. These judgments are based on a variety of factors, such as knowledge, experience and industry practice.

Liquidity and Financing Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The primary source of funds available to the Company is from equity financing. The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis, to support its exploration plans, and to ensure that it will have sufficient liquidity to meet its liabilities when due. To the extent the Company does not believe it has sufficient liquidity to meet these obligations, management will consider securing additional funds through equity or debt transactions.

The Company does not have unlimited financial resources and there is no assurance that sufficient additional funding or financing will be available to the Company or its direct and indirect subsidiaries on acceptable terms, or at all, for further exploration or

Review of Operations

continued

development of its properties or to fulfill its obligations under any applicable agreements. Disruptions in the capital and credit markets as a result of uncertainty, geo-political events, changing or increased regulation of financial institutions, reduced alternatives or failures of significant financial institutions could adversely affect the Company's access to the liquidity needed for the business in the longer term. Failure to obtain such additional funding could result in the delay or indefinite postponement of the exploration and development of the Company's properties.

Metal Prices Risk

Even if commercial quantities of mineral deposits are discovered, there is no guarantee that a profitable market will exist for the sale of the metals produced. Factors beyond the control of the Company may affect the marketability of any minerals discovered. The prices of various metals have experienced significant movement over short periods of time, and are affected by numerous factors beyond the control of the Company, including, among other things, international economic and political trends, expectations of inflation, currency exchange fluctuations, interest rates and global or regional consumption patterns, speculative activities and increased production due to improved mining and production methods. The Company is particularly exposed to the risk of movement in the price of copper and gold.

Foreign Currency Fluctuations Risk

The Company is exposed to foreign exchange fluctuations with respect to A\$, US\$, MNT C\$. The Company's financial results are reported in A\$. Salaries for certain local employees in Mongolia may be paid in MNT. The Company's operations are in Mongolia and some of its payment commitments and exploration expenditures under the various agreements governing its rights are denominated in MNT and US\$. As a result, the Company's financial position and results are impacted by the exchange rate fluctuations among A\$, US\$, MNT and C\$. Such fluctuations may materially affect the Company's financial position and results.

Environmental Risk

Existing and possible future environmental legislation, regulations and actions could cause significant expense, capital expenditures, restrictions and delays in the activities of the Company, the extent of which cannot be predicted and which may well be beyond the capacity of the Company to fund. Failure to comply with applicable environmental laws and permitting requirements may result in enforcement actions thereunder, including orders issued by regulatory or judicial authorities causing operations to cease, and may include corrective measures requiring capital expenditures, installation of additional equipment or remedial actions.

Operational Risk

The Company's activities are subject to a number of operational risks and hazards, some of which are beyond its control. These risks and hazards include unexpected maintenance or technical problems, periodic interruptions due to inclement or hazardous weather conditions, natural disasters such as earthquakes, industrial accidents, power, water or fuel supply interruptions or the increase in the price of such supplies, critical equipment failure, malfunction and breakdowns of information management systems, fires, and unusual or unexpected variations in mineralization, geological or mining conditions.

Directors' Report

The directors present their report, together with the financial statements, on the consolidated entity (referred to hereafter as the 'Group') consisting of Xanadu Mines Ltd (referred to hereafter as the 'Company' or 'Parent Entity') and the entities it controlled at the end of, or during, the period ended 31 December 2017.

Directors

The following persons were Directors of Xanadu Mines Ltd during the whole of the financial period and up to the date of this report, unless otherwise stated:

Kevin Tomlinson (appointed 29 May 2017)
Andrew Stewart
Ganbayar Lkhagvasuren
Hannah Badenach
Marcus Engelbrecht
Darryl Clark
Michele Muscillo (appointed 14 August 2017)
Mark Wheatley (ceased 29 May 2017)
Barry Lavin (ceased 29 May 2017)

Principal activities

The principal activities of the entities within the Group during the year were exploration and development of its various mineral exploration projects in Mongolia.

Dividends

There were no dividends paid, recommended or declared during the current or previous financial period.

Results of operations

The Company realised a loss of \$3.8 million for the period ending 31 December 2017 (31 December 2016: \$2.1 million) and recognised total net assets of \$45.8 million (31 December 2016: \$36.8 million). The Company had other operating expenses of \$3.5 million before net foreign currency losses (31 December 2016: \$2.9 million) including wages expense of \$1.7 million (31 December 2016: \$1.8 million). A review of operations is presented before the directors' report.

Significant changes in the state of affairs

There were no significant changes in the state of affairs of the Group during the financial period.

Matters subsequent to the end of the financial period

On 26 February 2018, the Company announced that it has applied for the listing of its ordinary shares on the Toronto Stock Exchange to complement its ASX listing and has filed a preliminary non-offering prospectus with the Ontario Securities Commission.

No other matter or circumstance has arisen since 31 December 2017 that has significantly affected, or may significantly affect the group's operations, the results of those operations, or the group's state of affairs in future financial years.

Likely developments and expected results of operations

Information on likely developments in the operations of the group and the expected results of operations have been included in the review of operations report. The Company intends to continue to invest and explore the projects described in this report.

Directors' Report

continued

Information on Directors

Name:	Kevin Tomlinson (appointed on 29 May 2017)
Title:	Non-Executive Chairman
Qualifications:	MAIG, FSI, MSc
Experience and expertise:	Kevin has more than 30 years' experience in the resource sector, firstly as a geologist and then moving into the finance sector where he worked extensively in and finance sectors within the Canadian (TSXV, TSX), Australian (ASX) and United Kingdom (AIM, LSE) stock markets. In Australia, Kevin held senior executive roles with Plutonic Resources and Hartleys Australia as Head of Research. In London, he was Managing Director of Investment Banking at Westwind Partners/Stifel Nicolaus raising equity and providing corporate advice for many resources companies. Kevin brings extensive experience in exploration, development and financing of mining projects internationally.
Other current directorships:	Cardinal Resources Limited (appointed 7 November 2016 – current), Plymouth Minerals Limited (appointed 8 June 2017 - current), Samco Gold Limited (appointed 16 January 2012 – current)
Former directorships (last 3 years):	Centamin Plc (appointed January 2012 – ceased May 2016), Orbis Gold Ltd (appointed April 2014 – ceased February 2015), Besra Gold Inc (appointed January 2012 – ceased April 2015)
Special responsibilities:	Member of the Audit and Risk Committee, Nomination and Remuneration Committee and Safety, Health and Environment Committee
Interests in shares:	290,000
Interests in rights:	3,000,000

Name:	Dr Andrew Stewart
Title:	Managing Director & Chief Executive Officer
Qualifications:	BSc, PhD, MAIG, MSEG, MAICD
Experience and expertise:	Andrew is a geologist with over 15 years' experience in mineral exploration; primarily focussed on project generation, project evaluation and exploration strategy development throughout Asia and Eastern Europe. Andrew has particular expertise in porphyry copper and epithermal gold deposits, but has worked across a diverse range of commodities. He holds a BSc (Hons) from Macquarie University and a PhD from the Centre of Ore Deposits and Exploration Studies at the University of Tasmania. During his time at Ivanhoe Mines and Vale Andrew held various technical and management positions in Mongolia and Indonesia and has been involved in several green fields discoveries. After providing technical and program management for Vale in Indonesia and Mongolia, Andrew joined Xanadu Mines as Chief Geologist leading the gold and base metals project generation and evaluation team in Mongolia. In 2016 Andrew became the Managing Director & Chief Executive Officer of Xanadu Mines.
Other current directorships:	None
Former directorships (last 3 years):	None
Special responsibilities:	Managing Director
Interests in shares:	4,031,083
Interests in rights:	7,000,000

Name:	Ganbayar Lkhagvasuren
Title:	Executive Director
Qualifications:	M.IBL
Experience and expertise:	Ganbayar is a co-founder of Xanadu and has been a Director since 2006. He is the joint venture partner in Mongol Metals LLC and brings a vital Mongolian perspective to the Board of Directors.
Other current directorships:	None
Former directorships (last 3 years):	None
Special responsibilities:	Member of the Safety, Health and Environment Committee
Interests in shares:	16,558,329
Interests in rights:	4,000,000

Directors' Report

continued

Name: Hannah Badenach
Title: Non-Executive Director
Qualifications: B. Laws (Hons), B. Arts
Experience and expertise: Hannah is a lawyer and an Executive Director at Noble Resources International Pte Ltd (Noble). Hannah has built and manages the Mongolian business and also runs the global Base Metals business on behalf of Noble. Hannah has worked in various markets globally and has extensive commercial and business development experience. She has been responsible for the development and execution of business development strategies for the last 14 years.
Other current directorships: Aspire Mining Limited (ASX listed) (appointed 18 April 2013 - current)
Former directorships (last 3 years): None
Special responsibilities: None
Interests in shares: 1,301,738
Interests in rights: None

Name: Dr Darryl Clark
Title: Independent Non-Executive Director
Qualifications: B.Sc (Honours), Phd (Economic Geology), FAusIMM
Experience and expertise: Darryl is an exploration geologist whose career has taken him throughout Australia, Central Asia and South East Asia for over 26 years. His responsibilities over the last 16 years have involved him in a diverse range of technological, political and cultural environments with unique challenges. During previous corporate roles with both Vale and BHP Billiton, and in consulting roles including SRK, he has been responsible for business development strategies, designing multi-commodity exploration programs and the co-ordination of exploration teams to deliver discovery events. Currently, Darryl is President for Cameco Kazakhstan and has oversight for the Inkai Joint Venture mining operation in Kazakhstan owned by Cameco Corporation and Kazatomprom.
Other current directorships: None
Former directorships (last 3 years): None
Special responsibilities: Chairman of Safety, Health and Environment Committee and a member of the Nomination and Remuneration Committee
Interests in shares: 1,661,500
Interests in rights: 1,000,000

Name: Marcus Engelbrecht
Title: Non-Executive Director
Qualifications: MAICD, H Compt
Experience and expertise: Marcus is a well-rounded senior mining executive with considerable experience in the international mining industry. He has worked in various emerging markets across the globe, including South East Asia, Africa and South America and brings a good network and reputation across the international institutional investment community. Marcus has worked in the mining industry since 1985 and spent 20 years at BHP Billiton through to 2005 where he served as Chief Financial Officer for their Diamonds and Specialty Products business. From 2009 to 2011, he served as Chief Financial Officer of ASX/TSX/NZX listed OceanaGold Corporation and from 2011 to 2013, he served as Managing Director and Chief Executive Officer of London AIM listed and Singapore based Archipelago Resources Plc, a gold producer in Indonesia. Marcus is currently the Managing Director of Crusader Resources Ltd, an ASX listed explorer with interests in Brazil.
Other current directorships: Crusader Resources Limited (appointed 20 November 2017 – current)
Former directorships (last 3 years): Stratex International Plc (appointed September 2016 – ceased November 2017)
Special responsibilities: Member of the Audit and Risk Committee
Interests in shares: 766,666
Interests in rights: 333,334

Directors' Report

continued

Name:	Michele Muscillo (appointed on 14 August 2017)
Title:	Independent Non-Executive Director
Qualifications:	LL.B
Experience and expertise:	Michele is a Partner with HopgoodGanim Lawyers in Brisbane. He has practised exclusively in corporate law for the duration of his legal career and has extensive experience in mergers and acquisitions and capital markets transactions, including the negotiation of significant commercial contracts and agreements. His key areas of practice include Corporate Advisory and Governance, Mergers and Acquisitions, Capital Markets and Resources and Energy. Michele is also currently a Non-Executive Director with ASX-Listed Aeris Resources Limited (ASX: AIS) and a Non-Executive Director with ASX/TSX listed Cardinal Resources Limited (ASX/TSX: CDV). Formerly, Michele was also Non-Executive Director of Orbis Gold Limited from the time of its ASX listing, through the discovery of its flagship Natougou project and ultimately to the sale of the company to TSX-Listed SEMAFO Inc. (TSX: SMF) in 2015.
Other current directorships:	Cardinal Resources Limited (appointed 12 October 2017 – current), Aeris Resources Limited (appointed 2 May 2013 – current).
Former directorships (last 3 years):	Orbis Gold Limited (appointed August 2008 – ceased March 2015)
Special responsibilities:	Chairman of the Audit and Risk Committee and Nomination and Remuneration Committee
Interests in shares:	None
Interests in rights:	1,000,000

'Other current directorships' quoted above are current directorships for listed entities only and excludes directorships of all other types of entities, unless otherwise stated.

'Former directorships (last 3 years)' quoted above are directorships held in the last 3 years for listed entities only and excludes directorships of all other types of entities, unless otherwise stated.

Company Secretary

Phil Mackey, B Bus

Phil was appointed Company Secretary of Xanadu in May 2017. Phil has over three decades of listed and unlisted company secretarial and commercial experience, including multi-jurisdictional board practice as both a company secretary and a director. Previously, Phil served as Company Secretary of ASX and SGX dual listed Australand Group Limited (a quadruple stapled group) and Deputy Company Secretary of AMP Limited. Phil's commercial experience includes appointment as Chief Operating Officer (Specialised Funds) at Babcock & Brown. Phil is a Fellow of the Governance Institute Australia and a Graduate Member of the Australian Institute of Company Directors.

Meetings of Directors

The number of meetings of the Company's Board of Directors ('the Board') and of each Board committee held during the period ended 31 December 2017 and the number of meetings attended by each Director were:

	Full Board		Audit Committee		Governance Committee		Safety, Health and Environment Committee	
	Attended	Held	Attended	Held	Attended	Held	Attended	Held
K Tomlinson	10	10	1	1	–	–	1	1
A Stewart	17	17	–	–	–	–	–	–
G Lkhagvasuren	13	17	1	2	–	–	2	2
H Badenach	15	17	–	–	2	2	–	–
D Clark	14	17	–	–	2	3	2	2
M Engelbrecht	16	17	2	2	1	3	–	–
M Muscillo	5	5	–	–	–	–	–	–

Held: represents the number of meetings held during the time the Director held office or was a member of the relevant Committee.

As at the date of this report the Company has a Safety, Health and Environment Committee, Audit and Risk Committee and a Nomination and Remuneration Committee. Further details are set out in the Corporate Governance Statement on the Company's website.

Directors' Report

continued

Remuneration Report (audited)

The Remuneration Report, which has been audited, outlines the key management personnel ('KMP') remuneration arrangements for the Group, in accordance with the requirements of the Corporations Act 2001 and its Regulations.

KMP have authority and responsibility for planning, directing and controlling the activities of the Company and the consolidated entity, including directors of the Company and other executives. KMP comprise the Directors of the Company and executives of the Company and the Group including the most highly remunerated executives.

The remuneration report is set out under the following main headings:

- Principles used to determine the nature and amount of remuneration
- Details of remuneration
- Service agreements
- Share-based compensation
- Additional information
- Additional disclosures relating to key management personnel.

Principles used to determine the nature and amount of remuneration

Xanadu is a Mongolian-focused exploration company. Our strategy is to convert our South Gobi porphyry copper and gold projects into mineable deposits and build long-term value for shareholders by becoming the next internationally competitive mid-tier copper and gold company in Asia.

The Company's remuneration philosophy is to ensure that the level and composition of remuneration is competitive, reasonable and appropriate to attract, retain and motivate the directors and employees with the skills required to deliver on the Company's strategy. Our philosophy recognises the importance of people and a team approach.

Important attributes that impact on Xanadu's success are:

- exploration and safety excellence, dedication and persistence;
- understanding of Mongolia and a strong national team;
- ability to communicate exploration success in the public markets to attract capital and increase shareholder value; and
- adherence to good corporate governance principles.

When considering remuneration matters, the Governance Committee reviews and recommends to the Board on matters of remuneration policy, specific recommendations in relation to senior management and all matters concerning equity plans and awards.

Executive Remuneration

There are up to three categories of remuneration employed to reward employees depending on their role and responsibility within Xanadu:

1. Total Fixed Remuneration;
2. Short Term Incentive; and
3. Long Term Incentive.

The remuneration mix consists of fixed and variable or "at-risk" pay and of short and longer-term rewards.

Total Fixed Remuneration

Total Fixed Remuneration (TFR) comprises base salary, any relevant allowances and statutory contributions that the Company is legally required to make in the local jurisdiction. TFR is set with reference to market data and will reflect the scope of the role and the size and activities of the Company.

TFR is reviewed annually as part of the performance appraisals undertaken in the fourth quarter of the year (prior to finalisation of the following year's budget).

Within Mongolia the term net and gross TFR is used. Net TFR is fixed remuneration net of all taxes including Personal Income Tax and Social Insurance Tax and the Company is responsible for paying these taxes. Gross TFR includes personal income tax but excludes employer social insurance tax. Within Australia, the term TFR is inclusive of personal income tax but excludes payroll tax.

Directors' Report

continued

Variable or At-Risk Incentive Remuneration

It is the Board's policy to deliver at-risk incentive remuneration to employees as both a Short Term Incentive (STI) and a Long Term Incentive (LTI). The payment of STIs and LTIs are linked to achievement of agreed performance measures and establishes a variable remuneration arrangement that links short and long term performance with short and longer term rewards.

Any equity awarded will be governed by the Xanadu Equity Incentive Plan (Plan), and if awarded to a Director, the award will be subject to shareholder approval.

The Plan was initially approved by shareholders at the 2013 Annual General Meeting, reapproved at the 2016 Annual General Meeting, and permits the award of a number of styles of awards including Options and Share Rights to employees. The issue of securities under the Plan is subject to the Xanadu Securities Trading Policy. Shares issued may be acquired on-market, transferred or issued from the capital of the Company.

Short Term Incentive (STI)

Xanadu has established the STI to achieve the following objectives:

- focus employees on the achievements of annual key safety, financial and business targets that the Board believes will lead to sustained and improved business performance; and
- reward and recognise superior performance, if achieved.

The incentive offered under the STI will vary depending upon individual performance against key performance indicators (KPIs) and any discretion employed by the Board. KPIs for the Executive Chairman (for the relevant period), Managing Director & Chief Executive Officer (MD & CEO) and MD & CEO direct reports are approved by the Board upon recommendation from the Governance Committee. KPIs for all other employees are approved by the MD & CEO. Depending on the individual's position, KPIs will include a range of metrics including health and safety, exploration results, corporate governance, financial stewardship, risk management, business development and leadership. Payment of STIs can be cash or shares which is also at the discretion of the Board.

Long Term Incentive (LTI)

The Board believes that an appropriately designed long-term incentive is an important component of the Group's remuneration arrangements. The LTI is a key tool to allow the Group to attract and retain talented directors, executive and managers and ensure the interests of LTI participants are aligned with those of shareholders in creating long-term shareholder value.

The Board's policy is to design equity style awards as LTIs. The vesting of an LTI award is dependent on the achievement of longer term objectives, at least including share price growth over a three-year performance period.

Total Reward Mix - Executives

As a guide, the proportion of remuneration attributable to each component of the Xanadu remuneration philosophy is dependent on the level of seniority of the employee.

The target total reward mix on average is as follows:

	Total Fixed Remuneration %	STI % of TFR	LTI % of TFR
Managing Director & Chief Executive Officer	100	50	50
MD & CEO Direct Reports	100	30	30

The STI and LTI percentages of TFR are the maximum payable and the overall mix may vary depending on individual circumstances, legacy contracts and other benefits associated with expatriate allowances. The value of equity based awards is determined at the time of grant using industry standard valuation techniques.

Non-Executive Remuneration

The aggregate cash remuneration for Non-Executive Directors will not exceed the maximum approved amount of \$350,000. The Board seeks to set aggregate remuneration at a level which provides the Company with the ability to attract and retain directors of the highest calibre, whilst incurring a cost which is acceptable by shareholders. Non-Executive Directors may also participate in the Xanadu Equity Incentive Plan if participation is approved by shareholders.

Directors' Report

continued

The amount of aggregate remuneration sought to be approved by shareholders and the manner in which it is apportioned amongst Directors is reviewed annually. The Board considers fees paid and securities issued to Non-Executive Directors of comparable companies when undertaking the annual review as well as the time commitment of directors in discharging duties at Board, Committee work and any additional assistance provided to the Company. Currently, the Non-Executive Director base fee is \$52,000 per annum and a Committee Chairman receives \$4,000 per annum per committee. The Non-Executive Chairman receives fee of \$120,000 per annum.

Non-Executive Directors are encouraged by the Board to hold shares purchased on market in accordance with the Xanadu Securities Trading Policy. The Board considers that by holding shares in the Company, the Non-Executive Directors are aligning themselves with the best interests of the shareholders.

Details of remuneration

Amounts of remuneration

Details of the remuneration of key management personnel of the Group are set out in the following tables.

The key management personnel of the Group consisted of the Directors of Xanadu Mines Ltd and the following persons:

- M Dambiinyam - Chief Financial Officer
- M Brown - Chief Geologist

Year ended	Short-term benefits			Post-employment	Share-based	Total
	Cash salary and fee	Bonus	Others/ Non-monetary	benefits Super-annuation	payments Equity-settled	
31 December 2017	\$	\$	\$	\$	\$	\$
<i>Non-Executive Directors:</i>						
K Tomlinson*	98,913	-	-	-	67,462	166,375
D Clark	56,000	-	-	-	13,698	69,698
M Engelbrecht	51,142	-	-	4,858	18,799	74,799
M Muscillo**	19,500	-	-	-	13,698	33,198
M Wheatley***	38,214	18,415	-	3,630	-	60,259
B Lavin***	22,434	-	-	2,131	(42,506)	(17,941)
<i>Executive Directors:</i>						
A Stewart	378,170	72,872	70,395	-	157,412	678,849
G Lkhagvasuren	226,462	35,699	-	-	70,352	332,513
<i>Other KMP:</i>						
M Dambiinyam	152,440	21,380	-	-	13,463	187,283
M Brown	220,000	-	-	-	13,463	233,463
	<u>1,263,275</u>	<u>148,366</u>	<u>70,395</u>	<u>10,619</u>	<u>325,841</u>	<u>1,818,496</u>

* appointed 29 May 2017

** appointed 14 August 2017

*** ceased 29 May 2017 and forfeited share rights

H Badenach did not receive any remuneration.

Directors' Report

continued

Year ended 31 December 2016	Short-term benefits			Post-employment benefits	Share-based payments ²	Total \$
	Cash salary and fee \$	Bonus \$	Others/ Non-monetary \$	Super- annuation \$	Equity- settled	
<i>Non-Executive Directors:</i>						
M Wheatley ¹	178,912	-	-	31,151	21,540	231,603
D Clark	51,999	-	-	-	-	51,999
B Lavin	54,795	-	-	5,205	5,484	65,484
M Engelbrecht	51,142	-	-	4,858	62,908	118,908
<i>Executive Directors:</i>						
A Stewart	390,121	-	72,620	-	79,206	541,947
G Lkhagvasuren	225,415	-	-	-	47,821	273,236
<i>Other KMP:</i>						
M Dambiinyam	151,660	-	-	-	32,125	183,785
M Brown	4,231	-	-	-	-	4,231
	<u>1,108,275</u>	<u>-</u>	<u>72,620</u>	<u>41,214</u>	<u>249,084</u>	<u>1,471,193</u>

1 On 24 October 2016, Mark Wheatley moved from Executive Chairman to Non-Executive Chairman.

2 Includes Short-term Incentives issued in shares

H Badenach did not receive any remuneration.

The proportion of remuneration linked to performance and the fixed proportion are as follows:

Name	Fixed remuneration		At risk - STI		At risk - LTI	
	Year ended 31 December 2017	Year ended 31 December 2016	Year ended 31 December 2017	Year ended 31 December 2016	Year ended 31 December 2017	Year ended 31 December 2016
<i>Non-Executive Directors:</i>						
K Tomlinson	59%	-	-	-	41%	-
D Clark	80%	100%	-	-	20%	-
M Engelbrecht	75%	47%	-	-	25%	53%
M Muscillo*	59%	92%	-	-	41%	8%
M Wheatley**	69%	91%	31%	9%	-	-
B Lavin**	100%	92%	-	-	-	8%
<i>Executive Directors:</i>						
A Stewart	66%	85%	11%	14%	23%	1%
G Lkhagvasuren	68%	82%	11%	17%	21%	1%
<i>Other KMP:</i>						
M Dambiinyam	81%	83%	12%	16%	7%	1%
M Brown	94%	100%	-	-	6%	-

* appointed 14 August 2017

** ceased 29 May 2017

Directors' Report

continued

Service agreements

Remuneration and other terms of employment for key management personnel are formalised in service agreements. Details of these agreements are as follows:

Name: Andrew Stewart
Title: Managing Director & Chief Executive Officer
Details: Dr Stewart's fixed remuneration is an annual salary package of US\$260,000 plus compulsory taxes and social insurance applicable as an employee in Mongolia. Dr Stewart also receives a rental allowance of US\$30,000 per annum, travel and health care entitlements. In the event of termination of Dr Stewart's employment other than in the case of misconduct, the executive must give a minimum of 6 months' notice prior to termination, and the Company must give 9 months' notice prior to termination. The Company may, at its discretion, provide Dr Stewart with payment of fixed remuneration in whole or in part in lieu of notice. For the avoidance of doubt, the Company's right to make such a payment does not give Dr Stewart any right to receive such a payment.

Name: Ganbayar Lkhagvasuren
Title: Executive Director
Details: Mr Lkhagvasuren's fixed remuneration is an annual salary package of MNT429 million (A\$239,000) including compulsory taxes and social insurance applicable as an employee in Mongolia (social insurance payable in Mongolia is not identical to superannuation in Australia). In the event of Mr Lkhagvasuren's employment being terminated other than in the case of misconduct, Mr Lkhagvasuren must give a minimum of 3 months' notice prior to termination, and the Company must give 3 months' notice prior to termination.

Name: Munkhsaikhan Dambiinyam
Title: Chief Financial Officer
Details: Mr Dambiinyam's fixed remuneration is an annual salary package of MNT257 million (A\$143,400) plus the compulsory taxes and social insurance applicable as an employee in Mongolia (social insurance payable in Mongolia is not identical to superannuation in Australia). In the event of termination of Mr Dambiinyam's employment other than in the case of misconduct, Mr Dambiinyam must give a minimum of 3 months' notice prior to termination, and the Company must give 3 months' notice prior to termination.

Name: Mathew Brown
Title: Chief Geologist
Details: Mr Brown's fixed remuneration is an annual salary package of A\$220,000 including any applicable taxes required to be withheld. In the event of termination of Mr Brown's employment other than in the case of misconduct, the executive must give a minimum of 6 months' notice prior to termination, and the Company must give 6 months' notice prior to termination.

Key management personnel have no entitlement to termination payments in the event of removal for misconduct.

Share-based compensation

Issue of shares

Details of shares issued to Directors and other key management personnel as part of compensation during the period ended 31 December 2017 are set out below:

Name	Date	Shares	Issue price	\$
M Engelbrecht	29 June 2017	333,333	\$0.00	-
M Dambiinyam	29 June 2017	350,000	\$0.00	-

Options

Directors' Report

continued

There were no options over ordinary shares granted to or vested by Directors and other key management personnel as part of compensation during the period ended 31 December 2017.

Share rights

Details of share rights over ordinary shares granted, vested and lapsed for Directors and other key management personnel as part of compensation during the period ended 31 December 2017 are set out below:

Name	Grant date	Expiry date	Number of rights granted	Fair value of rights granted \$	Number of rights vested	Fair value of rights vested \$	Number of rights lapsed
<i>Non-Executive Directors:</i>							
K Tomlinson	16 November 2017	29 May 2019	3,000,000	810,000	-	-	-
D Clark	16 November 2017	11 October 2019	1,000,000	270,000	-	-	-
M Engelbrecht	23 December 2015	16 June 2018	-	-	333,333	60,000	-
M Muscillo	16 November 2017	11 October 2019	1,000,000	270,000	-	-	-
<i>Executive Directors:</i>							
A Stewart	16 November 2017	29 May 2019	7,000,000	1,890,000	-	-	-
G Lkhagvasuren	16 November 2017	26 July 2019	4,000,000	1,080,000	-	-	-
<i>Other KMP:</i>							
M Dambiinyam	1 June 2014	1 June 2017	-	-	350,000	63,000	-
M Dambiinyam	26 July 2017	26 July 2019	2,000,000	360,000	-	-	-
M Brown	26 July 2017	26 July 2019	2,000,000	360,000	-	-	-

Additional information

The section below contains further detail on how the Company's performance has impacted on remuneration outcomes for executives under the Company's incentive programs.

The table below contains a snapshot of the Company's performance against annual financial Key Performance Indicators:

	2013	Jun 2014	Dec 2014*	2015	2016	2017
Share price at financial year end (\$)	0.03	0.04	0.10	0.11	0.21	0.28
Basic earnings per share (cents per share)	(9.41)	(4.09)	(1.21)	(1.15)	(0.47)	(0.72)
Diluted earnings per share (cents per share)	(9.41)	(4.09)	(1.21)	(1.15)	(0.47)	(0.72)

* 6 months period

Additional disclosures relating to key management personnel

Shareholding

The number of ordinary shares in the Company held during the financial period by each Director and other members of key management personnel of the Group, including their personally related parties, is set out below:

	Balance at the start of the period	On-market purchases	Vesting of share rights	Balance at the end of the period
<i>Non-Executive Directors</i>				
K Tomlinson	-	290,000	-	290,000
H Badenach	1,057,738	244,000	-	1,301,738
D Clark	1,556,000	105,500	-	1,661,500
M Engelbrecht	433,333	-	333,333	766,666
M Muscillo	-	-	-	-
<i>Executive Directors:</i>				
A Stewart	4,011,083	20,000	-	4,031,083
G Lkhagvasuren	16,558,329	-	-	16,558,329
<i>Other KMP:</i>				
M Dambiinyam	1,128,578	-	350,000	1,478,578
M Brown	-	-	-	-
	24,745,061	659,500	683,333	26,087,894

Directors' Report

continued

Share rights holding

The number of share rights over ordinary shares in the Company held during the financial period by each Director and other members of key management personnel of the Group, including their personally related parties, is set out below:

	Balance at the start of the period	Granted	Vested and exercised	Balance at the end of the period
<i>Share rights over ordinary shares</i>				
K Tomlinson	-	3,000,000	-	3,000,000
D Clark	-	1,000,000	-	1,000,000
M Engelbrecht	666,667	-	(333,333)	333,334
M Muscillo	-	1,000,000	-	1,000,000
A Stewart	-	7,000,000	-	7,000,000
G Lkhagvasuren	-	4,000,000	-	4,000,000
M Dambiinyam	350,000	2,000,000	(350,000)	2,000,000
M Brown	-	2,000,000	-	2,000,000
	<u>1,016,667</u>	<u>20,000,000</u>	<u>(683,333)</u>	<u>20,333,334</u>

This concludes the remuneration report, which has been audited.

Directors' Report

continued

Shares under option

Unissued ordinary shares of Xanadu Mines Ltd under option at the date of this report are as follows:

Grant date	Expiry date	Exercise price	Number under option
21 January 2014*	14 January 2019	\$0.00	35,000,000
			<u>35,000,000</u>

* Series A and Series B options issued to the vendor of the Red Mountain Mining Licence. Vesting of Series A (15,000,000) is contingent on recognition of a JORC resource of at least 300,000 tonnes contained copper equivalent, and Series B (20,000,000) is contingent on the recognition of a JORC resource of at least 900,000 tonnes contained copper equivalent.

No person entitled to exercise the options had or has any right by virtue of the option to participate in any share issue of the Company or of any other body corporate.

Shares under share rights

Unissued ordinary shares of Xanadu Mines Ltd under share rights at the date of this report are as follows:

Grant date	Expiry date (vesting price)	Exercise price	Number under rights
23 December 2015	16 June 2018 (vesting price*: \$0.2281)	\$0.00	333,334
26 July 2017	26 July 2019 (vesting range**: \$0.40-\$0.60)	\$0.00	4,000,000
16 November 2017	29 May 2019 (vesting range**: \$0.40-\$0.60)	\$0.00	10,000,000
16 November 2017	26 July 2019 (vesting range**: \$0.40-\$0.60)	\$0.00	4,000,000
16 November 2017	11 October 2019 (vesting range**: \$0.40-\$0.60)	\$0.00	2,000,000
			<u>20,333,334</u>

* The share rights vest where the closing price of the shares on any 3 consecutive trading days during the period from the appointment date to the day immediately preceding the vesting date exceeds the hurdle price.

** The share rights vest where the volume weighted average price for 45 consecutive days during the period from the grant date to the day immediately preceding the vesting date exceeds the hurdle price.

No person entitled to exercise the share rights had or has any right by virtue of the share right to participate in any share issue of the Company or of any other body corporate. Details of the vesting conditions of the share rights, including share price thresholds, are described in the notes to the financial statements.

Shares issued on the exercise of options

There were no ordinary shares of Xanadu Mines Ltd issued on the vesting and exercise of options during the period ended 31 December 2017 and up to the date of this report.

Indemnity and insurance of officers

During or since the end of the year, the Company has not given any indemnity to a current or former officer or auditor against a liability or made any agreement under which an officer or auditor may be given any indemnity of the kind covered by subsection 199A(2) or (3) of the Corporations Act 2001.

During the financial period, the Company paid a premium in respect of a contract to insure the Directors and executives of the Company against a liability to the extent permitted by the Corporations Act 2001. The contract of insurance prohibits disclosure of the nature of the liability and the amount of the premium.

Indemnity and insurance of auditor

To the extent permitted by law, the Company has agreed to indemnify the auditors, Ernst & Young, as part of the terms of its audit engagement against claims by third parties arising from the audit. No payment has been made to indemnify the auditors during the financial year. During the financial period, the Company has not paid a premium in respect of a contract to insure the auditor of the Company or any related entity.

Directors' Report

continued

Proceedings on behalf of the Company

No person has applied to the Court under section 237 of the Corporations Act 2001 for leave to bring proceedings on behalf of the Company, or to intervene in any proceedings to which the Company is a party for the purpose of taking responsibility on behalf of the Company for all or part of those proceedings.

Non-audit services

Details of the amounts paid or payable to the auditor for non-audit services provided during the financial period by the auditor are outlined in Note 22 to the financial statements.

Other services in relation to tax advice were provided by Ernst & Young during the financial year. The fees, excluding GST, were \$1,200 (2016: \$1,000) for those services. Therefore, the Directors are satisfied that given the total quantum paid for the non-audit services provided during the financial year by Ernst & Young as the external auditor, the general standard of independence for auditors imposed by the Corporations Act was not compromised.

Officers of the Company who are former partners of Ernst & Young

There are no officers of the Company who are former partners of Ernst & Young.

Rounding of amounts

The Company is of a kind referred to in the ASIC Instrument 2016/191, issued by the Australian Securities and Investments Commission, relating to 'rounding-off'. Amounts in this report have been rounded off in accordance with that Corporations Instrument to the nearest thousand dollars, or in certain cases, the nearest dollar.

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on the following page.

Auditor

Ernst & Young continues in office in accordance with section 327 of the Corporations Act 2001.

This report is made in accordance with a resolution of directors, pursuant to section 298(2)(a) of the Corporations Act 2001.

On behalf of the Directors



Kevin Tomlinson

Non-Executive Chairman
23 March 2018

Auditor's Independence Declaration



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

As lead auditor for the audit of Xanadu Mines Limited for the financial year ended 31 December 2017, I declare to the best of my knowledge and belief, there have been:

- a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Xanadu Mines Limited and the entities it controlled during the financial year.

A handwritten signature in black ink that reads 'Ernst + Young' in a cursive, stylized font.

Ernst & Young

A handwritten signature in black ink that appears to be 'S Jarrett' in a cursive, stylized font.

Scott Jarrett
Partner
23 March 2018

Statement of Profit or Loss and Other Comprehensive Income

For the period ended 31 December 2017

	Note	Consolidated	
		2017 \$'000	2016 \$'000
Other income	4	169	1,260
Expenses			
Depreciation and amortisation expense		(91)	(114)
Other expenses	5	(3,535)	(2,901)
Finance costs		(344)	(376)
Revaluation loss on financial assets at fair value through profit or loss		(30)	-
Loss before income tax expense		(3,831)	(2,131)
Income tax expense	6	-	-
Loss after income tax expense for the period		(3,831)	(2,131)
Other comprehensive income			
<i>Items that may be reclassified subsequently to profit or loss</i>			
Foreign currency translation		(1,957)	(7,436)
Other comprehensive income for the period, net of tax		(1,957)	(7,436)
Total comprehensive income for the period		<u>(5,788)</u>	<u>(9,567)</u>
Loss for the period is attributable to:			
Non-controlling interest		11	124
Owners of Xanadu Mines Ltd	16	(3,842)	(2,255)
		<u>(3,831)</u>	<u>(2,131)</u>
Total comprehensive income for the period is attributable to:			
Non-controlling interest		374	363
Owners of Xanadu Mines Ltd		(6,162)	(9,930)
		<u>(5,788)</u>	<u>(9,567)</u>
		Cents	Cents
Basic earnings per share	30	(0.72)	(0.47)
Diluted earnings per share	30	(0.72)	(0.47)

The above statement of profit or loss and other comprehensive income should be read in conjunction with the accompanying notes

Statement of Financial Position

As at 31 December 2017

	Note	Consolidated	
		2017 \$'000	2016 \$'000
Assets			
Current assets			
Cash and cash equivalents	7	9,065	8,277
Financial assets at fair value through profit or loss	8	100	-
Prepayment and other assets		5	46
Other receivables	9	498	469
Total current assets		9,668	8,792
Non-current assets			
Property, plant and equipment	10	388	307
Deferred exploration expenditure	11	37,157	31,952
Total non-current assets		37,545	32,259
Total assets		47,213	41,051
Liabilities			
Current liabilities			
Trade and other payables	12	1,262	422
Term loan - related party	13	-	3,814
Total current liabilities		1,262	4,236
Non-current liabilities			
Other		159	49
Total non-current liabilities		159	49
Total liabilities		1,421	4,285
Net assets		45,792	36,766
Equity			
Issued capital	14	108,452	93,964
Reserves	15	(2,513)	(519)
Accumulated losses	16	(65,164)	(61,322)
Equity attributable to the owners of Xanadu Mines Ltd		40,775	32,123
Non-controlling interest	17	5,017	4,643
Total equity		45,792	36,766

The above statement of financial position should be read in conjunction with the accompanying notes

Statement of Changes in Equity

For the period ended 31 December 2017

Consolidated	Issued capital \$'000	Other reserves \$'000	Foreign currency translation reserve \$'000	Accumulated losses \$'000	Non-controlling interest \$'000	Total equity \$'000
Balance at 1 January 2016	82,108	8,135	(1,052)	(59,067)	4,280	34,404
Profit/(loss) after income tax expense for the period	-	-	-	(2,255)	124	(2,131)
Other comprehensive income for the period, net of tax	-	-	(7,675)	-	239	(7,436)
Total comprehensive income for the period	-	-	(7,675)	(2,255)	363	(9,567)
<i>Transactions with owners in their capacity as owners:</i>						
Contributions of equity, net of transaction costs (note 14)	11,489	-	-	-	-	11,489
Share-based payments (note 31)	366	74	-	-	-	440
Balance at 31 December 2016	<u>93,963</u>	<u>8,209</u>	<u>(8,727)</u>	<u>(61,322)</u>	<u>4,643</u>	<u>36,766</u>
Consolidated	Issued capital \$'000	Other reserves \$'000	Foreign currency translation reserve \$'000	Accumulated losses \$'000	Non-controlling interest \$'000	Total equity \$'000
Balance at 1 January 2017	93,963	8,209	(8,727)	(61,322)	4,643	36,766
Profit/(loss) after income tax expense for the period	-	-	-	(3,842)	11	(3,831)
Other comprehensive income for the period, net of tax	-	-	(2,320)	-	363	(1,957)
Total comprehensive income for the period	-	-	(2,320)	(3,842)	374	(5,788)
<i>Transactions with owners in their capacity as owners:</i>						
Contributions of equity, net of transaction costs (note 14)	14,487	-	-	-	-	14,488
Share-based payments (note 31)	-	326	-	-	-	326
Balance at 31 December 2017	<u>108,450</u>	<u>8,534</u>	<u>(11,047)</u>	<u>(65,164)</u>	<u>5,017</u>	<u>45,792</u>

The above statement of changes in equity should be read in conjunction with the accompanying notes

Statement of Cash Flows

For the period ended 31 December 2017

	Note	Consolidated	
		2017 \$'000	2016 \$'000
Cash flows from operating activities			
Payments to suppliers and employees		(2,968)	(2,612)
Interest received		24	36
Interest and other finance costs paid		(427)	(396)
Net cash used in operating activities	29	(3,371)	(2,972)
Cash flows from investing activities			
Payments for property, plant and equipment	10	(220)	-
Payments for exploration and evaluation	11	(6,237)	(4,383)
Payments of deferred consideration		-	(3,934)
Proceeds from disposal of property, plant and equipment		26	-
Net cash used in investing activities		(6,431)	(8,317)
Cash flows from financing activities			
Proceeds from issue of shares	14	13,945	12,204
Repayment of borrowings		(2,092)	-
Transaction costs on issue of shares		(869)	(715)
Net cash from financing activities		10,984	11,489
Net increase in cash and cash equivalents		1,182	200
Cash and cash equivalents at the beginning of the financial period		8,277	8,639
Effects of exchange rate changes on cash and cash equivalents		(394)	(562)
Cash and cash equivalents at the end of the financial period	7	9,065	8,277

The above statement of cash flows should be read in conjunction with the accompanying notes

Notes to the Financial Statements

For the period ended 31 December 2017

Note 1. Significant accounting policies

The principal accounting policies adopted in the preparation of the financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

New or amended Accounting Standards and Interpretations adopted

The group has adopted all of the new or amended Accounting Standards and Interpretations issued by the Australian Accounting Standards Board ('AASB') that are mandatory for the current reporting period.

Any new or amended Accounting Standards or Interpretations that are not yet mandatory have not been early adopted.

Basis of preparation

These general purpose financial statements have been prepared in accordance with Australian Accounting Standards and Interpretations issued by the Australian Accounting Standards Board ('AASB') and the Corporations Act 2001, as appropriate for for-profit oriented entities. These financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board ('IASB').

Historical cost convention

The financial statements have been prepared under the historical cost convention, except for, where applicable, the revaluation of available-for-sale financial assets, financial assets and liabilities at fair value through profit or loss, investment properties, certain classes of property, plant and equipment and derivative financial instruments.

Critical accounting estimates

The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in note 2.

Parent entity information

In accordance with the Corporations Act 2001, these financial statements present the results of the group only. Supplementary information about the parent entity is disclosed in Note 26.

Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Xanadu Mines Ltd ('Company' or 'Parent Entity') as at 31 December 2017 and the results of all subsidiaries for the period then ended. Xanadu Mines Ltd and its subsidiaries together are referred to in these financial statements as the 'group'.

Subsidiaries are all those entities over which the group has control. The group controls an entity when the group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the group. They are de-consolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between entities in the group are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the group.

The acquisition of subsidiaries is accounted for using the acquisition method of accounting. A change in ownership interest, without the loss of control, is accounted for as an equity transaction, where the difference between the consideration transferred and the book value of the share of the non-controlling interest acquired is recognised directly in equity attributable to the parent.

Non-controlling interest in the results and equity of subsidiaries are shown separately in the statement of profit or loss and other comprehensive income, statement of financial position and statement of changes in equity of the group. Losses incurred by the group are attributed to the non-controlling interest in full, even if that results in a deficit balance.

Where the group loses control over a subsidiary, it derecognises the assets including goodwill, liabilities and non-controlling interest in the subsidiary together with any cumulative translation differences recognised in equity. The group recognises the fair value of the consideration received and the fair value of any investment retained together with any gain or loss in profit or loss.

Notes to the Financial Statements

continued

Note 1. Significant accounting policies (continued)

Foreign currency translation

The financial statements are presented in Australian dollars, which is Xanadu Mines Ltd's functional and presentation currency. The functional currencies of the group's foreign subsidiaries are Mongolian Tugrug ("MNT") and Singapore Dollar ("SGD").

Foreign currency transactions

Foreign currency transactions are translated into Australian dollars using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at financial period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss.

Foreign operations

The assets and liabilities of foreign operations are translated into Australian dollars using the exchange rates at the reporting date. The revenues and expenses of foreign operations are translated into Australian dollars using the average exchange rates, which approximate the rates at the dates of the transactions, for the period. All resulting foreign exchange differences are recognised in other comprehensive income through the foreign currency reserve in equity. The foreign currency reserve is recognised in profit or loss when the foreign operation or net investment is disposed of.

Revenue recognition

Revenue is recognised when it is probable that the economic benefit will flow to the group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable.

Interest income

Interest revenue is recognised as interest accrues using the effective interest method. This is a method of calculating the amortised cost of a financial asset and allocating the interest income over the relevant period using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset.

Other revenue

Other revenue is recognised when it is received or when the right to receive payment is established.

Income tax

The income tax expense or benefit for the period is the tax payable on that period's taxable income based on the applicable income tax rate for each jurisdiction, adjusted by the changes in deferred tax assets and liabilities attributable to temporary differences, unused tax losses and the adjustment recognised for prior periods, where applicable.

Deferred tax assets and liabilities are recognised for temporary differences at the tax rates expected to be applied when the assets are recovered or liabilities are settled, based on those tax rates that are enacted or substantively enacted, except for:

- When the deferred income tax asset or liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither the accounting nor taxable profits; or
- When the taxable temporary difference is associated with interests in subsidiaries, associates or joint ventures, and the timing of the reversal can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

The carrying amount of recognised and unrecognised deferred tax assets are reviewed at each reporting date. Deferred tax assets recognised are reduced to the extent that it is no longer probable that future taxable profits will be available for the carrying amount to be recovered. Previously unrecognised deferred tax assets are recognised to the extent that it is probable that there are future taxable profits available to recover the asset.

Deferred tax assets and liabilities are offset only where there is a legally enforceable right to offset current tax assets against current tax liabilities and deferred tax assets against deferred tax liabilities; and they relate to the same taxable authority on either the same taxable entity or different taxable entities which intend to settle simultaneously. Income taxes relating to items recognised directly in equity are recognised in equity and not in the income statement.

Notes to the Financial Statements

continued

Note 1. Significant accounting policies (continued)

Other taxes

Revenues, expenses and assets are recognised net of the amount of GST except:

- where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

Cash flows are included in the Cash Flow Statement on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority are classified as operating cash flows.

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

Current and non-current classification

Assets and liabilities are presented in the statement of financial position based on current and non-current classification.

An asset is classified as current when: it is either expected to be realised or intended to be sold or consumed in the group's normal operating cycle; it is held primarily for the purpose of trading; it is expected to be realised within 12 months after the reporting period; or the asset is cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period. All other assets are classified as non-current.

A liability is classified as current when: it is either expected to be settled in the group's normal operating cycle; it is held primarily for the purpose of trading; it is due to be settled within 12 months after the reporting period; or there is no unconditional right to defer the settlement of the liability for at least 12 months after the reporting period. All other liabilities are classified as non-current.

Deferred tax assets and liabilities are always classified as non-current.

Cash and cash equivalents

Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less. For the purposes of the Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Investments

All investments are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment. After initial recognition, investments, which are classified as held for trading and available-for-sale, are measured at fair value. Gains or losses on investments held for trading are recognised in the income statement.

Gains or losses on available-for-sale investments are recognised as a separate component of equity until the investment is sold collected or otherwise disposed of, or until the investment is determined to be impaired. Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the group has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification.

Long-term investments that are intended to be held-to-maturity, such as bonds, are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any discount or premium on acquisition, over the period to maturity. For investments carried at amortised cost, gains and losses are recognised in income when the investments are derecognised or impaired, as well as through the amortisation process. For investments that are actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on the balance sheet date.

For investments where there is no quoted market price, fair value is determined by reference to the current market value of another instrument which is substantially the same or is calculated based on the expected cash flows of the underlying net asset base of the investment. Purchases and sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place are recognised on the trade date i.e. the date that the Group commits to purchase the asset.

Notes to the Financial Statements

continued

Note 1. Significant accounting policies (continued)

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are either: (i) held for trading, where they are acquired for the purpose of selling in the short-term with an intention of making a profit; or (ii) designated as such upon initial recognition, where they are managed on a fair value basis or to eliminate or significantly reduce an accounting mismatch. Except for effective hedging instruments, derivatives are also categorised as fair value through profit or loss. Fair value movements are recognised in profit or loss.

Impairment of financial assets

The amount of the impairment allowance for financial assets carried at cost is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the current market rate of return for similar financial assets.

At each reporting date, the group assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, the group makes a formal estimate of the recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount the asset is considered impaired and is written down to its recoverable amount.

Deferred exploration and evaluation expenditure

Costs arising from exploration and evaluation activities relating to an area of interest are carried forward, provided such costs are expected to be recouped through successful development, or by sale, or where exploration and evaluation activities have not, at balance date, reached a stage to allow a reasonable assessment regarding the existence of economically recoverable resources. Rights of tenure must be current to carry forward deferred exploration and evaluation expenditure.

Costs carried forward in respect of an area of interest that is abandoned are written off in the year in which the decision to abandon is made.

Costs on productive areas are amortised over the life of the area of interest to which such costs relate on the production output basis.

Property, plant and equipment

Land and buildings are shown at fair value, based on periodic, at least every 3 years, valuations by external independent valuers, less subsequent depreciation and impairment for buildings. The valuations are undertaken more frequently if there is a material change in the fair value relative to the carrying amount. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Increases in the carrying amounts arising on revaluation of land and buildings are credited in other comprehensive income through to the revaluation surplus reserve in equity. Any revaluation decrements are initially taken in other comprehensive income through to the revaluation surplus reserve to the extent of any previous revaluation surplus of the same asset. Thereafter the decrements are taken to profit or loss.

Plant and equipment is stated at historical cost less accumulated depreciation and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Depreciation is calculated on a straight-line basis to write off the net cost of each item of property, plant and equipment (excluding land) over their expected useful lives as follows:

Plant and equipment:	2-10 years
Motor vehicles:	4-5 years

The residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each reporting date.

An item of property, plant and equipment is derecognised upon disposal or when there is no future economic benefit to the group. Gains and losses between the carrying amount and the disposal proceeds are taken to profit or loss. Any revaluation surplus reserve relating to the item disposed of is transferred directly to retained profits.

The carrying values of property, plant & equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash generating units are written down to their recoverable amount.

Notes to the Financial Statements

continued

Note 1. Significant accounting policies (continued)

The recoverable amount of property, plant and equipment is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses are recognised in the income statement.

Investment in Joint Venture

An associate is an entity over which the consolidated entity has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control. The considerations made in determining significant influence or joint control are similar to those necessary to determine control over subsidiaries. The consolidated entity's investments in its associate and joint venture are accounted for using the equity method.

Under the equity method, the investment in an associate or a joint venture is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the consolidated entity's share of net assets of the associate or joint venture since the acquisition date. Goodwill relating to the associate or joint venture is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The statement of profit or loss reflects the consolidated entity's share of the results of operations of the associate or joint venture. Any change in OCI of those investees is presented as part of the consolidated entity's Other Comprehensive Income (OCI). In addition, when there has been a change recognised directly in the equity of the associate or joint venture, the consolidated entity recognises its share of any changes, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the consolidated entity and the associate or joint venture are eliminated to the extent of the interest in the associate or joint venture.

The aggregate of the consolidated entity's share of profit or loss of an associate and a joint venture is shown on the face of the statement of profit or loss outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate or joint venture. The financial statements of the associate or joint venture are prepared for the same reporting period as the consolidated entity. When necessary, adjustments are made to bring the accounting policies in line with those of the consolidated entity.

After application of the equity method, the consolidated entity determines whether it is necessary to recognise an impairment loss on its investment in its associate or joint venture. At each reporting date, the consolidated entity determines whether there is objective evidence that the investment in the associate or joint venture is impaired. If there is such evidence, the consolidated entity calculates the amount of impairment as the difference between the recoverable amount of the associate or joint venture and its carrying value, then recognises the loss as 'Share of profit of an associate and a joint venture' in the statement of profit or loss.

Rehabilitation of property

Where conditions of title, or other rights to use property including rights to mine require that rehabilitation activities be carried out during the course of the use of the property, costs of such are brought to account as an expense at the time incurred. Where, due to current or previous activities, an obligation exists to carry out rehabilitation works in the future, provision is made for the mine site rehabilitation and restoration by recognising the present value of expected rehabilitation cash flows as a provision. These provisions include costs associated with reclamation, plant closure and monitoring activities. The discount on the provision unwinds as an interest expense. These costs have been determined on the basis of current costs, current legal requirements and current technology. Changes in estimates are dealt with on a prospective basis.

Uncertainty exists as to the amount of restoration obligations which will be incurred due to:

- uncertainty as to the remaining life of existing operating sites; and
- the impact of changes in environmental legislation.

Assumptions have been made as to the remaining useful life of existing sites based on studies conducted by independent and internal technical advisers. Such studies are conducted on an ongoing basis.

Notes to the Financial Statements

continued

Note 1. Significant accounting policies (continued)

Impairment of non-financial assets

Goodwill and other intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount.

Recoverable amount is the higher of an asset's fair value less costs of disposal and value-in-use. The value-in-use is the present value of the estimated future cash flows relating to the asset using a pre-tax discount rate specific to the asset or cash-generating unit to which the asset belongs. Assets that do not have independent cash flows are grouped together to form a cash-generating unit.

Trade and other payables

Liabilities are recognised for amounts to be paid in the future for goods or services received, whether or not billed to Xanadu. Trade accounts payable are normally settled within 30 days.

Borrowings

Loans and borrowings are initially recognised at the fair value of the consideration received, net of transaction costs. They are subsequently measured at amortised cost using the effective interest method.

Where there is an unconditional right to defer settlement of the liability for at least 12 months after the reporting date, the loans or borrowings are classified as non-current.

Finance costs

Finance costs attributable to qualifying assets are capitalised as part of the asset. All other finance costs are expensed in the period in which they are incurred.

Fair value measurement

When an asset or liability, financial or non-financial, is measured at fair value for recognition or disclosure purposes, the fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; and assumes that the transaction will take place either: in the principal market; or in the absence of a principal market, in the most advantageous market.

Fair value is measured using the assumptions that market participants would use when pricing the asset or liability, assuming they act in their economic best interest. For non-financial assets, the fair value measurement is based on its highest and best use. Valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value are used, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

Assets and liabilities measured at fair value are classified, into three levels, using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. Classifications are reviewed at each reporting date and transfers between levels are determined based on a reassessment of the lowest level of input that is significant to the fair value measurement.

For recurring and non-recurring fair value measurements, external valuers may be used when internal expertise is either not available or when the valuation is deemed to be significant. External valuers are selected based on market knowledge and reputation. Where there is a significant change in fair value of an asset or liability from one period to another, an analysis is undertaken, which includes a verification of the major inputs applied in the latest valuation and a comparison, where applicable, with external sources of data.

Issued capital

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Business combinations

The acquisition method of accounting is used to account for business combinations regardless of whether equity instruments or other assets are acquired.

Notes to the Financial Statements

continued

Note 1. Significant accounting policies (continued)

The consideration transferred is the sum of the acquisition-date fair values of the assets transferred, equity instruments issued or liabilities incurred by the acquirer to former owners of the acquiree and the amount of any non-controlling interest in the acquiree. For each business combination, the non-controlling interest in the acquiree is measured at either fair value or at the proportionate share of the acquiree's identifiable net assets. All acquisition costs are expensed as incurred to profit or loss.

On the acquisition of a business, the group assesses the financial assets acquired and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic conditions, the group's operating or accounting policies and other pertinent conditions in existence at the acquisition-date.

Where the business combination is achieved in stages, the group remeasures its previously held equity interest in the acquiree at the acquisition-date fair value and the difference between the fair value and the previous carrying amount is recognised in profit or loss.

Contingent consideration to be transferred by the acquirer is recognised at the acquisition-date fair value. Subsequent changes in the fair value of the contingent consideration classified as an asset or liability is recognised in profit or loss. Contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity.

The difference between the acquisition-date fair value of assets acquired, liabilities assumed and any non-controlling interest in the acquiree and the fair value of the consideration transferred and the fair value of any pre-existing investment in the acquiree is recognised as goodwill. If the consideration transferred and the pre-existing fair value is less than the fair value of the identifiable net assets acquired, being a bargain purchase to the acquirer, the difference is recognised as a gain directly in profit or loss by the acquirer on the acquisition-date, but only after a reassessment of the identification and measurement of the net assets acquired, the non-controlling interest in the acquiree, if any, the consideration transferred and the acquirer's previously held equity interest in the acquirer.

Business combinations are initially accounted for on a provisional basis. The acquirer retrospectively adjusts the provisional amounts recognised and also recognises additional assets or liabilities during the measurement period, based on new information obtained about the facts and circumstances that existed at the acquisition-date. The measurement period ends on either the earlier of (i) 12 months from the date of the acquisition or (ii) when the acquirer receives all the information possible to determine fair value.

Earnings per share

Basic earnings per share

Basic earnings per share is calculated by dividing the profit attributable to the owners of Xanadu Mines Ltd, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial period, adjusted for bonus elements in ordinary shares issued during the financial period.

Diluted earnings per share

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

Share-based payment transactions

In addition to consulting fees and salaries, the consolidated entity provides benefits to certain directors and employees of the consolidated entity in the form of share-based payment transactions, whereby directors and employees render services in exchange for shares or rights over shares ("equity-settled transactions").

The cost of equity-settled transactions with employees (including directors) is measured by reference to the fair value at the date at which they are granted. The fair value of the options is determined by an independent written valuation. The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the vesting conditions, if any, are fulfilled.

The cumulative expenses recognised for equity-settled transactions at each reporting date until vesting date reflects:(i) the extent to which the vesting period, if any, has expired; and (ii) the consolidated entity's best estimate of the number of equity instruments that will ultimately vest. No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date. The income statement charge or credit for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

Notes to the Financial Statements

continued

Note 1. Significant accounting policies (continued)

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is only conditional upon a market condition.

If the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any modification that increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee, as measured at the date of modification.

If an equity-settled award is cancelled, it is treated as if it had vested on the date of the cancellation, and any expense not yet recognised is recognised immediately. However, if a new award is substituted for the cancelled award and designated a replacement award on the date it is granted, the cancelled and new award are treated as if they were a modification of the original award, as described in the previous paragraph.

Goods and Services Tax ('GST') and other similar taxes

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the tax authority. In this case it is recognised as part of the cost of the acquisition of the asset or as part of the expense.

Receivables and payables are stated inclusive of the amount of GST receivable or payable. The net amount of GST recoverable from, or payable to, the tax authority is included in other receivables or other payables in the statement of financial position.

Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to the tax authority, are presented as operating cash flows. Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the tax authority.

Rounding of amounts

The Company is of a kind referred to in Corporations Instrument 2016/191, issued by the Australian Securities and Investments Commission, relating to 'rounding-off'. Amounts in this report have been rounded off in accordance with that Corporations Instrument to the nearest thousand dollars, or in certain cases, the nearest dollar.

New Accounting Standards and Interpretations not yet mandatory or early adopted

Australian Accounting Standards and Interpretations that have recently been issued or amended but are not yet mandatory, have not been early adopted by the group for the reporting period ended 31 December 2017. The group has not yet assessed the impact of these new or amended Accounting Standards and Interpretations.

Note 2. Critical accounting judgements, estimates and assumptions

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts in the financial statements. Management continually evaluates its judgements and estimates in relation to assets, liabilities, contingent liabilities, revenue and expenses. Management bases its judgements, estimates and assumptions on historical experience and on other various factors, including expectations of future events, management believes to be reasonable under the circumstances. The resulting accounting judgements and estimates will seldom equal the related actual results. The judgements, estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities (refer to the respective notes) within the next financial year are discussed below.

Share-based payment transactions

The group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by using either the Binomial or Black-Scholes model taking into account the terms and conditions upon which the instruments were granted. The accounting estimates and assumptions relating to equity-settled share-based payments would have no impact on the carrying amounts of assets and liabilities within the next annual reporting period but may impact profit or loss and equity.

Carrying value of exploration assets

The group applies judgements in determining the carrying value of exploration assets in particular in determining which exploration costs should be capitalised or expensed. The group assesses impairment of such assets at each reporting date by evaluating conditions specific to the group.

Notes to the Financial Statements

continued

Going concern basis of accounting

The financial statements have been prepared on a going concern basis, which contemplates the continuity of normal business activity and the realisation of assets and the settlement of liabilities in the normal course of business.

Note 3. Operating segments

The group operates predominantly in the minerals exploration sector. The principle activity of the group is exploration for copper and gold. The group classifies these activities under a single operating segment, in a single geographical segment; the Mongolian exploration projects. Regarding the exploration operating segment, the Chief Operating Decision Maker (determined to be the Board of Directors) receives information on the exploration expenditure incurred. This information is disclosed in deferred exploration expenditure note of the financial report. No segment revenues are disclosed as all segment expenditure is capitalised, with the exception of expenditure written off. The non-current assets of the group, attributable to the parent entity, are located in Mongolia.

Note 4. Other income

	Consolidated	
	2017	2016
	\$'000	\$'000
Interest	24	36
Gain on settlement of deferred consideration	-	1,224
Gain on sale of plant and equipment	15	-
Deferred consideration received on sale of interest in tenement	130	-
Other income	<u>169</u>	<u>1,260</u>

In November 2017, the Company received 10,000,000 fully paid ordinary shares from Aspire Mining Limited (Aspire), a company listed on the ASX. The shares received were in relation to the granting of the Nuurstei Mining Licence to Aspire under the Sales and Purchase Agreement dated 13 June 2014 between Xanadu and Aspire.

In 2016, the Company has recognised a gain of \$1,224,000 as a result of the settlement of the deferred consideration. An agreement was reached in January 2016 to reduce the deferred consideration by settling the liability early.

Note 5. Other expenses

	Consolidated	
	2017	2016
	\$'000	\$'000
Other expenses		
Administration expenses	1,461	839
Net foreign currency loss	1	1
Wages and management fees	1,747	1,812
Share-based payments	326	249
	<u>3,535</u>	<u>2,901</u>

Note 6. Income tax expense

	Consolidated	
	2017	2016
	\$'000	\$'000
<i>Numerical reconciliation of income tax expense and tax at the statutory rate</i>		
Loss before income tax expense	(3,831)	(2,131)
Tax at the statutory tax rate of 30%	(1,149)	(639)
Tax effect amounts which are not deductible/(taxable) in calculating taxable income:		
Tax effect of expenses not allowed for tax purposes	107	91
	<u>(1,042)</u>	<u>(548)</u>
Current period tax losses not recognised	858	561
Difference in overseas tax rates - Mongolia at 25% (June 2014: 25%)	57	55
Difference in overseas tax rates - Singapore at 17% (June 2014: 17%)	32	(68)
Income tax expense	<u>-</u>	<u>-</u>

Notes to the Financial Statements

continued

Note 6. Income tax expense (continued)

At the reporting date, the group has estimated tax losses of \$25,197,000 (Dec 2016: \$22,080,000). A deferred tax asset has not been recognised for these losses because it is not probable that future taxable income will be available to use against such losses.

Note 7. Current assets - cash and cash equivalents

	Consolidated	
	2017	2016
	\$'000	\$'000
Cash at bank and on hand	9,065	8,277

Cash at bank earns interest at floating rates based on daily bank deposit rates.

Note 8. Current assets - financial assets at fair value through profit or loss

	Consolidated	
	2017	2016
	\$'000	\$'000
Ordinary shares - designated at fair value through profit or loss	100	-

Refer to note 20 for further information on fair value measurement.

The ordinary shares relates to the 10,000,000 shares held in Aspire Mining Limited, a company listed on the ASX (ASX code: AKM). The carrying value of the shares is based on the closing share price of AKM at 31 December 2017.

Note 9. Current assets - Other receivables

	Consolidated	
	2017	2016
	\$'000	\$'000
Sundry debtors	83	68
GST recoverable	415	401
	498	469

Sundry debtors relate to interest on term deposits accrued but not yet received, refund of goods and services tax payments due and other current loans. Balances within sundry debtors do not contain impaired assets and are not past due. It is expected that these balances will be received in full. Due to the short term nature of these receivables, their carrying value is assumed to approximate their fair value. The maximum exposure to credit risk is the fair value of receivables.

Note 10. Non-current assets - Property, plant and equipment

	Consolidated	
	2017	2016
	\$'000	\$'000
Plant and equipment - at cost	393	332
Less: Accumulated depreciation	(259)	(235)
	134	97
Motor vehicles - at cost	347	358
Less: Accumulated depreciation	(93)	(148)
	254	210
	388	307

Notes to the Financial Statements

continued

Note 10. Non-current assets - Property, plant and equipment (continued)

Reconciliations

Reconciliations of the written down values at the beginning and end of the current and previous financial period are set out below:

Consolidated	Plant & Equipment \$'000	Motor Vehicles \$'000	Total \$'000
Balance at 1 January 2016	136	227	363
Additions	21	55	76
Exchange differences	(20)	(39)	(59)
Depreciation expense	(40)	(33)	(73)
Balance at 31 December 2016	97	210	307
Additions	82	138	220
Disposals	(1)	(54)	(55)
Exchange differences	(4)	(10)	(14)
Depreciation expense	(40)	(30)	(70)
Balance at 31 December 2017	<u>134</u>	<u>254</u>	<u>388</u>

Note 11. Non-current assets - Deferred exploration expenditure

	Consolidated 2017 \$'000	2016 \$'000
Deferred exploration expenditure	<u>37,157</u>	<u>31,952</u>

Reconciliations

Reconciliations of the written down values at the beginning and end of the current and previous financial period are set out below:

Consolidated	Exploration & evaluation & \$'000	
	2017 \$'000	2016 \$'000
Balance at 1 January 2016		34,049
Expenditure during the period		4,764
Exchange differences		(6,861)
Balance at 31 December 2016		31,952
Expenditure during the period		7,086
Exchange differences		(1,881)
Balance at 31 December 2017		<u>37,157</u>

Note 12. Current liabilities - trade and other payables

	Consolidated	
	2017 \$'000	2016 \$'000
Trade payables	1,261	339
Accrued expenses	1	83
	<u>1,262</u>	<u>422</u>

Refer to note 19 for further information on financial risk management objectives and policies. Trade payables and other creditors are non-interest bearing and are normally settled on 30 day terms.

Notes to the Financial Statements

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Note 13. Current liabilities - Term loan - related party

	Consolidated	
	2017 \$'000	2016 \$'000
Term loan - related party	-	3,814

Refer to note 19 for further information on financial risk management objectives and policies.

During the year, the group has settled the term loan (which is denominated in USD) by way of combined cash (AUD\$2.9 million) and equity (AUD\$1.4 million).

Note 14. Equity - Issued capital

	Consolidated			
	2017 Shares	2016 Shares	2017 \$'000	2016 \$'000
Ordinary shares - fully paid (net of transaction cost)	588,687,267	511,218,639	108,452	93,964

Movements in ordinary share capital

Details	Date	Shares	\$'000
Balance	1 January 2016	445,285,489	82,108
Shares issued - Settlement of Red Mountain Acquisition	1 April 2016	1,364,000	191
Shares issued - Equity Incentive Plan	20 May 2016	2,333,333	-
Shares issued - Short Term Incentives	20 May 2016	1,403,716	176
Shares issued - Placement	27 June 2016	56,332,101	11,304
Shares issued - Deferred cash settlement	27 June 2016	4,500,000	900
Transaction costs		-	(715)
Balance	31 December 2016	511,218,639	93,964
Shares issued – Equity Incentive Plan	29 June 2017	683,333	-
Shares issued – Placement	5 October 2017	76,785,295	15,357
Transaction costs		-	(870)
Balance	31 December 2017	588,687,267	108,451

Ordinary shares

Ordinary shares entitle the holder to participate in dividends and the proceeds on the winding up of the Company in proportion to the number of and amounts paid on the shares held. The fully paid ordinary shares have no par value and the Company does not have a limited amount of authorised capital.

On a show of hands every member present at a meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.

Share buy-back

There is no current on-market share buy-back.

Capital risk management

The group's objectives when managing capital is to safeguard its ability to continue as a going concern, so that it can provide returns for shareholders and benefits for other stakeholders and to maintain an optimum capital structure to reduce the cost of capital.

Capital is regarded as total equity, as recognised in the statement of financial position, plus net debt. Net debt is calculated as total borrowings less cash and cash equivalents.

Notes to the Financial Statements

continued

Note 14. Equity - issued capital (continued)

Management effectively manages the group's capital by assessing the group's financial risks and adjusting its capital structure in response to changes in these risks and in the market. These responses include the management of expenditure and debt levels, distributions to shareholders and share and option issues.

Note 15. Equity - reserves

	Consolidated	
	2017	2016
	\$'000	\$'000
Foreign currency reserve	(11,047)	(8,727)
Share-based payments reserve	8,534	8,208
	<u>(2,513)</u>	<u>(519)</u>

Share-based payments

This reserve is used to record the value of equity benefits provided to directors and employees as part of their fees and remuneration, and external service providers for goods and services provided (including acquisition of tenements).

Foreign currency translation reserve

This reserve is used to accumulate the changes in the value investments in subsidiaries that arise from changes in the exchange rates.

Movements in reserves

Movements in each class of reserve during the current and previous financial period are set out below:

Consolidated	Share - based payments \$'000	Foreign currency translation \$'000	Total \$'000
Balance at 1 January 2016	8,135	(1,052)	7,083
Share based payment - employee benefits	73	-	73
Foreign currency translation	-	(7,675)	(7,675)
Balance at 31 December 2016	8,208	(8,727)	(519)
Share-based payments - employee benefits	326	-	326
Foreign currency translation	-	(2,320)	(2,320)
Balance at 31 December 2017	<u>8,534</u>	<u>(11,047)</u>	<u>(2,513)</u>

Note 16. Equity - accumulated losses

	Consolidated	
	2017	2016
	\$'000	\$'000
Accumulated losses at the beginning of the financial period	(61,322)	(59,067)
Loss after income tax expense for the period	(3,842)	(2,255)
Accumulated losses at the end of the financial period	<u>(65,164)</u>	<u>(61,322)</u>

Note 17. Equity - non-controlling interest

	Consolidated	
	2017	2016
	\$'000	\$'000
Non-controlling interest	<u>5,017</u>	<u>4,643</u>

Notes to the Financial Statements

continued

Note 18. Equity - dividends

There were no dividends paid, recommended or declared during the current or previous financial period.

Note 19. Financial risk management objectives and policies

Financial risk management

The group's principal financial instruments comprise cash, short-term deposits, receivables, payables and loans. The main purpose of these financial instruments is to raise finance for its operations. The consolidated entity has financial instruments such as debtors and creditors, which arise directly from its operations.

The group manages its exposure to key financial risks in accordance with its risk management policy with the objective to ensure that the financial risks inherent in exploration activities are identified and managed accordingly.

The main financial risks that arise in the normal course of business for the group's financial instruments are foreign currency risk, interest rate risk, credit risk and liquidity risk. Management employs different methods to measure and mitigate the different risks to which the group is exposed. These include monitoring exposure to foreign exchange risk and assessments of market forecast for interest rate, foreign exchange and commodity prices. Liquidity risk is managed by development of rolling budgets and forecasts.

Primary responsibility for identification and control of financial risks lies with the Managing Director and Chief Financial Officer, under the authority of the Board. The Board is abreast of these risks and agrees any policies that may be implemented to manage the risks identified.

Market risk

Foreign currency risk

As a result of significant operations in Mongolia and the majority of expenditure being denominated in United States Dollars, the group's balance sheet can be affected significantly by movements in the USD and AUD exchange rates per MNT. The group seeks to mitigate the effect of its foreign currency exposure by holding part of its cash reserves in US Dollars.

The group also has transactional currency exposures. Such exposure arises from sales or purchases by an operating entity in currencies other than the functional currency.

The group's currency risk to USD foreign denominates financial assets and liabilities at the end of the reporting period, expressed in Australian Dollars, was as follows:

	Assets		Liabilities	
	2017 \$'000	2016 \$'000	2017 \$'000	2016 \$'000
Consolidated				
Cash and cash equivalents	6,883	5,291	-	-
Term loan - related party	-	-	-	3,813
	<u>6,883</u>	<u>5,291</u>	<u>-</u>	<u>3,813</u>

The following sensitivity is based on the foreign exchange risk exposures in existence at the balance date:

	AUD strengthened			AUD weakened		
	% change	Effect on profit before tax	Effect on equity	% change	Effect on profit before tax	Effect on equity
Consolidated - 2017						
AUD/USD	10%	688	688	(10%)	(625)	688

Notes to the Financial Statements

continued

Note 19. Financial risk management objectives and policies (continued)

Consolidated - 2016	AUD strengthened			AUD weakened		
	% change	Effect on profit before tax	Effect on equity	% change	Effect on profit before tax	Effect on equity
AUD/USD	10%	<u>(148)</u>	<u>(148)</u>	(10%)	<u>148</u>	<u>148</u>

Management believe the balance date risk exposures are representative of the risk exposure inherent in the financial instruments.

Interest rate risk

The group's exposure to market risk for changes in interest rates relates primarily to its cash held in variable interest accounts.

As at the reporting date, the group had the following cash and cash equivalents and variable rate borrowings outstanding:

Consolidated	2017		2016	
	Weighted average interest rate %	Balance \$'000	Weighted average interest rate %	Balance \$'000
Cash and cash equivalents	2.40%	9,065	2.40%	8,277
Interest bearing loans and borrowings	-	-	10.68%	(3,814)
Net exposure to cash flow interest rate risk		<u>9,065</u>		<u>4,463</u>

An analysis by remaining contractual maturities is shown in 'liquidity and interest rate risk management' below.

The following sensitivity is based on the interest rate risk exposures in existence at the balance date:

Consolidated - 2017	Basis points increase			Basis points decrease		
	Basis points change	Effect on profit before tax	Effect on equity	Basis points change	Effect on profit before tax	Effect on equity
Net interest rate risk exposure	100	<u>90</u>	<u>90</u>	(100)	<u>(90)</u>	<u>(90)</u>

Consolidated - 2016	Basis points increase			Basis points decrease		
	Basis points change	Effect on profit before tax	Effect on equity	Basis points change	Effect on profit before tax	Effect on equity
Net interest rate risk exposure	100	<u>45</u>	<u>45</u>	(100)	<u>(45)</u>	<u>(45)</u>

The movements in post-tax profit are due to the movements in interest amounts from higher cash balances held that balance date in comparison to the prior period.

Credit risk

Credit risk arises from the financial assets of the group, which comprise cash and cash equivalents, and other receivables. The group's exposure to credit risk arises from potential default of the counter party, with a maximum exposure equal to the carrying amount of these instruments.

The group trades only with recognised, creditworthy third parties, and as such collateral is not requested nor is it the group's policy to securitise its trade and other receivables.

In addition, receivable balances are monitored on an ongoing basis with the result that the group's exposure to bad debts is not significant.

Notes to the Financial Statements

continued

Note 19. Financial risk management objectives and policies (continued)

Liquidity risk

Liquidity risk arises from the group's management of working capital. It is the risk that the group will encounter difficulty in meeting its financial obligations as they fall due.

The group's policy is to ensure that it will always have sufficient cash to allow it to meet its liabilities when they become due. To achieve this aim, it seeks to maintain cash balances to meet expected requirements for a period of at least twelve months.

The Board receives cash flow projections on a monthly basis as well as information regarding cash balances. At the balance sheet date, these projections indicated that the group expected to have sufficient liquid resources to meet its obligations, and forward expenditure commitments, under all reasonably expected circumstances.

Fair value

Unless otherwise stated, the carrying amounts of financial instruments reflect their fair value.

Note 20. Fair value measurement

Fair value hierarchy

The following tables detail the group's assets and liabilities, measured or disclosed at fair value, using a three level hierarchy, based on the lowest level of input that is significant to the entire fair value measurement, being:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: Unobservable inputs for the asset or liability.

Consolidated - 2017	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
<i>Assets</i>				
Ordinary shares - Aspire Mining Limited (ASX: AKM)	100	-	-	100
Total assets	100	-	-	100

There were no transfers between levels during the financial period.

Note 21. Key management personnel disclosures

Directors

The following persons were directors of Xanadu Mines Ltd during the financial period:

Kevin Tomlinson	Non-Executive Chairman (appointed 29 May 2017)
Andrew Stewart	Managing Director & Chief Executive Officer
Ganbayar Lkhagvasuren	Executive Director
Hannah Badenach	Non-Executive Director
Marcus Engelbrecht	Non-Executive Director
Darryl Clark	Independent Non-Executive Director
Michele Muscillo	Independent Non-Executive Director (appointed 14 August 2017)
Mark Wheatley	Non-Executive Chairman (ceased 29 May 2017)
Barry Lavin	Non-Executive Chairman (ceased 29 May 2017)

Other key management personnel

The persons who also had the authority and responsibility for planning, directing and controlling the major activities of the group, directly or indirectly, during the financial period were Munkhsaikhan Dambiinyam, Chief Financial Officer, and Mathew Brown, Chief Geologist.

Notes to the Financial Statements

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Note 21. Key management personnel disclosures (continued)

Compensation

The aggregate compensation made to directors and other members of key management personnel of the group is set out below:

	Consolidated	
	2017	2016
	\$	\$
Short-term employee benefits	1,482,036	1,176,664
Post-employment benefits	10,619	41,214
Share-based payments	368,841	249,084
	<u>1,818,496</u>	<u>1,466,962</u>

Note 22. Remuneration of auditors

During the financial period the following fees were paid or payable for services provided by Ernst & Young, the auditor of the Company:

	Consolidated	
	2017	2016
	\$	\$
<i>Audit services - Ernst & Young</i>		
Audit or review of the financial statements - Australia	80,374	69,525
Audit or review of the financial statements - Singapore	3,743	8,311
<i>Other services - Ernst & Young</i>		
Tax services	1,200	1,000
	<u>85,317</u>	<u>78,836</u>

Note 23. Contingent liabilities

There are no material contingent liabilities relating to the Company and/or the Group.

Note 24. Commitments

Commitments in relation to exploration licences contracted at the reporting date, including regulatory charges such as license fees, but not recognised as liabilities within one year are \$0.7 million (31 December 2016: \$0.6 million). As the future exploration activity is in most cases dependent upon reserves being found it is not possible to set out the funds due to be contributed in more than one year's time. No other commitments or contingencies existed at 31 December 2017.

Note 25. Related party transactions

Parent entity

Xanadu Mines Ltd is the parent entity.

Subsidiaries

Interests in subsidiaries are set out in note 27.

Key management personnel

Disclosures relating to key management personnel are set out in note 21 and the remuneration report included in the directors' report.

Transactions with related parties

On 2 January 2017, the Company relocated its Ulaanbaatar office and entered into a rental agreement with Ganbayar Lkhagvasuren, a Director of the Company. The transaction between related parties is on normal commercial terms and conditions no more favourable than those available to other parties that are arm's length. The company paid rent totalling \$88,428 for the year ended 31 December 2017 (\$7,369 being one month rent).

Notes to the Financial Statements

continued

Note 25. Related party transactions (continued)

Receivable from and payable to related parties

There were no trade receivables from or trade payables to related parties at the current and previous reporting date.

Loans to/from related parties

There were no loans to/from related parties as at 31 December 2017.

Terms and conditions

All transactions were made on normal commercial terms and conditions and at market rates.

Note 26. Parent entity information

Set out below is the supplementary information about the parent entity.

Statement of profit or loss and other comprehensive income

	Parent	
	2017	2016
	\$'000	\$'000
Loss after income tax	(2,507)	(8,658)
Total comprehensive income	(2,507)	(8,658)

Statement of financial position

	Parent	
	2017	2016
	\$'000	\$'000
Total current assets	8,754	6,205
Total assets	48,564	36,221
Total current liabilities	94	58
Total liabilities	94	58
Equity		
Issued capital	108,452	93,964
Share-based payments reserve	8,534	8,208
Other reserves	256	256
Accumulated losses	(68,772)	(66,265)
Total equity	48,470	36,163

Contingent liabilities

The parent entity had no contingent liabilities as at 31 December 2017.

Capital commitments - Property, plant and equipment

The parent entity had no capital commitments for property, plant and equipment at as 31 December 2017.

Significant accounting policies

The accounting policies of the parent entity are consistent with those of the group, as disclosed in Note 1, except for the following:

- Investments in subsidiaries are accounted for at cost, less any impairment, in the parent entity.
- Investments in associates are accounted for at cost, less any impairment, in the parent entity.
- Dividends received from subsidiaries are recognised as other income by the parent entity and its receipt may be an indicator of an impairment of the investment.

Notes to the Financial Statements

continued

Note 27. Interests in subsidiaries

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in Note 1:

Name	Principal place of business / Country of incorporation	Ownership interest	
		2017 %	2016 %
Xanadu Exploration Mongolia LLC	Mongolia	100.00%	100.00%
Xanadu Metals Mongolia LLC	Mongolia	100.00%	100.00%
Xanadu Copper Mongolia LLC	Mongolia	100.00%	100.00%
Xanadu Mines Singapore Pte Ltd	Singapore	100.00%	100.00%
Khuiten Metals Pte Ltd	Singapore	100.00%	100.00%
Mongol Metals LLC	Mongolia	85.00%	79.80%
Vantage LLC	Mongolia	90.00%	90.00%
Oyut Ulaan LLC	Mongolia	90.00%	90.00%

Note 28. Events after the reporting period

No other matter or circumstance has arisen since 31 December 2017 that has significantly affected, or may significantly affect the group's operations, the results of those operations, or the group's state of affairs in future financial years.

Note 29. Reconciliation of loss after income tax to net cash used in operating activities

	Consolidated	
	2017 \$'000	2016 \$'000
Loss after income tax expense for the period	(3,831)	(2,131)
Adjustments for:		
Depreciation and amortisation	91	114
Net fair value loss on available-for-sale financial assets	30	-
Share-based payments	326	249
Foreign exchange differences	1	1
Interest on loan capitalised	-	(20)
Gain on deferred consideration	-	(1,224)
Net loss on sale of plant and equipment	29	-
Deferred consideration received on sale of interest in tenement	(130)	-
Change in operating assets and liabilities:		
Increase in other receivables and prepayments	13	(11)
Increase/(decrease) in trade and other payables	100	50
Net cash used in operating activities	(3,371)	(2,972)

Note 30. Earnings per share

	Consolidated	
	2017 \$'000	2016 \$'000
Loss after income tax	(3,831)	(2,131)
Non-controlling interest	(11)	(124)
Loss after income tax attributable to the owners of Xanadu Mines Ltd	(3,842)	(2,255)

Notes to the Financial Statements

continued

Note 30. Earnings per share (continued)

	Number	Number
Weighted average number of ordinary shares used in calculating basic earnings per share	530,079,477	478,840,156
Weighted average number of ordinary shares used in calculating diluted earnings per share	530,079,477	478,840,156
	Cents	Cents
Basic earnings per share	(0.72)	(0.47)
Diluted earnings per share	(0.72)	(0.47)

Note 31. Share-based payments

The Xanadu Equity Incentive Plan was approved by shareholders at the Company's 2013 Annual General Meeting ("Plan"). Under the Plan, the Board may grant options and share rights over ordinary shares in the Company to certain key management personnel of the group. The share rights are issued for nil consideration and are granted in accordance with performance guidelines established by the Board.

No options have been granted under this Plan.

Set out below are summaries of share rights granted under the plan:

31 December 2017

Grant date	Expiry date	Exercise price	Balance at the start of the period	Granted	Vested and awarded	Expired/forfeited/other *	Balance at the end of the period
28/11/2014	18/09/2017	\$0.00	1,000,000	-	-	(1,000,000)	-
01/12/2014	01/06/2017	\$0.00	350,000	-	(350,000)	-	-
23/12/2015	16/06/2018	\$0.00	666,667	-	(333,333)	-	333,334
23/12/2016	23/12/2019	\$0.00	1,800,000	-	-	(1,800,000)	-
26/07/2017	26/07/2019	\$0.00	-	4,000,000	-	-	4,000,000
16/11/2017	26/05/2019	\$0.00	-	10,000,000	-	-	10,000,000
16/11/2017	26/07/2019	\$0.00	-	4,000,000	-	-	4,000,000
16/11/2017	11/10/2019	\$0.00	-	2,000,000	-	-	2,000,000
			3,816,667	20,000,000	(683,333)	(2,800,000)	20,333,334

31 December 2016

Grant date	Expiry date	Exercise price	Balance at the start of the period	Granted	Vested and awarded	Expired/forfeited/other *	Balance at the end of the period
22/05/2013	23/05/2016	\$0.00	600,000	-	(600,000)	-	-
22/11/2013	23/05/2016	\$0.00	600,000	-	(600,000)	-	-
16/05/2014	28/02/2016	\$0.00	1,250,000	-	-	(1,250,000)	-
28/11/2014	18/09/2017	\$0.00	1,000,000	-	-	-	1,000,000
01/12/2014	01/06/2017	\$0.00	700,000	-	(350,000)	-	350,000
23/12/2015	16/06/2018	\$0.00	1,000,000	-	(333,333)	-	666,667
23/12/2016	23/12/2019	\$0.00	-	1,800,000	-	-	1,800,000
			5,150,000	1,800,000	(1,883,333)	(1,250,000)	3,816,667

* Lapsed during the period.

Notes to the Financial Statements

continued

Note 31. Share-based payments (continued)

Should the KMP remain employed with Xanadu at the date of vesting, the share rights will vest where the closing price or share price of Xanadu shares (as the case may be depending on the terms of issue) on consecutive trading days during the period exceeds the hurdle price. If hurdle price is not met, share rights get accumulated to a future vesting date until the expiry date where all unvested share rights lapse. Vesting conditions are as follows:

- 333,334 share rights which may vest on 16 June 2018 if the closing price of shares on any 3 consecutive trading days in the prior 12 month period exceeds \$0.2281.
- 4,000,000 share rights which may vest on 26 July 2018 if the volume weighted average price for 45 consecutive days in the prior 12 month period exceeds \$0.40.
- 5,000,000 share rights which may vest on 26 May 2018 if the volume weighted average price for 45 consecutive days in the prior 12 month period exceeds \$0.40.
- 1,000,000 share rights which may vest on 11 October 2018 if the volume weighted average price for 45 consecutive days in the prior 12 month period exceeds \$0.40.
- 4,000,000 share rights which may vest on 26 July 2019 if the volume weighted average price for 45 consecutive days in the prior 12 month period exceeds \$0.60.
- 5,000,000 share rights which may vest on 26 May 2019 if the volume weighted average price for 45 consecutive days in the prior 12 month period exceeds \$0.60.
- 1,000,000 share rights which may vest on 11 October 2018 if the volume weighted average price for 45 consecutive days in the prior 12 month period exceeds \$0.60.

Directors' Declaration

In the directors' opinion:

- the attached financial statements and notes comply with the Corporations Act 2001, the Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements;
- the attached financial statements and notes comply with International Financial Reporting Standards as issued by the International Accounting Standards Board as described in note 1 to the financial statements;
- the attached financial statements and notes give a true and fair view of the group's financial position as at 31 December 2017 and of its performance for the financial period ended on that date; and
- there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

The directors have been given the declarations required by section 295A of the Corporations Act 2001.

Signed in accordance with a resolution of directors made pursuant to section 295(5)(a) of the Corporations Act 2001.

On behalf of the Directors



Kevin Tomlinson

Non-Executive Chairman

23 March 2018

Independent Auditor's Report to the Members of Xanadu Mines Ltd



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Independent Auditor's Report to the Members of Xanadu Mines Limited

Report on the Audit of the Financial Report

Opinion

We have audited the financial report of Xanadu Mines Limited (the Company) and its subsidiaries (collectively the Group), which comprises the consolidated statement of financial position as at 31 December 2017, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

In our opinion, the accompanying financial report of the Group is in accordance with the *Corporations Act 2001*, including:

- a) giving a true and fair view of the consolidated financial position of the Group as at 31 December 2017 and of its consolidated financial performance for the year ended on that date; and
- b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report. We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial report of the current year. These matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial report. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial report.



Going Concern

Why significant to the audit

The Directors have concluded that in their opinion there are reasonable grounds to believe that the Group has the ability to pay its debts as and when they fall due.

Accordingly they have prepared the financial statements on a going concern basis as disclosed in Note 2.

Estimated future cash flows, the availability of financing and the requirements of the Group's financiers have all been considered by the Directors in reaching this conclusion.

The going concern assumption is fundamental to the basis of preparation of the financial statements.

Accordingly, our consideration of this matter and the related disclosures was one of the most significant matters addressed by our audit.

How our audit addressed the matter

We assessed the Group's cash flow model supporting the Directors' assessment that the Group continues to be a going concern. Our procedures included:

- ▶ considering the accuracy of exploration and evaluation expenditure commitments;
- ▶ assessed the basis for projected administration overhead costs.
- ▶ considered the impact of a range of cash flow sensitivities to the model and to the conclusion reached by the Directors
- ▶ challenged the sensitivities and stress testing that the Group performed on the going concern forecast
- ▶ assessed the possible mitigating actions identified by the Group in the event that actual cash flows are below forecast; and
- ▶ Assessed the consistency of the assumptions included within the going concern model with the statements related to future plans and commitments contained within the Annual Report and financial statements.



Carrying value of capitalised exploration and evaluation

Why significant to the audit

Capitalised exploration and evaluation assets are the Group's largest asset. The carrying value of exploration and evaluation assets is impacted by Xanadu Mines Limited's ability, and intention, to continue to explore their exploration assets. The results of exploration work also determines to what extent the mineral reserves and resources may or may not be commercially viable for extraction. Due to the quantum of this asset and the subjectivity involved in determining its carrying value, this is a key audit matter.

Refer to Note 11 - Exploration and evaluation assets to the financial statements for the amounts held on the Balance sheet by the Group as at 31 December 2017 and related disclosure.

How our audit addressed the matter

Our procedures to address the Group's assessment of the carrying value of exploration and evaluation assets included:

- ▶ considered the Company's right to explore in the relevant exploration area which included obtaining and assessing relevant documentation such as license agreements;
- ▶ considered the Group's intention to carry out significant exploration and evaluation activity in the relevant exploration area which included assessment of the Group's cash-flow forecast models, discussions with senior management and Directors as to the intentions and strategy of the Group;
- ▶ assessed the carrying value of assets where recent exploration activity in a given exploration license provided negative indicators as to the recoverability of other capitalised costs;
- ▶ assessed the commercial viability of results relating to exploration and evaluation activities carried out in the relevant licensed area; and
- ▶ assessed the ability to finance any planned future exploration and evaluation activity.



Information Other than the Financial Report and Auditor's Report Thereon

The directors are responsible for the other information. The other information comprises the information included in the Company's 2018 Annual Report, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon, with the exception of the Remuneration Report and our related assurance opinion.

In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the Financial Report

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

In preparing the financial report, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Report

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Independent Auditor's Report to the Members of Xanadu Mines Ltd



- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the financial report. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated to the directors, we determine those matters that were of most significance in the audit of the financial report of the current year and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.



Report on the Audit of the Remuneration Report

Opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 15 to 21 of the directors' report for the year ended 31 December 2017.

In our opinion, the Remuneration Report of Xanadu Mines Limited for the year ended 31 December 2017, complies with section 300A of the *Corporations Act 2001*.

Responsibilities

The directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

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

Ernst & Young

A handwritten signature in black ink that reads 'Scott Jarrett'.

Scott Jarrett
Partner
Sydney
23 March 2018

ASX Additional Information

Additional information required by the Australian Securities Exchange Limited (ASX) Listing Rules and not disclosed elsewhere in the Report is set out below. The information is current as at 9 March 2018.

(a) Substantial shareholders

The number of securities held by substantial shareholders and their associates, as disclosed to Xanadu and ASX are set out below:

	Fully Paid Ordinary Shares	
	Number of Shares	Percentage of Shares
CAAF Limited	147,577,553	25.07% ¹
Copper Plate Success Limited	147,577,553	25.07% ¹
Bank of Nova Scotia and 1832 Asset Management L.P.	40,250,000	6.84% ²
Noble Resources International Pte. Ltd.	40,034,228	7.77% ³
Fast Lane Australia Pty Ltd	30,600,000	5.73% ⁴

¹ As notified to Xanadu on 16 October 2017. CAAF Limited and Copper Plate Success Limited are associates as defined in the Corporations Act 2001 (Cth).

² As notified to Xanadu on 6 November 2017.

³ As notified to Xanadu on 23 November 2015.

⁴ As notified to Xanadu on 5 January 2016.

(b) Number of security holders and securities on issue

Quoted securities

Xanadu has on issue 588,687,267 fully paid ordinary shares held by 1,046 shareholders.

Unquoted securities

Share rights

Xanadu has on issue 20,633,334 unquoted share rights with various vesting prices held by 11 right holders. For the purposes of ASX Listing Rule 4.10.7, 3 rights holders hold between 10,001 - 100,000 rights and 8 rights holder holds more than 100,001 rights.

Options

Xanadu has on issue:

35,000,000 unquoted options with various exercise prices held by 1 option holder:

- 15,000,000 unquoted Series A options held by 1 option holder (Temujin Mining Corp). The issue of these options were approved by shareholders at Xanadu's 2013 Annual General Meeting; and
- 20,000,000 unquoted Series B options held by 1 option holder (Temujin Mining Corp). The issue of these options were approved by shareholders at Xanadu's 2013 Annual General Meeting.

For the purposes of ASX Listing Rule 4.10.7, each option holder holds more than 100,001 options.

(c) Voting rights

Ordinary shares

The voting rights attached to ordinary shares are that on a show of hands, every member present, in person or proxy, has one vote and upon a poll, each share shall have one vote.

Share rights

Share rights holders do not have any voting rights on the share rights held by them.

Options

Option holders do not have any voting rights on the options held by them.

ASX Additional Information

(d) Distribution of security holders

	Fully paid ordinary shares		
	Number of Holders	Number of Shares	Percentage of Shares
1 - 1,000	39	11,733	0%
1,001 - 5,000	170	547,810	0.09%
5,001 - 10,000	158	1,331,394	0.23%
10,001 - 100,000	461	18,699,485	3.18%
100,001 and over	218	568,096,845	96.50%
	1,046	588,687,267	100.00%

(e) Unmarketable parcel of shares

The number of shareholders holding less than a marketable parcel of ordinary shares is 87. 2,041 shares comprise a marketable parcel at Xanadu's closing share price of \$0.245 on 9 March 2018.

(f) Twenty largest shareholders of quoted equity securities

	Fully paid ordinary shares	
	Number of Shares	Percentage of Shares
1. HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED	125,283,042	21.28
2. ASIA CAPITAL AND ADVISORS PTE LTD <COPPER PLATE SUCCESS LTD A/C>	66,756,241	11.34
3. NOBLE RESOURCES INTERNATIONAL PTE LTD	47,094,978	8.00
4. FAST LANE AUSTRALIA PTY LTD	30,000,000	5.10
5. SAKARI ENERGY TRADING PTE LTD	24,642,332	4.19
6. CM SUPER FUND PTY LTD <CAROL MCCOLL SUPER FUND A/C>	17,000,000	2.89
7. MR GANBAYAR LKHAGVASUREN	16,558,329	2.81
8. OSISKO GOLD ROYALTIES LTD	15,000,000	2.55
9. BNP PARIBAS NOMINEES PTY LTD <AGENCY LENDING DRP A/C>	14,459,602	2.46
10. CITICORP NOMINEES PTY LTD	14,201,308	2.41
11. BELFORT INVESTMENT ADVISORS LIMITED	11,369,431	1.93
12. EMSDALE HOLDINGS PTY LTD	9,000,000	1.53
13. ROJO NERO CAPITAL PTY LTD	8,909,090	1.51
14. BNP PARIBAS NOMS PTY LTD <DRP>	8,764,680	1.49
15. BELLARINE GOLD PTY LTD <RIBBLESDALE SUPER FUND A/C>	7,807,788	1.33
16. BNP PARIBAS NOMINEES PTY LTD <IB AU NOMS RETAILCLIENT DRP>	7,175,603	1.22
17. FARRINGTON CORPORATE SERVICES PTY LTD <FARRINGTON SUPER FUND A/C>	6,498,100	1.10
18. BIKINI ATOLL INVESTMENTS PTY LTD	4,960,000	0.84
19. MRS JAN MEEK	4,511,144	0.77
20. UBS NOMINEES PTY LTD	4,221,669	0.72
	444,213,337	75.46%

(g) On market buy-back

There is no current on market buy-back of Xanadu shares.

(h) Tenements held as at 10 March 2017

Area of Interest	Tenements	Location	Interest
Kharmagtai	MV17387A ¹	Omnogovi Province	76.5%
Red Mountain	MV017129	Dornogovi Province	90%
Sharchuluut	13670x	Bulgan Province	100%

¹The Kharmagtai project has been funded through Xanadu's interest in Mongol Metals LLC by a combination of equity and shareholder advances converted to equity periodically. Xanadu's interest in Mongol Metals LLC is equivalent to 85.0% as at 9 March 2017 (an effective 76.5% interest in the Kharmagtai project).