ERDENE GOLD INC.

Management Discussion and Analysis
First Quarter - March 31, 2006

This interim Management Discussion and Analysis of Erdene Gold Inc. (the "Company") provides analysis of the Company's financial results for the three months ended March 31, 2006 and its financial position as at March 31, 2006. The following discussion and analysis provides a summary of selected consolidated financial information for the three month period ended March 31, 2006 and 2005, and includes financial information relating to the Company and its wholly owned subsidiaries, Erdene Gold International Inc. and Erdene International Exploration Inc., both of which are incorporated under the laws of Barbados, as well as Erdene Mongol XXK and Erdene Energy XXK, both of which are incorporated under the laws of Mongolia. The consolidated financial statements of the Company have been prepared by management, in Canadian dollars, in accordance with Canadian generally accepted accounting principles (see note 1: Summary of Significant Accounting Policies). The following information should be read in conjunction with the unaudited interim consolidated financial statements of the Company for the three months ended March 31, 2006 and 2005, and the audited consolidated financial statements of the Company for the year ended December 31, 2005, including all accompanying notes to the consolidated financial statements.

This discussion includes certain statements that may be deemed "forward-looking statements". All statements in this discussion, other than statements of historical fact, that address reserve potential, exploration drilling, exploitation activities and events or developments that the Company expects, are forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially from those in forward-looking statements include market prices, exploitation and exploration results, continued availability of capital and financing and general economic, market or business conditions. Investors are cautioned that any such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in the forward-looking statements. The information contained herein is stated as of May 10, 2006 and is subject to change after that date.

This Management Discussion and Analysis has been prepared in accordance with the provisions of National Instrument 51-102, Section 5 and Form 51-102F1 and has been approved by the Company's Board of Directors.

1.01 Date of report

This report is prepared as of May 10, 2006

1.02 Nature of Business and Overall Performance

General

The Company is a resource exploration company listed on the TSX Exchange with no operating cash flow and whose level of expenditures is dependent on the sale of share capital to finance its exploration programs. As a result, the Company has no current sources of revenue other than interest earned on cash and short-term money market instruments, all of which was derived from issuances of share capital. Therefore, it is difficult to identify any meaningful trends or develop an analysis from the Company's cash flows.

The Company is well-funded and is primarily engaged in exploration and development of mineral deposits. The Company is principally focused on the discovery and acquisition of large tonnage, low cost, gold, copper, molybdenum, uranium and coal deposits in Mongolia. In addition, the Company is involved in a program of seeking out and acquiring small to mid-size mineral projects in Mongolia and elsewhere with near-term cash flow potential. At March 31, 2006 the Company held 68 mineral licenses in Mongolia representing 20 projects covering approximately 4 million acres.

Agreement with Xstrata Coal Canada Limited

On February 16, 2006 the Company concluded an agreement with Xstrata Coal Canada Limited ("Xstrata Coal") a subsidiary of Xstrata plc (London Stock Exchange: XTA.L; Zurich Stock Exchange: XTA.S), pursuant to which Xstrata Coal subscribed for 3,000,000 common shares of Erdene at $1.00/share, resulting in Xstrata Coal owing a 9.8% equity interest in the Company, at the date of the transaction.

Under the agreement, Xstrata Coal was granted a first option to enter into a joint venture and earn a 75% interest in any coal opportunity in Mongolia identified by the Company by funding all work through completion of a feasibility study. Should the Company elect to develop or pursue third party participation in any non-coal projects or properties in Mongolia or elsewhere, Xstrata Coal has a 60-day right to review all supporting project information and, if it wishes to participate in the project, to negotiate the terms of its participation before the Company may make the opportunity available to another party or develop the property itself. Xstrata Coal has the right to name a nominee to the Board of Directors of the Company and on February 24, 2006 named Jeffrey Gerard as their nominee to the Company's Board. The rights granted to Xstrata Coal under the agreement expire if Xstrata Coal does not maintain a 5% equity position in the Company although parties' rights and obligations for any established joint venture survive.

Under the agreement, Xstrata is entitled to participate in all future financings of the Company to allow Xstrata Coal to hold up to 9.9% of the common shares of the Company.

Agreement with International Uranium Corporation

On June 14, 2005, pursuant to an April 4th Memorandum of Understanding with International Uranium Corporation ("IUC"), the Company granted International Uranium Mongolia Ltd. ("IUM") the exclusive right and option to acquire a 65 per cent interest in its uranium properties. IUM must spend $6,000,000 of eligible expenditures on the properties over a period of up to four years. The Company and IUM have also formed a strategic alliance for the purpose of staking additional ground in Mongolia for the exploration of uranium over a three year period. In addition, IUC purchased 1.0 million common shares of Erdene at a price of $1.00 per share by way of a private placement. A finder's fee totaling $60,000 was paid in connection with this transaction.

The Company's exploration program is led by a senior management team with extensive exploration experience in Mongolia. The total budget for 2006 is approximately $4 million. The company will continue to fund operating losses and exploration expenditures out of existing working capital that amounted to $7.3 million at March 31, 2006.

Agreement with Gallant Minerals Limited

On March 1, 2005, the Company signed an agreement with Gallant Minerals Limited ("Gallant") to acquire 16 uranium licenses and applications in Mongolia, to obtain possession and control of certain assets and geological data pertaining to Mongolia and to receive an exclusive and irrevocable option to acquire all of the issued and outstanding shares of Gallant's wholly-owned subsidiary, Tamerlane International Limited ("Tamerlane") which controls 100% ownership of 13 properties in Mongolia with potential to contain gold, copper and/or molybdenum. On closing on March 1, 2005, the Company committed US$75,000, 400,000 common shares of the Company and 800,000 warrants with each warrant entitling Gallant to purchase one common share of the Company for prices ranging from CAN$0.60 to CAN$1.00 for a period of 24 months from the date of issue.

Under the option terms, the Company committed to the following payments, expenditures and deliverables at set dates on or before February 28, 2007 in exchange for 100% ownership of Tamerlane:

a) US$275,000;

b) Direct or indirect expenditures aggregating $US 1,000,000 on the properties acquired or under option to acquire; and,

c) 1,200,000 common shares of the Company.

The Company has met its obligation to incur US$1,000,000 of expenditures on the optioned properties and on March 1, 2006 paid to Gallant US$125,000 and issued 500,000 common shares of the Company as part of the obligations and deliverables presented above.

Gallant is entitled to receive a net smelter return royalty on certain properties ranging from 1% to 1.5%, subject to a royalty buy-down provision at the option of the Company. The Company can terminate the agreement or accelerate payment at any time. Should the Company not meet its commitments under the agreement, the agreement can be terminated by Gallant upon serving notice, whereupon the Company shall return possession and control of certain assets to Gallant and effectively cancel the option.

1.03 Selected Annual Information

The following information has been extracted from the Company's audited consolidated financial statements.

Expressed in thousands of Canadian dollars except per share amounts.

Fiscal Year Ended December 31	**2005**	**2004**	**2003**	**2002**
Revenues	$ 170	$ 198	$ 9	$ -
Loss for the year	$ 4,981	$ 4,437	$ 629	$ 76
Basic and diluted loss per share	$ 0.19	$ 0.19	$ 0.14	$ 0.05
Total assets	$ 6,649	$ 9,426	$ 4,161	$ 445
Total long-term liabilities	$ -	$ -	$ -	$ -
Cash dividends declared	Nil	Nil	Nil	Nil

All financial data has been prepared in accordance with Canadian generally accepted accounting principles.

1.04 Results of Operations

Three months ended March 31, 2006 and 2005

The Company had a loss of $676,966 for the three months ended March 31, 2006 as compared to a loss of $507,388 during the same period last year.

Total exploration expenses for the three months ended March 31, 2006 amounted to $357,775 compared to $385,227 in the previous year. Costs were incurred in preparation for the 2006 field season, scheduled to begin in April. The increase in geological services in 2006 of $176,653 is mainly due to two items: First, approximately $60,000 of the variance is the addition of three full time geological staff brought on after the Gallant acquisition Q1 2005; second, stock based compensation of approximately $70,000 was allocated to technical staff in Q1 2006 with the balance attributable to year over year increases in compensation. There was no stock based compensation booked in the first quarter of 2005.

All direct costs related to the acquisition of resource property interests have been capitalized as an asset which during the first quarter of 2006 amounted to $758,135 as compared to $803,309 in the first quarter of 2005.

General and administrative expenses for the three months ended March 31, 2006 were $401,576 compared to $230,860 for the same period in 2006. $52,920 of the increase is due to stock based compensation charged to operations in the first quarter of 2006 versus zero dollars charged in 2005. $46,679 of the increase in general and administrative expenses is due to increased travel and related costs associated with increased investor relations activities and conferences.

Other income amounted to $82,385 for the first quarter of 2006 compared with $108,699 for the same period in 2005. The primary reason for the $26,314 decrease from 2005 was a result of the Company recognizing a smaller foreign exchange gain of $5,841 in the first quarter of 2006 compared with a $58,623 foreign exchange gain for the same period in 2005. This lower foreign exchange gain was partially offset by higher interest revenue in the first quarter of 2006 compared to same quarter in 2005. This increase in interest earned is due to higher interest rates in 2006 versus 2005.

As an exploration company that charges exploration costs to operations until an economically recoverable resource has been identified, reported losses vary directly with the extent of the exploration programs conducted. As the Company obtains exploration results from existing resource properties (and those it acquires) that justify and enable further equity financing and continued exploration programs, reported losses will continue and will vary with the extent of exploration activity until such time as economically recoverable resources are identified that warrant development to generate sustainable revenues from operations. Conversely, should exploration results not justify further equity financing or should further equity financing not be available or insufficient to conduct planned exploration programs, exploration activity would be reduced with exploration funds directed toward projects with highest potential, resulting in lower reported losses. All of the Company's properties are currently in the exploration phase and accordingly, all exploration costs were charged to operations. There can be no assurance that the Company's properties will contain an economically recoverable resource.

1.05 Summary of Quarterly Results

Expressed in thousands of Canadian dollars except per share amounts

	Fiscal 2006	Fiscal 2005				Fiscal 2004		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
	Mar-06	Dec-05	Sep-05	Jun-05	Mar-05	Dec-05	Sep-05	Jun-05
Revenue	$44	$28	$54	$53	$35	$43	$67	$63
Loss	$677	$1,209	$1,573	$1,692	$507	$1,110	$2,417	$703
Basic and diluted loss per share	$0.02	$0.05	$0.06	$0.06	$0.02	$0.04	$0.11	$0.03
Total Assets	$10,345	$6,649	$7,924	$9,375	$9,806	$9,426	$11,022	$12,578

All financial data has been prepared in accordance with Canadian generally accepted accounting principles.

1.06 Liquidity and Capital Resources

The Company had working capital at March 31, 2006 of $7.3 million representing a decrease of $0.6 million from the March 31, 2005 working capital position of $7.9 million. The decrease is primarily due to expenditures related to the Company's 2005 exploration program and general and administrative costs in support of this program offset by just under $5 million of equity proceeds during the same period.

Current working capital is sufficient to fund the Company's remaining 2006 budgeted expenditures and meet its property and contractual commitments for the next 36 months provided however, upon approval of the Kaoclay acquisition by the Kaoclay shareholders, the Company will be required to finance Kaoclay's obligations under the Donkin Alliance Agreement (See Section 1.02). Otherwise, the timing for additional financing will be determined largely by market conditions and the results of the Company's ongoing exploration program.

During the three months ended March 31, 2006, $758,135 was expended on additions to resource property interests, compared with additions of $803,309 during the three months ended March 31, 2005. Of the $758,135 expended in the first quarter of 2006, $535,000 was a non cash payment made as part of the Gallant Agreement (500,000 common shares at $1.07 per share (see section 1.02)). Of the $803,309 expended in the first quarter of 2005, $796,830 was non cash payments made as part of the Gallant Agreement ($400,000 in common shares and the fair value of warrants at issue date, totalling $396,831). During the first quarter of 2006, $2,975 was expended on capital assets compared to $78,091 in 2005. The 2005 expenditures related primarily to purchase of computer, office and field equipment to support the Company's exploration program.

Other than as discussed herein, the Company is not aware of any trends, demands, commitments, events or uncertainties that may result in the Company's liquidity or capital resources either materially increasing or decreasing at present or in the foreseeable future. Material increases or decreases in the Company's liquidity and capital resources will be substantially determined by the success or failure of the Company's exploration programs on its resource properties and its ability to obtain sufficient equity financing.

1.07 Contractual Obligations

As of March 31, 2006 the Company is committed to the following obligations:

- The Company has entered into an operating lease for office space until August 31, 2011 representing total payments of $288,778 to the end of the lease. The Company has the right to terminate the lease by giving notice prior to the anniversary date, after 2007.
- Pursuant to the Gallant Agreement (see section 1.02), the Company is committed to the following deliverables:
    - On or before March 1, 2007, the Company shall deliver to Gallant 700,000 shares of Erdene and a payment of US$ 150,000.

1.08 Off-Balance Sheet Arrangements

As at March 31, 2006 the Company had no material off-balance sheet arrangements such as guarantee contracts, contingent interest in assets transferred to an entity, derivative instruments obligations or any obligations that trigger financing, liquidity, market or credit risk to the Company.

1.09 Transactions with Related Parties

See Note 5 to the unaudited interim consolidated financial statements at March 31, 2006.

1.10 Proposed Transactions

Proposed Acquisition of Kaoclay Resources Inc

On February 21, 2006 the Company announced it reached an agreement with Kaoclay Resources Inc. ("Kaoclay") whereby the Company will acquire all of the outstanding shares of Kaoclay in exchange for shares and warrants of the Company. Based in Halifax, Nova Scotia, Kaoclay has three advanced-stage projects including coal assets in Nova Scotia and kaolin clay and aggregate assets in Georgia and South Carolina, USA. Each project has an experienced partner that is responsible for all operations. With the kaolin project already in early commercial production, Kaoclay had annual revenue of $1 million and cash flow from operations of $483,000 in the fiscal year ended June 30, 2005.

Each Kaoclay share will be exchanged for 1.65 Erdene shares and a half warrant with each full warrant entitling the holder to purchase an Erdene share at $1.60 for a period of three years from closing giving an approximate purchase price consideration of $15.6 million for the transaction. All of the directors of Kaoclay who own or control shares have agreed to vote these shares in support of the transaction. Kaoclay will be entitled to name two nominees to the Board of Directors of the Company. The transaction must be approved by the shareholders of Kaoclay at a Special Meeting of Shareholders scheduled for May 25, 2006 and is subject to the receipt of all required regulatory and court approvals. If all required approvals are received, it is expected that closing will take place in early June, 2006.

In December 2004, the Nova Scotia Department of Natural Resources ("NSDNR") issued a "Call for Proposals for the Exploration/Development of the Donkin Coal Resource Block". The Donkin Coal Resource Block is the largest remaining undeveloped coal resource in the Sydney, Nova Scotia, coalfield.

The Donkin Alliance, in which Kaoclay has a 20% interest, was formed to submit a proposal to the NSDNR for the exploration and development of the Donkin Coal Resource Block. The alliance partners signed the Alliance Agreement effective March 11, 2005, and are presently negotiating the terms of a definitive joint venture agreement and sales agency agreement. Kaoclay owns a 20% interest in the Donkin Coal Alliance, Xstrata Coal Pty Ltd. owns 66% and the Atlantic Green Energy Development (USA) owns 14%.

Conditional on approval of the transaction by the Kaoclay shareholders, pursuant to the Alliance Agreement, Kaoclay agreed to fund up to Cdn$10 million in respect of expenditures incurred during the Pre-feasibility and Detailed Feasibility Phases of the Donkin Coal Project, provided such expenditures qualify as Canadian exploration expenses ("CEE") for purposes of the Income Tax Act (Canada). Upon closing, Erdene would immediately arrange the financing of Kaoclay’s CEE obligations under the Alliance Agreement. A preliminary estimate of the total budget for the Pre-feasibility and Detailed Feasibility Phases is approximately $15 million and it is expected to commence mid-2006 and take 18 to 24 months to complete.

Kaoclay is not required to fund any portion of the pre-production or development expenditures for the kaolin clay and aggregate projects. These projects will be fully funded by the respective partners with Kaoclay entitled to receive royalties from each of the commercial operations.

If the transaction closes, the dilutive effect of this transaction to the current shareholders of the Company would be as follows:

Erdene shares outstanding at March 31, 2006	31,868,210
Kaoclay shares	8,979,950
Exchange ratio	1.65
Equivalent Erdene shares to be issued to Kaoclay shareholders	14,816,918
Erdene post acquisition shares outstanding	46,685,128

1.11 Critical Accounting Estimates

Critical accounting estimates used in the preparation of the Company's consolidated financial statements include the Company's estimate of the recoverable value of its resource properties, the value attributed to stock-based compensation and future taxes. These estimates could be significantly affected by factors beyond the Company's control.

The acquisition cost of resource properties are recorded as an asset on the balance sheet under the caption resource property interests until such time as the related property(ies) commence commercial production at which time it will be depleted against related mine revenue from the property(ies) or when the Company determines the carrying value of a property cannot be recovered, in which case the carrying value will be written off or down to its recoverable value. Since the Company charges all exploration costs to operations when incurred, and ultimately to deficit, until potential for an economically recoverable resource has been identified, management feels confident that the recoverable value of its resource properties equals or exceeds its carrying value on the Company's balance sheet at March 31, 2006.

The $127,008 of stock-based compensation recognized in the first quarter of 2006 was calculated using the Black-Scholes model, a recognized option/warrant valuation formula, which is highly dependent on the expected volatility of the market price of the Company's common shares. The Company used an expected volatility rate of 80% in 2006 (80% in 2005). This is an estimate only based on using past share trading data to predict future volatility and actual volatility may be different from the estimate used in the valuation formula. Although the actual cost of stock-based compensation can vary materially from the estimated cost recorded in the Company's financial statements, it represents a non-cash expense and, as such, has no impact on the Company's financial position or liquidity.

1.12 Changes in Accounting Policies

The accounting policies applied in the preparation of the March 31, 2006 unaudited interim consolidated financial statements did not differ from those applied in the preparation of the December 31, 2005 audited financial statements. A detailed summary of the Company's accounting policies and any estimates derived therefrom is described in Note 1 of the March 31, 2006 unaudited interim consolidated financial statements.

1.13 Financial Instruments and Other Risks

The Company's financial instruments consist of cash, marketable securities, accounts receivable, prepaid expenses and accounts payable. Management does not believe these financial instruments expose the Company to any significant interest, currency or credit risks. The fair market value of these financial instruments approximates their carrying values, unless otherwise noted.

In conducting its business, the principal risks and uncertainties faced by the Company relate primarily to exploration results and, to a lesser extent, metal prices. Exploration for minerals and development of mining operations involve many risks, many of which are outside the Company's control. In addition to the normal and usual risks of exploration and mining, the Company works in remote locations that lack the benefit of infrastructure and easy access.

At this stage in the Company's development it relies on equity financing for its long-term working capital and capital requirements to fund its exploration and development programs. Future equity financing could be adversely or positively affected by many factors outside the Company's control such as market or commodity price changes, changes in the value of the Canadian dollar against the US dollar and/or the Mongolian Tugrik, general economic conditions, exploration results or political or economic changes in Mongolia. The Company does not have sufficient funds to put any of its properties into commercial production from its current financial resources. There is no assurance that such financing will be available to the Company when required, or that it will be available on acceptable terms.

1.14 Outstanding Share Data

See Note 6 to the March 31, 2006 unaudited interim consolidated financial statements for detail as to the change in the issued and outstanding common shares, warrants and options of the Company during the three months ended March 31, 2006.

Share Capital

During the three months ended March 31, 2006 the Company issued, pursuant to the Xstrata Agreement described in Section 1.02 of this report, 3,000,000 common shares at $1.00/share. On March 1, 2006 the Company issued 500,000 shares to Gallant Minerals Limited as part of the agreement signed on March 1, 2005 (see section 1.02).

Warrants

During the three months ended March 31, 2006, 1,008,575 warrants were exercised for total gross proceeds of $780,788 (828,575 warrants at $0.85 per share and 180,000 warrants at $0.425 per share) and 700 expired, bringing the outstanding warrants at the date of this report to 1,580,000.

Stock Options

During the three months ended March 31, 2006, 90,000 options were exercised to purchase 90,000 common shares of the Company at an average of $0.578 per share for proceeds of $52,000; and 180,000 options were granted to certain directors, employees and contractors, bringing the outstanding options at the date of this report to 2,420,000.

1.15 Exploration Results

Overview

At March 31, 2006 the Company had not yet started the field work on it's 2006 exploration season. Exploration costs incurred in the first quarter were predominantly for preparation and planning for the 2006 season. The following is a brief summary for each of the Company's exploration projects which are expected to incur work in 2006.

Zuun Mod Porphyry Molybdenum Project

The Zuun Mod property is a porphyry molybdenum prospect located in Bayankhongor Province approximately 950km southwest of Ulaanbaatar and 180km north of the Mongolia-China border. The property consists of two adjoining licenses totaling 90,344 hectares. The licenses are registered in the name of Anian Resources XXK and subject to the agreement with Gallant Minerals Limited (refer to section 1.02).

The Zuun Mod project has been under exploration and evaluation since 2002. Subsequent to signing the agreement with Gallant Minerals Limited in March 2005, the Company carried out extensive exploration that has resulted in the delineation of multiple targets with highly significant, relatively near surface molybdenum intersections. The type and styles of alteration and mineralization within the Company's Zuun Mod property are consistent with many characteristics documented from other porphyry-type deposits within Mongolia and also worldwide.

Erdene commissioned an independent technical review of the Zuun Mod Porphyry Molybdenum - Copper Project in south-central Mongolia in accordance with National Instrument 43-101. The report was completed in September of 2005. In conjunction with recommendation from the independent consultant, the Company carried out a six hole, 1,793 metre, drilling program to further delineate known molybdenum mineralization and to test regional exploration targets.

The most recent drill results further strengthen management's view that Zuun Mod hosts a potentially economic molybdenum resource. The increasing grades near surface in the southern portion of the Racetrack zone, significant thickness of mineralized zones and the large untested areas remaining, attest to the potential of the Zuun Mod project. Because of these factors and the project's close proximity to Chinese markets, processing capacity and infrastructure, the Company's management is very positive about the potential of the project.

Internal scoping studies will be undertaken in the spring of 2006 to determine the parameters of a pre-feasibility study.

Erdenet Ikh-Tal Porphyry Copper Project

The Erdenet Project is located in Orkhon and Bulgan aimags in northern Mongolia, approximately 250km northwest of Ulaanbaatar, the capital of Mongolia. The properties are connected to Ulaanbaatar by paved road and a rail line which is a spur of the Trans Mongolian railroad which runs through Mongolia between Russia and China. The Erdenet Ikh-Tal properties consist of five contiguous exploration licenses (Ikh Tal 1 to 5) covering 16,580 hectares which surround the Erdenet Mine open pit copper-molybdenum mining operation. The licenses are registered in the name of Anian Resources XXK and subject to the agreement with Gallant Minerals Limited (refer to section 1.02).

The project goal is to conduct exploration for extensions of porphyry-style copper/ molybdenum mineralization on the Company's exploration licenses that surround the Erdenet open pit copper/molybdenum mining operation. Erdenet is the second largest porphyry copper deposit in

Central Asia and one of the largest in the world, with published mining reserves in 2002 of 766.7 million tonnes grading 0.61% copper and 0.015% molybdenum.

Erdene began exploring for extensions of the copper/molybdenum mineralization on its Erdenet properties in May 2005 with reconnaissance mapping and sampling, magnetic and gradient IP surveys and diamond drilling. Recently completed IP surveys have identified two large, very intense geophysical anomalies east of the mine site (Baglai North and Baglai South) with coincident surface alteration and favourable geology. Management has selected and prioritized multiple diamond drills targets for testing starting in late spring 2006.

Tsenkher Gol Gold Project

The Tsenkher Gol property is located in Khentii Province 180km east of Ulaanbaatar and is accessible by a newly paved highway. The property consists of two contiguous licenses totalling 7,982 hectares. The licenses are registered in the name of Anian Resources XXK and subject to the agreement with Gallant Minerals Limited (refer to section 1.02).

Extensive surface work in 2005, including 1km of trenching and chip sampling outlined large gold bearing alteration zones in altered granite and cut by gold bearing quartz veins. Three auriferous target zones are evident: Altan Suult, SE Khond Uul, and NW Khond Uul. All three zones show evidence indicating strong structural control of gold mineralization. Tsenkher Gol is of similar style of mineralization to Centerra Gold’s Boroo deposit. The 2006 program will include additional geophysics, surface sampling as well as a drill program.

Energy Project - Uranium

Erdene holds 31 exploration licenses in south eastern Mongolia totaling 1,178,488 hectares. All of the licenses are registered in the name of Erdene Mongol or Erdene Energy, both of which are wholly owned by the Company. Nine of these licenses were acquired from Gallant Minerals Ltd and are subject to a 1% NSR Royalty, which can be reduced to 0.5% in certain circumstances by making certain payments (refer to section 1.02).

Pursuant to an agreement dated June 14, 2005, between the Company and International Uranium Corporation ("IUC"), IUC has the option to earn a 65% interest in the uranium minerals on the properties by spending a minimum of $6 million over a four-year period and by meeting other obligations. Under the terms of the agreement, the Company was the operator for the 2005 exploration program. All necessary funds for uranium exploration were covered by IUC as per the terms of the joint venture agreement.

IUC’s focus is on sandstone-hosted deposits that can be mined using the "In Situ Leach" ("ISL") method. Successful "In Situ Leach" ("ISL") pilot plant testing was completed by IUC on adjacent properties previously. The 2006 exploration program is being managed by IUC who are planning to drill test the uranium potential on the Erdene controlled licenses.

Energy Project – Coal

As part of the uranium exploration project, the Company identified an area prospective for coal exploration. The Galshar Coal property is located approximately 300 km southeast of Ulaanbaatar. The mineral exploration license (9383X) is referred to as Tsagaan Undur Tolgoi and consists of 3,808 hectares situated in Dornogobi Province. This property is part of the Company's large Galshar Property block which consists of 15 contiguous exploration licenses that total 359,067 hectares. The license is 100% owned by the Company and is registered in the name of the Erdene Mongol XXK.

Erdene's initial drilling of the Galshar coal project intersected a 49 metre coal seam in the central part of an area where previous drilling intersected coal seams over a three kilometer strike length that is open to the northeast. The Company's property covers most of this area and surrounds an open pit coal mine which supplies coal to local towns. The Company's initial hole (CDD-01) was collared approximately 300 metres northwest of the existing mine.

The company is awaiting results from further testing of samples from our Galshar coal project. The Galshar coal region shows good potential for development of a large volume thermal coal resource however quality needs to be further assessed. Further drilling and testing is planned for 2006 assuming positive feedback from the testing underway.

In addition to Galshar, the Company will be conducting a coal generative program in cooperation with Xstrata Coal with the highest priority evaluating numerous prospective metallurgical coal deposits in the southwest part of the country. These exploration efforts will be fully funded by Xstrata (refer to section 1.02 for further information about the Xstrata agreement).

Other Base and Precious Metals Properties:

Biger, Wild Mountain, Temuujin, Blue Springs, Baruun Kharat and Yargait will receive reconnaissance exploration this year to determine whether additional work, including drilling, is warranted.

1.16 Disclosure Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining the Company's disclosure controls and procedures (as defined in Multilateral Instrument 52- 109, Certification of Disclosure in Issuers' Annual and Interim Filings). The Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the design and operation of the Company's disclosure controls and procedures as of March 31, 2006, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its consolidated subsidiaries required to be disclosed in the Company's reports filed or submitted under the Multilateral Instrument would have been known to them.

1.17 Outlook

The Company continues to be optimistic about the potential demonstrated by its principal and early stage resource properties and by the opportunities for near term cash flow with the successful conclusion of the Kaoclay Resources Inc. acquisition (See Section 1.10). Success from the efforts of the Company's 2006 exploration program on any of its properties will result in an expanded program on the relevant property or properties relative to the significance of the results. Conversely, if anticipated results are not forthcoming on a particular property, a disciplined review and evaluation program will be in place to ensure expenditures are scaled back where management feels they may not be warranted.

1.18 Qualified Persons

J. Christopher Cowan, P.Eng., serves as the qualified person under National Instrument 43-101 and supervises all of the Company's exploration programs. All samples are assayed at SGS Laboratory in Ulaanbaatar, Mongolia or Perth Australia. In addition to internal checks by SGS Laboratory, the Company incorporates a QA/QC sample protocol utilizing prepared standards, sample splits and duplicates.

1.19 Other Information

Additional information regarding the Company is available on SEDAR at www.sedar.com and on the Company's website at www.erdene.com.

Interim Consolidated Financial Statements of

ERDENE GOLD INC.

First Quarter 2006

Three months ended March 31, 2006 and 2005
(unaudited)

Prepared by Management - See Notice to Reader

99 Wyse Road, Suite 1480
Dartmouth, Nova Scotia
Canada B3A 4S5
Tel 902.423.6419
Fax 902.423.6432

May 10, 2006

NOTICE TO READER

Under National Instrument 51-102, Part 4, subsection 4.3 (3) (a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice to this effect. These interim consolidated financial statements have been prepared by management of the Company. Management have compiled the unaudited interim consolidated balance sheet of Erdene Gold Inc. as at March 31, 2006, the audited consolidated balance sheet as at December 31, 2005 and the unaudited interim consolidated statements of operations and deficit and cash flows for the three months ended March 31, 2006 and 2005. The Company’s independent auditors have not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the March 31, 2006 and 2005 consolidated interim financial statements. Readers are cautioned that these statements may not be appropriate for their intended purposes.

ERDENE GOLD INC.

Interim Consolidated Balance Sheets

March 31, 2006 and December 31, 2005

	2006 (unaudited)	2005 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 7,236,883	$ 4,269,991
Marketable securities (market value, 2006 - $209,001; 2005 - $123,000)	83,333	50,666
Accounts receivable (note 2)	111,335	189,599
Prepaid expenses	14,417	12,862
	7,445,968	4,523,118
Resource property interests (note 3)	2,759,843	2,001,708
Capital assets, net (note 4)	118,329	123,780
Other assets	20,925	–
	$ 10,345,065	$ 6,648,606
Liabilities and Shareholders' Equity		
Liabilities:		
Accounts payable and accrued liabilities	$ 146,080	$ 253,474
Due to related parties (note 5)	10,925	24,902
	157,005	278,376
Shareholders' equity:		
Share capital (note 6)	21,946,907	17,372,074
Contributed surplus (note 7)	1,121,742	1,201,779
Deficit	(12,880,589)	(12,203,623)
	10,188,060	6,370,230
Commitments (note 12)		
	$ 10,345,065	$ 6,648,606

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

"David Carnell" Director

"Kenneth MacDonald" Director

ERDENE GOLD INC.

Interim Consolidated Statements of Operations and Deficit

Three months ended March 31, 2006, with comparative figures for the three months ended March 31, 2005
(unaudited)

	2006	2005
Expenses:		
Exploration expenses:		
Diamond drilling	$ 1,823	$ 2,258
Analytical and assaying	9,223	45,878
Geological services	308,041	131,388
Geo-technical surveys	–	9,108
Logistical and field support	58,544	105,060
Professional services	–	30,539
Travel	20,822	59,788
Other	60	1,208
Exploration partner contributions	(40,738)	–
	357,775	385,227
General and administrative expenses:		
Depreciation	7,426	9,311
Insurance	12,323	9,941
Investor relations and communications	63,555	46,022
Office	30,063	13,035
Professional services	53,616	22,753
Regulatory compliance	22,225	20,617
Administrative services	99,653	82,218
Stock-based compensation	52,920	–
Travel and accommodations	56,637	27,491
Other	3,158	528
	401,576	230,860
Other income (expenses):		
Interest revenue	43,877	35,206
Gain on sale of resource property	32,667	14,667
Foreign exchange	5,841	58,623
Other	–	203
	82,385	108,699
Loss for the period	676,966	507,388
Deficit, beginning of period	12,203,623	7,162,309
Share issue costs	–	–
Deficit, end of period	$ 12,880,589	$ 7,669,697
Basic and diluted loss per share (note 8)	$ 0.02	$ 0.02
Weighted average number of common shares outstanding	29,301,409	26,158,738

See accompanying notes to consolidated financial statements.

ERDENE GOLD INC.

Interim Consolidated Statements of Cash Flows

Three months ended March 31, 2006, with comparative figures for the three months ended March 31, 2005
(unaudited)

	2006	2005
Cash provided by (used in):		
Operations:		
Loss for the period	$ (676,966)	$ (507,388)
Items not involving cash:		
Depreciation	8,426	10,360
Stock-based compensation	127,008	–
Gain on sale of resource property	(32,667)	(14,667)
Change in non-cash operating working capital	(77,330)	(650,582)
	(651,529)	(1,162,277)
Financing:		
Issue of common shares for cash	3,000,000	–
Issue of common shares on exercise of options and warrants	832,789	28,241
	3,832,789	28,241
Investing:		
Proceeds on sale of resource property	32,667	14,667
Resource property interests	(223,135)	(6,479)
Purchase of capital assets	(2,975)	(78,091)
Other assets	(20,925)	–
	(214,368)	(69,903)
Increase (decrease) in cash and equivalents	2,966,892	(1,203,939)
Cash and equivalents, beginning of period	4,269,991	8,579,289
Cash and equivalents, end of period	$ 7,236,883	$ 7,375,350

See accompanying notes to consolidated financial statements.

Nature of business:

Erdene Gold Inc. (formerly 3779751 Canada Inc.) (the "Company") was incorporated by Articles of Incorporation dated June 27, 2000, pursuant to the provisions of the Canada Business Corporations Act. The principal business of the Company is the exploration and development of mineral deposits. The Company is principally focused on the discovery and acquisition of large tonnage, low cost, gold, copper, molybdenum, uranium and coal deposits in Mongolia. In addition, the Company is involved in a program of seeking out and acquiring small to mid-size mineral projects in Mongolia and elsewhere with near-term cash flow potential. To date the Company has not yet earned any operating revenues and is considered to be in the development stage.

On December 14, 2005, Erdene was granted a senior listing and began trading on the Toronto Stock Exchange (TSX - ERD). Shares were previously listed on the TSX Venture Exchange.

1. Summary of significant accounting policies:

(a) Principles of consolidation:

These consolidated financial statements are presented in Canadian dollars and include those accounts of the Company and its wholly-owned subsidiaries Erdene Gold International Inc. and Erdene International Exploration Inc. (incorporated under the laws of Barbados); and Erdene Mongol XXK and Erdene Energy XXK (incorporated under the laws of Mongolia). Inter-company accounts and transactions have been eliminated.

(b) Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the years. Significant estimates and assumptions relate to the recoverability of resource property interests and the calculation of stock-based compensation. While management believes that these estimates and assumptions are reasonable, actual results could differ.

(c) Cash and cash equivalents:

The Company considers deposits in banks and highly liquid investments with remaining maturities of three months or less at the date of acquisition as cash and cash equivalents.

(d) Marketable securities:

Marketable securities are carried at the lower of cost and quoted market value.

1. Summary of significant accounting policies (continued):

(e) Resource property interests:

All direct costs related to the acquisition of resource property interests are capitalized by property. Exploration costs are charged to operations in the period incurred until such time as it has been determined that a property has potential for an economically recoverable resource, in which case subsequent exploration costs and the costs incurred to develop a property will be capitalized. When a resource property is brought into commercial production, the capitalized costs of that property will be depleted over the estimated economic life of the property.

Gains or losses are recognized on property dispositions when the value of the consideration received exceeds or is less than, respectively, the carrying value of the property. Partial dispositions or option proceeds with respect to undeveloped properties are credited against the cost of the related property except that, when the proceeds exceed the costs, the excess is credited to operations. The aggregate costs related to abandoned properties are charged to operations.

The Company reviews the carrying values of its resource property interests on a regular basis by reference to the project economics, including the timing of the exploration and/or development work, the work programs and exploration results. When the carrying value of a property exceeds its estimated net recoverable amount, an impairment provision is made.

(f) Capital assets:

Capital assets are recorded at cost and are amortized over their estimated useful lives at the following annual rates and methods:

Asset	Basis	Rate
Equipment, furniture and fixtures	Declining balance	20%
Software and computers	Declining balance	33%

(g) Foreign currency translation:

Integrated subsidiaries are financially or operationally dependent on the parent company. The accounts of Erdene Gold International Inc., Erdene International Exploration Inc., Erdene Mongol XXK and Erdene Energy XXK, which are considered to be integrated operations, use the temporal method to translate its financial statements.

Under this method monetary items are translated at exchange rates in effect at the balance sheet date, non-monetary assets and liabilities are translated at historical exchange rates, and revenues and expenses are translated at average exchange rates for the period.

Realized and unrealized exchange gains and losses are included in earnings.

1. Summary of significant accounting policies (continued):

(h) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. A valuation allowance is provided when it is more likely than not that a future tax asset will not be recognized.

(i) Stock-based compensation:

The Company has a stock-based compensation plan, which is described in note 6. The Company accounts for all stock-based payments to non-employees and employee awards that are direct awards of stock using the fair value based method. Consideration paid by employees on the exercise of stock options is recorded as share capital.

Under the fair value based method, compensation cost attributable to awards to employees is measured at fair value at the grant date. Stock-based payments to non-employees are measured at the fair value of the consideration received, or the fair value of the equity instruments issued, or liabilities incurred, whichever is more reliably measurable at the grant date.

2. Accounts receivable:

	Mar 31, 2006	Dec 31, 2005
Exploration partner recovery	$ 40,738	$ 114,338
Other	70,597	75,261
	$ 111,335	$ 189,599

Other receivable includes an amount receivable of $45,000 (2005 - $45,000) from Peter Akerley, a director and officer, which is non-interest bearing and repayable on demand.

3. Resource property interests:

The Company's mineral exploration licenses in Mongolia are held by its subsidiaries Erdene Mongol XXK and Erdene Energy XXK. Mineral exploration licenses are valid for a period of three years and, through renewals, can be extended to a maximum of seven years. These rights are held in good standing through the payment of an annual license fee. Resource property interests are recorded at the cost of acquisition.

Xstrata agreement:

On February 16, 2006 the Company concluded an agreement with Xstrata Coal Canada Limited ("Xstrata Coal") a subsidiary of Xstrata plc (London Stock Exchange: XTA.L; Zurich Stock Exchange: XTA.S), pursuant to which Xstrata Coal subscribed for 3,000,000 common shares of Erdene at $1.00/share, resulting in Xstrata Coal owing a 9.8% equity interest in the Company, at the date of the transaction.

Under the agreement, Xstrata Coal was granted a first option to enter into a joint venture and earn a 75% interest in any coal opportunity in Mongolia identified by the Company by funding all work through completion of a feasibility study. Should the Company elect to develop or pursue third party participation in any non-coal projects or properties in Mongolia or elsewhere, Xstrata Coal has a 60-day right to review all supporting project information and, if it wishes to participate in the project, to negotiate the terms of its participation before the Company may make the opportunity available to another party or develop the property itself. Xstrata Coal has the right to name a nominee to the Board of Directors of the Company and on February 24, 2006 named Jeffrey Gerard as their nominee to the Company's Board. The rights granted to Xstrata Coal under the agreement expire if Xstrata Coal does not maintain a 5% equity position in the Company although parties' rights and obligations for any established joint venture survive.

Under the agreement, Xstrata is entitled to participate in all future financings of the Company to allow Xstrata Coal to hold up to 9.9% of the common shares of the Company.

Agreement with International Uranium Corporation

On June 14, 2005, pursuant to an April 4th Memorandum of Understanding with International Uranium Corporation ("IUC"), the Company granted International Uranium Mongolia Ltd. ("IUM") the exclusive right and option to acquire a 65 per cent interest in its uranium properties. IUM must spend $6,000,000 of eligible expenditures on the properties over a period of up to four years. The Company and IUM have also formed a strategic alliance for the purpose of staking additional ground in Mongolia for the exploration of uranium over a three year period. In addition, IUC purchased 1.0 million common shares of Erdene at a price of $1.00 per share by way of a private placement. A finder's fee totaling $60,000 was paid in connection with this transaction.

3. Resource property interests (continued):

Gallant option agreement:

On March 1, 2005 the Company entered into an agreement with Gallant Minerals Limited ("Gallant") to acquire certain uranium property licenses and license applications in Mongolia, obtain possession and control of certain assets and geological data pertaining to Mongolia and an exclusive and irrevocable option to acquire all of the issued and outstanding shares of Gallant's wholly-owned subsidiary, Tamerlane International Limited ("Tamerlane") which controls 100% ownership of mineral properties in Mongolia through it's wholly owned subsidiary Anian Resources XXK. On signing, the Company released to Gallant US $75,000, 400,000 common shares of the Company and 800,000 warrants with each warrant entitling Gallant to purchase one common share of the Company for prices ranging from $0.60 to $1.00 for a period of 24 months from the date of issue. The consideration provided to Gallant has been recorded by the Company as resource property interests and to March 31, 2006, has an ascribed value of $1,655,389. This includes the estimated fair value of the warrants issued on the date granted of $396,830. The Company also advanced $259,081 to Anian Resources XXK in order to maintain certain mineral licenses which form part of the agreement mentioned above.

The Company has recorded these advances as resource property interests. At March 31, 2006, the option consideration and advances to Anian Resources XXK paid have not yet been allocated to specific properties.

Under the option terms, the Company also committed to the following payments, expenditures and deliverables at set dates on or before February 28, 2007 in exchange for 100% ownership of Tamerlane:

i. US $275,000;

ii. Direct or indirect expenditures on properties aggregating US $1,000,000; and

iii. 1,200,000 common shares of the Company.

Gallant is entitled to a net smelter return royalty on certain properties ranging from 1% to 1.5%, subject to a buy-down provision.

The Company can terminate the agreement or accelerate payment at any time. Should the Company not meet its commitments, the agreement can be terminated by Gallant upon notice, where upon the Company shall return possession and control of certain assets and cancel the option. If the agreement is terminated prior to the Company complying with all of its commitments thereunder, the accumulated value will be written off as an expense at that time. The Company has met its obligation to incur $1,000,000 US of expenditures on the optioned properties. On March 1, 2006, $125,000 US was paid and 500,000 shares issued, as part of the above deliverables, consistent with the option terms.

4. Capital assets:

			March 31 2006	December 31 2005
	Cost	Accumulated depreciation	Net book value	Net book value
Equipment, furniture and fixtures	$ 79,790	$ 24,568	$ 55,222	$ 59,148
Software and computer	96,907	33,800	63,107	64,632
	$ 176,697	$ 58,368	$ 118,329	$ 123,780

5. Related parties and due to related parties:

The amounts due to related parties are payable to directors or companies related with directors or officers of the Company. These amounts are non-interest bearing and are repayable on demand as follows:

	March 31 2006	December 31 2005
Fisher Transport Limited	$ 10,925	$ 16,013
J.C. Cowan	–	8,889
	$ 10,925	$ 24,902

6. Share capital:

Authorized and issued:

	Three months ended March 31, 2006	
	Number of shares	$
Authorized:		
Unlimited number of common shares without par value		
Issued:		
Balance, December 31, 2005	27,269,635	$ 17,372,074
Issued for cash	3,000,000	3,000,000
Issued pursuant to option agreement	500,000	535,000
Issued on exercise of options and warrants	1,098,575	1,039,833
Total	31,868,210	$ 21,946,907

6. Share capital (continued):

Warrants:

The following table summarizes the continuity of the warrants for March 31, 2006:

	March 31, 2006	
	Number of Warrants	Weighted average exercise price
Balance, December 31, 2005	2,589,275	$ 0.700
Exercised	(1,008,575)	0.774
Expired	(700)	0.85
Closing balance	1,580,000	$0.650

The following is a summary of the warrants outstanding as of March 31, 2006:

Exercise Price	Expiry Date	Number of Warrants
$ 0.870	March 1, 2007	800,000
0.425	January 23, 2008	780,000
$ 0.650		1,580,000

Stock Options

The Company has a rolling 10% incentive stock option plan (“the Plan”) under which options to purchase common shares of the Company may be granted to directors, officers, employees and consultants of the Company. The number of common shares subject to options granted under the Plan is limited to 10% of the issued and outstanding common shares of the Company and no one person may receive in excess of 5% of the outstanding common shares of the Company at the time of grant (on a non-diluted basis).

6. Share capital (continued):

Stock Options (continued):

The following table summarizes the continuity of the stock options for March 31, 2006.

	March 31, 2006	
	Number of options	Weighted average exercise price
Balance, December 31, 2005	2,330,000	$ 0.690
Granted	180,000	1.050
Exercised	(90,000)	0.578
Closing balance	2,420,000	$0.723

The following is a summary of the options outstanding and exercisable as of March 31, 2006:

Exercise price	Expiry date	Number of options
$0.85	July 19, 2006	40,000
$0.425	May 8, 2008	400,000
$0.425	November 18, 2008	330,000
$0.85	March 31, 2009	100,000
$0.85	April 6, 2009	760,000
$0.85	August 26, 2009	100,000
$0.70	February 4, 2010	160,000
$0.77	May 1, 2010	90,000
$0.74	July 1, 2010	10,000
$0.85	August 5, 2010	250,000
$1.05	March 31, 2011	180,000
$0.723		2,420,000

6. Share capital (continued):

Stock Based Compensation:

The company estimates the fair value of stock based incentives at the date of grant using the Black-Scholes model, recognized over the vesting period with the following assumptions:

	2006	2005
Dividend yield	0%	0%
Risk-free interest rate	5.0%	4.0%
Expected volatility	80%	80%
Expected life	5 years	5 years

The estimated fair value of the 180,000 options granted during the reporting period under the Black-Scholes model was $127,008 and is presented in these financial statements as follows:

Exploration expenses	$ 74,088
General and administrative	$ 52,920

7. Contributed surplus:

The following summarizes amounts recorded as contributed surplus during the year:

	March 31 2006	December 31 2005
Opening balance	$ 1,201,779	$ 513,095
Warrants relating to resource property option agreement	–	396,831
Warrants/options exercised	(207,045)	(5,748)
Options expensed	127,008	297,601
	$ 1,121,742	$ 1,201,779

8. Basic and diluted loss per share:

As the Company incurred losses in the periods reported, the effect of outstanding warrants and options have been excluded from the computation of loss per share as their impact would be anti-dilutive, reducing loss per share.

9. Financial instruments:

(a) Fair values:

The fair values of the Company's financial assets and liabilities included in current assets and liabilities approximate their carrying values at each period-end.

(b) Credit risks:

The Company places its cash and cash equivalents with high-quality financial institutions and public companies and believes that no significant concentration of credit risk exists with respect to cash and cash equivalents.

10. Foreign currency risks:

The Company operates in Mongolia, giving rise to foreign exchange risk in the Mongolian togrog. To limit the Company's exposure to this risk, cash and cash equivalents are primarily held in Canadian and U.S. dollar bank accounts.

11. Segmented information:

(a) General information:

The Company operates in one industry, that being the exploration and development of resource properties for minerals with no reportable business segments. The Company has yet to earn revenue from operations.

(b) Geographic information:

The Company's head office is located in Nova Scotia, Canada with resource properties and exploration activities predominantly in Mongolia.

12. Commitments:

The Company has entered into an operating lease for office premises until August 31, 2011 representing total payments of $288,778 to the end of the lease. The Company has the right to terminate the lease by giving notice prior to the anniversary date, after 2007. Annual payments are as follows:

2006	$ 55,491
2007	56,601
2008	57,733
2009	58,888
2010	60,065
	$ 288,778

13. Proposed acquisition:

On February 21, 2006 the Company announced it reached an agreement with Kaoclay Resources Inc. ("Kaoclay") whereby the Company will acquire all of the outstanding shares of Kaoclay in exchange for shares and warrants of the Company. Based in Halifax, Nova Scotia, Kaoclay has three advanced-stage projects including coal assets in Nova Scotia and kaolin clay and aggregate assets in Georgia and South Carolina, USA. Each project has an experienced partner that is responsible for all operations. With the kaolin project already in early commercial production, Kaoclay had annual revenue of $1 million and cash flow from operations of $483,000 in the fiscal year ended June 30, 2005.

Each Kaoclay share will be exchanged for 1.65 Erdene shares and a half warrant with each full warrant entitling the holder to purchase an Erdene share at $1.60 for a period of three years from closing giving an approximate purchase price consideration of $15.6 million for the transaction. All of the directors of Kaoclay who own or control shares have agreed to vote these shares in support of the transaction. Kaoclay will be entitled to name two nominees to the Board of Directors of the Company. The transaction must be approved by the shareholders of Kaoclay at a Special Meeting of Shareholders scheduled for May 25, 2006 and is subject to the receipt of all required regulatory and court approvals. If all required approvals are received, it is expected that closing will take place in early June, 2006.

In December 2004, the Nova Scotia Department of Natural Resources ("NSDNR") issued a "Call for Proposals for the Exploration/Development of the Donkin Coal Resource Block". The Donkin Coal Resource Block is the largest remaining undeveloped coal resource in the Sydney, Nova Scotia, coalfield.

The Donkin Alliance, in which Kaoclay has a 20% interest, was formed to submit a proposal to the NSDNR for the exploration and development of the Donkin Coal Resource Block. The alliance partners signed the Alliance Agreement effective March 11, 2005, and are presently negotiating the terms of a definitive joint venture agreement and sales agency agreement. Kaoclay owns a 20% interest in the Donkin Coal Alliance, Xstrata Coal Pty Ltd. owns 66% and the Atlantic Green Energy Development (USA) owns 14%.

Conditional on approval of the transaction by the Kaoclay shareholders, pursuant to the Alliance Agreement, Kaoclay agreed to fund up to Cdn$10 million in respect of expenditures incurred during the Pre-feasibility and Detailed Feasibility Phases of the Donkin Coal Project, provided such expenditures qualify as Canadian exploration expenses ("CEE") for purposes of the Income Tax Act (Canada). Upon closing, Erdene would immediately arrange the financing of Kaoclay's CEE obligations under the Alliance Agreement. A preliminary estimate of the total budget for the Pre-feasibility and Detailed Feasibility Phases is approximately $15 million and it is expected to commence mid-2006 and take 18 to 24 months to complete.

13. Proposed acquisition (continued):

Kaoclay is not required to fund any portion of the pre-production or development expenditures for the kaolin clay or aggregate projects. These projects will be fully funded by the respective partners with Kaoclay entitled to receive royalties from each of the commercial operations.

If the transaction closes, the dilutive effect of this transaction to the current shareholders of the Company would be as follows:

Erdene shares outstanding at March 31, 2006	31,868,210
Kaoclay shares	8,979,950
Exchange ratio	1.65
Equivalent Erdene shares to be issued to Kaoclay shareholders	14,816,917
Erdene post acquisition shares outstanding	46,685,127

14. Comparative figures:

Certain comparative financial data for 2005 has been reclassified to conform to the presentation adopted in the 2006 financial statements.