



ERDENE GOLD INC.

Management Discussion and Analysis Second Quarter - June 30, 2006

This interim Management Discussion and Analysis of Erdene Gold Inc. (the "Company") provides analysis of the Company's financial results for the three and six months ended June 30, 2006 and its financial position as at June 30, 2006. The following discussion and analysis provides a summary of selected consolidated financial information for the three and six month period ended June 30, 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 incorporated under the laws of Barbados, Erdene Resources Inc. and its wholly owned subsidiary 6301954 Canada Inc., both incorporated under the laws of Canada, Sparta Kaolin Corporation, incorporated under the laws of Delaware 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 and six months ended June 30, 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 August 11, 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.

1.01 Date of report

This report is prepared as of August 11, 2006

1.02 Nature of Business and Overall Performance

General

Prior to the second quarter of 2006, the Company was a resource exploration company listed on the TSX Exchange with no operating cash flow. Effective June 12, 2006, the Company completed the acquisition of Kaoclay Resources Inc. ("Kaoclay") which, through the other companies acquired in the process, 6531954 Canada Inc. and Sparta Kaolin Corporation, owns three advanced-stage projects including coal

assets in Nova Scotia and aggregate and kaolin clay assets in Georgia, U.S.A. With the Georgia kaolin project already in 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. Cash flow is expected to increase over the next five years conditional on the Georgia aggregate project commencing production, anticipated in 2007, and culminating with the potential production from the Donkin coal exploration and development project in Cape Breton, Nova Scotia. Until a decision is made to proceed with commercial development of the aggregate and coal projects and to expand the scope of the kaolin operations and resultant cash flows increase substantially over current, the annual level of exploration expenditures of the Company is dependent primarily on the sale of share capital to finance its exploration programs. Prior to the acquisition of Kaoclay June 12, 2006, the Company had no sources of revenue other than interest earned on cash and short-term money market instruments derived from issuances of share capital. Post acquisition the Company also generates royalty income from its kaolin and aggregate properties which are early stage. Therefore, it is difficult to identify any meaningful trends or develop an analysis from the Company's cash flows.

The Company is well-funded with its focus is on the discovery of large tonnage, low cost, gold, copper, uranium, molybdenum and coal deposits and the development of its coal and industrial mineral interests in North America with near term cash flow potential. At June 30, 2006 the Company held 65 mineral licenses in Mongolia representing 16 projects covering approximately 3.5 million acres.

The following summarizes the Company's significant strategic alliances and agreements:

Acquisition of Kaoclay Resources Inc.

Effective June 12, 2006 the Company concluded by way of plan of arrangement the acquisition of Kaoclay Resources Inc. ("Kaoclay") (incorporated under the laws of Canada) and its wholly owned subsidiaries, Sparta Kaolin Corporation ("Sparta")(incorporated under the laws of Delaware) and 6531954 Canada Inc. (incorporated under the laws of Canada), Based in Halifax, Nova Scotia, Kaoclay, through its subsidiaries, controlled three advanced-stage projects including an interest in 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. Under the plan of arrangement the Company issued 1.65 common shares and a half warrant for each Kaoclay share (14,816,917 shares and 4,489,975 warrants for the 8,979,850 Kaoclay shares outstanding). Each warrant entitles the holder to purchase one common share of the Company for \$1.60 per share until June 15, 2009. The purchase price has been determined to be \$18,346,143, including acquisition costs of \$63,415.

The acquisition has been accounted for by the purchase method with the fair value of the consideration paid being allocated to the fair value of the identifiable assets acquired and liabilities assumed on the closing date set out below:

Cash and cash equivalents	\$	387,548
Other working capital, net		(416,361)
Capital assets		1,438,070
Resource property interests		13,038,000
Deferred revenue		(3,026,999)
Goodwill		7,796,080
Other intangibles		2,807,000
Future income tax liability		<u>(3,677,194)</u>
	\$	<u>18,346,144</u>

The fair value of the consideration paid under the plan of arrangement was:

Common shares	\$	16,537,998
Warrants		1,744,731
Transaction costs		<u>63,415</u>
	\$	<u>18,346,144</u>

In the process of completing the Arrangement, the Company first acquired the shares of Sparta and then amalgamated Kaoclay with Erdene Resources Inc. resulting in both Sparta and Erdene Resources Inc. becoming wholly owned subsidiaries of the Company. Hereafter, all references to Kaoclay applies equally to Erdene Resources Inc.

The Donkin Alliance was formed by or on behalf of Xstrata Coal Pty Limited (66%), Kaoclay Resources Inc. ("Kaoclay") (20%), American Transbridge Technologies LLC (9.3%) and PDC Resources Corporation (4.67%) to submit a proposal to the Province of Nova Scotia to secure the exclusive right to the Donkin Coal Project; namely, the project to explore, assess, study and, if feasible, develop the Donkin Coal Resource Block into an operating coal mine. Effective June 12, 2006, Kaoclay amalgamated with Erdene Resources Inc., a wholly-owned subsidiary of Erdene, under a court approved Plan of Arrangement and Kaoclay is now a wholly-owned subsidiary of Erdene which will operate under the name of Erdene Resources Inc (see note 5).

The members of the Donkin Alliance signed an agreement ("Alliance Agreement") effective March 11, 2005, and an amending agreement dated April 23, 2006. They are presently negotiating the terms of a definitive joint venture agreement and sales agency agreement. Pursuant to the April 23, 2006 amending agreement, Erdene's interest in the Donkin Alliance is held by 6531954 Canada Inc., a wholly owned subsidiary of Erdene Resources Inc., and Xstrata Coal Pty Limited's interest is held by Xstrata Coal Donkin Limited, a related party to Xstrata Coal Pty Limited. Xstrata Coal Donkin Management Limited, a related party to Xstrata Coal Donkin Ltd, is acting as manager for the Donkin Coal Project. If the Donkin Coal Project is approved to proceed to development, the manager will be responsible for mine development, including infrastructure, coal mining and processing, and coal distribution and sales programs.

On December 14, 2005, the NSDNR announced that the Donkin Alliance was the successful proponent in the call for proposals. On December 16, 2005, an application was submitted to the NSDNR on behalf of the Donkin Alliance for a special exploration license and a supporting work proposal and budget was

submitted on February 20, 2006. The special exploration license was issued by the Province of Nova Scotia in May 2006. In June 2006, Xstrata Coal Donkin Management Limited acquired the surface lands relating to the Donkin Coal Resource Block from the Cape Breton Development Corporation ("CBDC"). The Donkin Alliance began its exploration program and evaluation and scoping study ("Exploration Program") in June 2006.

Pursuant to the Alliance Agreement, the Company is committed to fund up to \$10,000,000 ("Initial Funding") of the expenditures incurred during the Exploration Program of the Donkin Coal Project provided such expenses qualify as CEE. Xstrata Coal Donkin Limited agreed to pay any other costs up to a maximum of \$5,000,000 but if the Company only pays a portion of the Initial Funding, Xstrata Coal Donkin Limited is only obliged to pay a corresponding portion of the \$5,000,000. The Company is responsible to fund 20% of any additional expenditures incurred in the Exploration Program if it is to maintain its 20% interest in the Donkin Coal Project. The remaining members of the Donkin Alliance are not required to fund any portion of the expenditures unless a development decision is made. A preliminary estimate of the total budget for the Exploration Program is approximately \$17,200,000 and it is expected to take 24 months to complete. The Company estimates that it will be required to expend \$3 to \$5 million in 2006 in connection with the Donkin Coal Project and, in July 2006, completed a \$6.0 million flow-through financing to fund its obligation.

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.

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.

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 approximately \$6 million at June 30, 2006.

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 June 30, 2006 and 2005

Until the acquisition of Kaoclay Resources Inc. on June 12, 2006, as a mineral exploration company, the majority of the Company's revenue was derived from interest income earned on cash balances. All direct costs related to the acquisition of resource property interests have been capitalized. Exploration expenses are charged to operations in the period incurred until such time as it has been determined that a property has potential for economically recoverable reserves, at which point subsequent exploration costs and the costs incurred to develop a property will be capitalized.

The Company had a loss of \$1,185,664 or \$0.04 per share for the three months ended June 30, 2006 as compared to a loss of \$1,691,542 or \$0.06 per share during the same period last year. Revenues increased to \$110,050 during the three months ended June 30, 2006 from \$52,329 in the same period in 2005, which was due to lab and royalty revenue earned post acquisition of Kaoclay Resources Inc on June 12, 2006 and higher interest earned on higher average cash balances during the period.

Total operating expenses for the second quarter decreased to \$1,171,668 from \$1,763,090 in the same period in 2005. Exploration expenses were \$635,292 for the three months ended June 30, 2006 compared to \$1,358,586 in 2005. The exploration budget for 2006 is just under \$3 million compared with just under \$4 million in 2005. The decrease in the second quarter of 2006 of \$723,294 is due largely to a \$480,791 reduction in diamond drilling as the 2006 drill program started much later in the quarter whereas in 2005 an extensive diamond drill program began at the Zuun Mod property in April. There were corresponding reductions in 2006 in geo-technical surveys, geological services and logistical and field support costs offset by reduced exploration partner recoveries that totaled \$259,430 representing \$740,221 of the reduction associated with the reduced program.

General and administrative expenses for the second quarter 2006 were \$536,376 compared to \$404,504 for the same period in 2005. The increase in the 2006 quarter is due in large part to professional fees associated with concluding the Alliance Agreement with Xstrata Coal, the acquisition of Kaoclay

Resources Inc., regulatory costs associated with the listing on the TSX of the warrants issued to Kaoclay shareholders and increased salaries offset by a reduction in stock based compensation of \$61,268.

Other income (expenses) amounted to \$(124,046) for the second quarter of 2006 compared with \$19,219 for the same period in 2005. The primary reason for the \$143,265 decrease from 2005 was a result of a write-down of resource properties during the quarter of \$90,898 with no write-down in the corresponding period in 2005 and a swing in foreign exchange loss of \$52,213 between the second quarter 2005 and 2006.

Six months ended June 30, 2006 and 2005

During the six months ended June 30, 2006 the Company incurred a loss of \$1,862,630 or \$0.06 per share as compared to a loss of \$2,198,930 or \$0.08 per share in the corresponding period in 2005. Revenues increased to \$153,927 during the six months ended June 30, 2006 from \$87,535 in 2005 which was due to lab and royalty revenue earned post acquisition of Kaoclay Resources Inc on June 12, 2006 and higher interest earned on higher average cash balances during the period.

Total operating expenses for the six months ended June 30, 2006 decreased to \$1,931,019 from \$2,379,177 in the same period in 2005. Exploration expenses were \$993,067 in the six months ended June 30, 2006 compared with \$1,743,813 in the same period in 2005. The decrease in 2005 is due to a reduced planned exploration program in 2006 largely a result of exploration partners, Xstrata Coal and International Uranium Corporation, funding the exploration costs on the Company's coal and uranium properties pursuant to alliance agreements. Accordingly, there was a major reduction in diamond drilling expenditures in 2006 and associated reductions in 2006 in geo-technical surveys, geological services and logistical and field support costs offset by reduced exploration partner recoveries. General and administrative expenses for the first half of 2006 were \$937,952 compared to \$635,364 for the same period in 2005. The increase is due to professional fees associated with concluding the Alliance Agreement with Xstrata Coal, the acquisition of Kaoclay Resources Inc., regulatory costs associated with the listing on the TSX of the warrants issued to Kaoclay shareholders, increased investor relations costs and associated travel and increased salaries, all in support of the expanded Company.

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 outside of the United States 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	
	Q2 Jun-06	Q1 Mar-06	Q4 Dec-05	Q3 Sep-05	Q2 Jun-05	Q1 Mar-05	Q4 Dec-05	Q3 Sep-05
Revenue	\$110	\$44	\$28	\$54	\$53	\$35	\$43	\$67
Loss	\$1,185	\$677	\$1,209	\$1,573	\$1,692	\$507	\$1,110	\$2,417
Basic and diluted loss per share	\$0.04	\$0.02	\$0.05	\$0.06	\$0.06	\$0.02	\$0.04	\$0.11
Total Assets	\$34,944	\$10,345	\$6,649	\$7,924	\$9,375	\$9,806	\$9,426	\$11,022

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

1.06 Liquidity and Capital Resources

The Company had working capital at June 30, 2006 of \$6.0 million as compared to \$4.2 million at December 31, 2005. The increase in working capital is mainly due the issue of 3,000,000 shares at \$1.00 to Xstrata Coal Canada Inc. on conclusion of the Alliance Agreement with Xstrata Coal (section 1.02) plus proceeds of \$849,789 from the exercise of warrants and options during the first six months of the year. This was partially offset by operating expenses in support of the 2006 exploration season. Current working capital is sufficient to fund the Company's remaining 2006 budgeted expenditures and meet its property and contractual commitments for the next 24 months.

Subsequent to quarter end and pursuant to the Donkin Coal Alliance agreement, on July 14, 2006, the Company completed a \$6,000,000 flow-through share financing at \$1.00 per share. These monies will be used to fund Kaoclay's CEE obligation under the agreement which will not exceed Cdn\$10 million. The need and timing for additional financing will be determined largely by the results of the Company's ongoing exploration program and market conditions.

Effective June 12, 2006 the Company concluded by way of plan of arrangement the acquisition of Kaoclay Resources Inc. ("Kaoclay"). Under the plan of arrangement the Company issued 1.65 common shares and a half warrant (14,816,917 shares and 4,489,975 warrants) for the 8,979,850 Kaoclay shares outstanding. Each warrant entitles the holder to purchase one common share of the Company for \$1.60 per share until June 11, 2009. The purchase price has been determined to be \$18,346,144, including acquisition costs of \$63,415.

The purchase has been accounted for by the purchase method with the fair value of the consideration paid being allocated to the fair value of the identifiable assets acquired and liabilities assumed on the closing date as set out below.

Assets and liabilities acquired:	
Cash and cash equivalents	\$ 387,548
Other working capital, net	(416,361)
Capital assets	1,438,070
Resource property interests	13,038,000
Deferred revenue	(3,026,999)
Goodwill	7,796,080
Other intangibles	2,807,000
Future income tax liability	(3,677,194)
	<u>\$ 18,346,144</u>

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 June 30, 2006 the Company is committed to the following obligations:

- The Company has an operating lease for office space until August 31, 2011. The Company has the right to terminate the lease by giving notice prior to the anniversary date, after 2007.
- The Company also assumed the lease of Kaoclay (which expires February 2007) upon closing of the Plan of Arrangement.
- Total rental commitments to the end of these leases are \$309,678.
- Pursuant to the Gallant Agreement (see section 1.02), in order to maintain it's option, 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 June 30, 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 (other than options and warrants) or any obligations that trigger financing, liquidity, market or credit risk to the Company.

1.09 Transactions with Related Parties

See Note 6 to the unaudited interim consolidated financial statements at June 30, 2006.

1.10 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 June 30, 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 June 30, 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 June 30, 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. 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 7 to the June 30, 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 six months ended June 30, 2006.

Share Capital

During the six months ended June 30, 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). On June 12, 2006 the Company issued 14,816,917 shares to the shareholders of Kaoclay pursuant to the Plan of Arrangement mentioned in section 1.02 and 1.06.

Warrants

During the six months ended June 30, 2006, 4,489,975 warrants were issued to Kaoclay shareholders pursuant to the Plan of Arrangement (section 1.02); 1,008,575 warrants were exercised during the same period 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 6,069,975.

Stock Options

During the six months ended June 30, 2006, 110,000 options were exercised to purchase 110,000 common shares of the Company at an average of \$0.627 per share for proceeds of \$69,000; and 180,000 options were granted to certain directors, employees and contractors, bringing the outstanding options at the date of this report to 2,400,000.

1.15 Exploration Results

Overview

At June 30, 2006 the Company had significant exploration activity underway in Mongolia including drill programs for uranium, gold and copper in addition to an extensive, country-wide coal evaluation program with its partner Xstrata Coal. In addition, a number of activities were underway on each of its North American projects through the respective partners. The following is a current overview for each of the Company's exploration projects which are expected to incur work expenditures during 2006.

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 Corporation ("EMC") open pit copper-molybdenum mining operation. The licenses are registered in the name of Anian Resources XXK and are 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.

During the 2nd quarter the Company's exploration team completed the dipole-dipole survey begun in late 2005 in the Baglai area east of the EMC mine site. A total of 21.4 line-kilometres of surveying was completed on 200m spaced lines. This program resulted in the identification of three priority geophysical targets east of the EMC Mine with coincident surface alteration and favourable geology.

- **North Baglai:** Strong silicified and sericitized granites, syenites and porphyry, with finely disseminated sulfides (pyrite-chalcopyrite-limonite-magnetite), are exposed at surface in the North Baglai area, approximately 200m east of EMC's property boundary. The dipole chargeability anomaly in the vicinity of this exposure is 15 to 19mv/V increasing to 40 to 50mv/V 400m to the east, between 200m and 400m depths. The dipole anomaly extends 800m east of the Erdenet boundary, is 800m wide and is coincident with a gradient geophysical anomaly and surface alteration.
- **South-Central Baglai:** A broad dipole chargeability anomaly was outlined extending under cover for 1,100m east of the EMC boundary and 2.5km southeast of the Erdenet pit. This anomaly is split into two strong lobes, 300m and 400 m wide coincident with surface alteration and are open to the east. These anomalies range from 10 to 28 mv/V and extend from 50m to greater than 350m depths. The northern lobe is characterized by coincident high resistivity and a magnetic low. The southern lobe is located in a hydro thermally altered zone identified by EMC in the early

1980's and which had been tested by a series of shallow holes several of which returned copper values up to 0.37%.

- **Interjacent:** A dipole chargeability anomaly coincident with a resistivity high and a silicified and malachite bearing alteration zone was outlined in a 200m wide corridor held by Erdene 3km south of the Erdenet pit. The 300m wide anomaly is 10mv/V and extends from 150m to greater than 400m depth.

In addition to the eastern targets, mapping and sampling on the Erdene property immediately adjacent to the EMC property boundary, 200m northwest of the open pit, have outlined several zones with favourable alteration and mineralization. Historical drilling on the EMC property, adjacent to this boundary, has intersected several highly anomalous zones of copper mineralization over widths up to 75m.

A program of eight holes totaling 1,600m of diamond drilling to test these anomalies started in mid-June and is continuing. Results will be reported on completion of the program and receipt of final analytical results.

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 totaling 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 containing up to 13.9g/t gold. Three auriferous target zones have been identified: Altan Suult, SE Khond Uul, and NW Khond Uul. All three zones show evidence indicating strong structural control of gold mineralization. The 2006 exploration program commenced in April and following additional mapping, an expanded soil geochemical survey and additional geophysical surveys (magnetic and IP) a series of eight drill holes were outlined to test coincident geochemical and geophysical anomalies. Results from the 2006 programs are described below:

Geologic mapping and rock chip sampling have been completed across the property indicating that additional gold bearing quartz veins, containing gold concentrations up to 214 ppb occur outward towards the license boundaries. Additionally, 13 chip samples of fault material from trench T9 (2005 trench) were collected to determine possible structural controls on mineralization. The sampled structures included both steep and shallow dipping faults that are typically comprised of coarse grained to pebble sized, granitoid wall rock supported in quartz-clay gouge, with and without limonite. The concentration of gold in all fault samples ranges from 23 to 1260 ppb (average of 369ppb). Highly anomalous gold occurs within both the steep and shallow dipping faults with local increases in gold concentration along fault margins where sub-parallel quartz veins were commonly identified. Northwest and sub-east-west striking fault and shear zones remain as key gold target zones across the property.

A total of 1381 soil samples were collected resulting in almost complete soil coverage over the properties. The gold in soil concentration in the Altan Suult zone is highly anomalous, containing up to

2,030 ppb gold, and infill sampling there indicates that gold mineralization is controlled along NW trending structures. Furthermore, anomalous soil gold concentrations in the SE part of property indicates the possible SE extension of the NW-trending Khond Uul mineralized zone. The zone may now be traced geochemically for over 7km. Additionally, gold-arsenic anomalies located in the NE part of the property indicate the possibility of another NW trending zone of structurally controlled mineralization having greater than 1 kilometer of strike length, and located over 3km NE of the Khond Uul Zone.

A 173 line-kilometer ground magnetometer survey was also completed during the quarter, and the overall magnetic survey now covers most of the property area. The broad irregular magnetic high anomaly identified over the NW Khond Uul zone in 2005 now extends to the edge of the license area to the north and northwest. This feature may reflect a higher magnetic response from the Proterozoic metamorphic units mapped as subcrop in the area, or perhaps a subsurface, magnetite bearing intrusive body. A moderate magnetic break is observed along the broad NE trending valley in the NW portion of Tsenkher Gol. Northeast trending structures may be of integral importance in the South Khentii Gold belt, and further exploration will be directed in this valley.

Additionally, 17.7 line-kilometers of IP dipole-dipole survey were completed over the Altan Suult and Khond Uul gold zones in an effort to delineate the extent of the electric anomalies identified in 2005. The inverted data confirm the presence of several large, EW and NW trending gradient array chargeability, and lesser resistivity anomalies crosscutting the central and NW parts of the Tsenkher Gol property. The largest feature is an EW trending 2220m long by 120m to 350m wide anomaly with intensities exceeding 24mv/V.

The 2006 drilling program started on June 15 and continued through to July 6. Eight holes were drilled for a total of 1363m. Three holes were drilled at the Altan Suult zone and five within the Khond Uul zone. The total number of 1 to 2m half-core samples collected and submitted for analysis is 709. Results will be reported on receipt of final analysis from SGS Analabs. Drill hole locations were primarily based upon the presence of substantial surface gold geochemical anomalies with all drill holes located over zones of high to very high rock and/or soil gold anomalism. These sites are also located within broad or extended zones of moderate to strong alteration and are locally coincident with well defined IP chargeability anomalies.

There are presently no lithologic constraints on gold mineralization since gold is hosted within most rock types including granitoid intrusive, gneissic granitoids, metasediment / metavolcanic, some dikes, and in fault and shear zones. As noted above, surface results indicate a correlation of gold occurring within structures and structure zones. Unit contacts may also contain gold mineralization, most typically when the contact is structural. The pending analysis of all data may resolve the constraints of gold mineralization, and whether specific units, unit contacts, or structures are more gold-bearing than others. Geochemically, geologically, and structurally, Tsenkher Gol remains consistent with either a reduced intrusion related gold system or an orogenic gold mineral system.

Energy Project - Uranium

Erdene holds 34 exploration licenses in south eastern Mongolia totaling 1,085,314 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 ISL pilot plant testing was completed previously by IUC.

The 2006 exploration program is being managed by IUC which initiated an extensive drill program in June to evaluate the uranium potential on a number of Erdene controlled licenses including Galshar, Yant and Tsagaan Del. The geology underlying the Company's properties is similar to that of IUC's Hairhan, Haraat and Gurvan Saihan licence areas, all of which host mineralized uranium deposits. The Company's 2005 program included extensive reconnaissance work covering over 1 million hectares and approximately 500 metres of reconnaissance drilling in three target areas. This preliminary work has provided IUC with significant targets in at least three licence areas controlled by Erdene.

The planned 2006 program includes 14km of rotary mud and core drilling on the Erdene properties. Drilling on the Galshar Uul licence was completed in early July totaling 49 holes testing six targets. All holes are being tested for natural gamma (cps) and resistivity using an in-hole probe. Drilling encountered clayey and sandy-clayey grey coloured carbonaceous sediment, which revealed surface and sub-surface oxidation in some areas. Highly anomalous values were encountered including:

- 0.013% uranium over 5m at 7m depth
- 0.015% over 1.4m at 30.5m depth
- 0.016% over 5.3m at 8.5m depth

Each of the above intersections are from separate holes within a 6km radius.

The results at Galshar are expected to warrant further work based on uranium anomalism, host rocks, and alteration but will be assessed at the conclusion of the 2006 field season to review the complete data package and rank targets generated.

Drilling on the Company's Tsaigan Del and Yant licenses is expected to begin in August. At Tsagaan Del ground radiometric surveys completed in 2005 identified several radioactive anomalies. A total of 4,500m of drilling is planned to test these anomalies in 2006.

Significant exploration is also planned for the Yant property which returned the most promising results during the 2005 program. Ground radiometric surveys carried out in 2005 identified a large radiometric anomaly. Wide spaced drilling was carried out on this anomaly in 2005. One hole intersected 33 to 56 ppm Uranium over an 11m section starting at surface within sediments consisting of conglomerate and sandstone. The Yant drilling also indicated some uranium enrichment in coarse sandstone units. IUC is planning a 600 to 1,000km of auto-gamma survey in 2006 followed by 4,000m of rotary drilling.

Energy Project – Coal

The Company is involved in a comprehensive coal generative program in cooperation with Xstrata Coal evaluating numerous prospective metallurgical and high quality thermal coal deposits. The Company's technical staff has compiled an extensive database on coal deposits, occurrences and prospective sedimentary basins allowing for a prioritization of targets. Data on approximately 350 coal deposits and occurrences have been entered into the database. Field evaluation of primary targets is ongoing with the goal of field evaluating those with the greatest potential to identify possible property acquisitions. This program is ongoing in consultation with Xstrata personnel. Erdene executive and Xstrata consultants completed a thorough field examination of the priority targets in June and the technical group is now in the process of completing detailed analysis of selected opportunities. These exploration efforts are being fully funded by Xstrata (refer to section 1.02 for further information about the Xstrata agreement).

One of the priority targets is the Company's Galshar Coal property located approximately 300km southeast of Ulaanbaatar, 250km north of the Chinese border and 65km east of a short-line rail station accessing the Trans-Mongolian rail road.

The Erdene exploration license (9383X) is referred to as Tsagaan Undur Tolgoi and consists of 3,798 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 Galshar property covers the majority of a coal bearing Cretaceous sedimentary basin and surrounds a small coal mine which supplies coal to local towns. The Company drilled an initial hole (CDD-01), in late 2005 approximately 300m northwest of the existing mine, which intersected multiple coal seams over 49m. Previous drilling in this area indicates that coal seams occur over a three kilometer strike length and is open to the northeast.

All samples were analyzed at the Mongolia Central Geological Laboratory in Ulaanbaatar. The hole was sampled beginning at 47.6m. Weighted average analytical results (Table 1) of whole core samples indicate coal quality to improve from lignitic, high ash (greater than 20%), brown coal near surface (47.6m), to a low ash (6.25%), low sulphur (0.37%) sub-bituminous coal seam over 21.8m beginning at 79.8m depth.

Table 1: Weighted Average Analysis

Sampled Interval (m)	Apparent Thickness (m)	Moisture % (AR)	Ash % (AD)	Volatiles % (AD)	Fixed Carbon %	Sulphur % (AD)	Phosphorous %	Calorific Value (AD) Kcal/kg	Btu/lb (Kcalx1.8)
47.6 - 49.6	2	11.1	27.31	48.99	43.75	0.54	<0.05	5984	10,771
56 – 66	5 seams 1m thick	10.3	37.83	53.79	33.77	0.06	<0.05	5280	9,504
67.4 - 79.8	12.4	11.1	28.87	56.28	41.78	0.96	0.06	5717	10,290
79.8 - 101.6	21.8	13.99	6.25	56.77	59.78	0.37	0.09	6336	11,404
103 - 104.5	1.5	13.3	38.21	53.35	39.3	0.89	<0.05	5747	10,345

AR- as received, AD- air dried

During the 2nd quarter analytical results of coal intersected in drill hole CDD-1 at Galshar were confirmed by an Australian laboratory. Diamond drilling is planned for late August to further test this coal seam and to confirm the quality of coal.

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 59,458 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 in late 2005 to further delineate known molybdenum mineralization and to test regional exploration targets.

These drill results further strengthened management's view that Zuun Mod hosts a significant 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.

During the quarter, company executives carried out site visits with a potential joint venture partner and held initial discussions regarding the use of molybdenum roasting facilities in China. The opportunities for potential future development of the Zuun Mod molybdenum project continue to be evaluated.

Biger Copper-Gold-PGE Project

The Biger project is an alkalic porphyry system with potential to host significant copper-gold-platinum mineralization. Biger is an early stage exploration project located in a highly prospective area for copper and gold in southwestern Mongolia. Previous work documented over 30 copper occurrences in the area of the property. Initial property examination and rock sampling identified copper values up to 2.8%, accompanied by elevated palladium (1.37 g/t), gold (0.5 g/t), and platinum (0.29 g/t). The strongest mineralized zones are coincident with composite ground magnetic high and low circular and annular anomalies, up to 1500m diameter. Scout drill testing of the coincident geochemical and geophysical anomalies in 2005 identified several copper mineralized intercepts hosted within potassic altered diorite and gabbrodiorite, including a 24m section that returned of 0.5% copper and elevated gold (86 ppb) and palladium (89 ppb) values. This copper-gold-PGE mineralized occurs within an outlier of altered granosyenite and diorite, referred to as Altan Khad, located in the center of the large Biger pediment. An

area of younger rocks and recent sediments covers an untested area with a radius of at least 6km from the drill intersection.

Geophysical modeling (3D) of the ground magnetic data have recently been completed and confirmed the magnetic high and low anomalies identified with the previous 2D-modeled data. Both models indicate the presence of several large circular magnetic anomalies located beneath the extensive pediment at Biger, including the Altan Khad feature. These features remain highly prospective as mineralized intrusive centers hosting alkaline porphyry style copper-gold-PGE mineralization. It is anticipated that geophysical IP surveys will be used to delineate sulfide bearing targets within the circular magnetic anomalies prior to a decision on additional drilling at Biger

Bayan Kharaat Copper Porphyry Project

The Bayan Kharaat property was obtained by GML in 2001 after a reconnaissance follow up of copper porphyry districts in Mongolia. Geologically the area is underlain by Early Permian age Khanui formation intermediate volcanic flows which have been covered by Permian-Triassic age felsic volcanics in central part of the area. In the southern part of the area, the volcanics are cut by Triassic-Jurassic age medium grained granite porphyry and fine grained diorite sub intrusion. The Triassic felsic volcanics exposed on ridge tops are intensively silicified with weak pyrite and sericite altered.

Strong pyrite and sericite altered granite porphyry intrusive occurs on a SW-NE elongated low ridge in the middle of the property. On the west side of the area, local weak prophyllitic alteration of the intrusive rocks was observed. In addition, strong copper oxide, minor copper sulfide and iron sulfide mineralization was found at one location in the felsic porphyry intrusive. Two other copper oxide bearing fractures in fine grain diorite were also discovered.

In 2005, Erdene completed a 44.8 line-kilometre ground magnetic survey and a 49.3 line-kilometre gradient IP survey over the southern and central portion of the Bayan Kharaat property. The magnetics showed very strong NE-SW and NW-SE trending linear features, which appear to intersect in the area of strong alteration and associated copper mineralization. A 2km long and 800m wide slightly NW-SE trending oval shaped high chargeability anomaly and coincident resistivity high occurs in the central part of the property and appears to be associated with the felsic volcanics.

In June 2006, a systematic soil survey was carried out on a 200m grid over the south western and south central portions of the property. A total of 473 soil samples on 50m centers and 24 scattered rock samples were collected and analyzed for copper and gold. Values were generally low and most samples were less than 30 ppm copper and 10 ppb gold.

Two target areas of co-incident silicification, sericite/pyrite alteration and elevated copper in soil and chargeability have been outlined on the NE-SW trending structure in granite porphyry in the southwest central area and in felsic volcanics in the west central area. Additional exploration programs are being considered.

North American Projects

The Company's North American project portfolio includes two notable industrial mineral projects as well as a 20% interest in the Donkin coal project. The industrial mineral opportunities include the Sparta

Kaolin project in Georgia, U.S., which is operated by J.M. Huber Corporation, and the Maddox Granite Aggregate project, a royalty project in the southeast U.S.A. managed by Rinker Materials Corporation (Rinker Materials).

Donkin Coal Project

As part of the recent acquisition of Kaoclay, Erdene acquired a 20% interest in the Donkin Coal Alliance with Xstrata Coal Canada (66%) and Atlantic Green Energy Development (14%). In December 2005, the alliance was granted the rights to acquire a special exploration license for the Donkin coal resource block, which is considered the last remaining undeveloped block of high quality coal off Cape Breton. In June 2006, the special exploration license was granted and property access rights were secured.

A 200 million tonne portion of the Donkin coal resource, considered to have very good thermal and metallurgical qualities, is targeted in the initial development planned. The project is located near a shipping terminal making it ideally located to serve the large Eastern U.S. market. Approximately \$100 million was spent on previous work that included the construction of two access tunnels.

The project achieved a number of significant milestones during the quarter with the Province of Nova Scotia granting a Special Exploration Licence and access to the Donkin site been secured. In addition, senior staff, including the Project Manager and the Project Engineer, has been appointed to the Glace Bay office, which was officially opened on June 8th by the CEOs of Xstrata Coal and Erdene Gold. Darren Nicholls, Project Manager has 20 years experience in the coal mining industry and has been operations manager for Xstrata Coal operations in Australia for the past six years. Gary Ellerbrook has been appointed Project Engineer. Gary has 28 years experience in mining, gas and water projects and has extensive knowledge of Cape Breton coal and the local area. The Donkin management team and its consultants have been very active in conducting community liaison meetings during the quarter and supervising the start-up of feasibility activities.

McElroy Bryan Geological Services Pty Ltd (MBGS) has been retained to compile all historical information on the Donkin Coal project and develop an updated model of the deposit. MBGS was established in 1970 and provides independent resource appraisals, technical reviews and due-diligence reports to the coal mining industry and financial institutions within Australia and overseas.

A two phase sampling program was carried out in June with a 400kg sample collected from the Harbour Seam during underground sampling at the adjacent Glace Bay Miners Museum in mid-June and delivered to Australia for testing and analysis. Results are pending. Preparation of the site for dewatering and tunnel access is now underway and is expected to commence in September, 2006.

Sparta Kaolin Project

One of the primary assets acquired through the Kaoclay merger is a large primary kaolin resource in Georgia, U.S.A. Due to an aggressive exploration and acquisition program by Kaoclay in the late 1990s, Erdene now controls a large high brightness primary clay resource through its subsidiary, Sparta Kaolin Corporation. The Company's phase II tested, in-ground, "premium" quality, primary kaolin resource in Georgia amounts to 27.4 million tons. For the project's development stage, Kaoclay partnered with industry leader Huber Engineered Materials (Huber), a subsidiary of J.M. Huber Corporation, a diversified multi-national company and one of the world's largest kaolin producers.

In October 2003, Kaoclay entered into an agreement with Huber for prepaid tonnage of crude kaolin. Huber conducted a due diligence evaluation program of the Sparta kaolin resource and performed an extensive product development program. This led to the successful commercialization of a light-weight coater product, in late 2004. Commercial production by Huber from Kaoclay's primary kaolin deposits began in 2005 under the product name HuberPrime™, a high quality light-weight coater product.

During the quarter, Huber mined 57,510 tons from two open pits on the Company's Lucky Area holdings in Hancock County, Georgia bringing the total year to date tons kaolin mined in 2006 to 101,974 tons. Also, in June 2006, Huber paid US\$300,000 to the Company to purchase future tonnage.

Much of the new development focus during the quarter was on testing kaolin clays in a second area of the Company's Georgia reserves located in McDuffie County. Drilling, engineering tests for mobile blunge and de grit facilities and laboratory testing were completed with results warranting proceeding to the permitting stage. The company continues to work with Huber and other third parties to identify products and markets to increase utilization of the raw material and therefore increase revenues and potentially volume mined and produced.

Maddox Aggregate Project

As a result of the Kaoclay acquisition, the company now owns the Maddox granite aggregate project in Georgia, U.S. Rinker Materials Corporation (Rinker Materials) has been granted an exclusive right by the Company to mine, process, and sell aggregate from the Maddox property subject to an industry competitive royalty.

The Maddox project is being developed as a quarry, primarily to serve the coastal markets by rail. Rinker Materials has submitted permitting applications and expects the project to be approved by the state regulatory agencies. The development decision is anticipated in late 2006. Rinker Materials has planned for the construction of a rail spur under Georgia State Highway 16, construction of the crushing plant, all equipment, and all site preparation. Rinker Materials has advised the Company that it expects the pre-production development period to be 9 to 12 months from the date the quarry permit is issued. The project has an estimated lifespan of at least 20 years.

Other Base and Precious Metals Properties:

Wild Mountain, Temuujin, Blue Springs, and Yargait will receive further evaluation this year to determine what additional work, including drilling, is warranted.

Project Generation Activity

The Company has been evaluating opportunities and reviewing submissions for mineral properties in Mongolia, Eastern Canada, the U.S.A., Southeast Asia and South America during the quarter. Should any of these become material the company will issue information regarding these activities.

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 June 30, 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 from the Kaoclay assets (see section 1.02 and 1.06). 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 with the exception of coal samples which were sent to the Central Geological Laboratory in Ulaanbaatar. In addition to internal checks by SGS Laboratory and the Central Geological 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.

Second Quarter 2006

Three and six months ended June 30, 2006 and 2005
(unaudited)

Prepared by Management - See Notice to Reader

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August 11, 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 June 30, 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 and six months ended June 30, 2006 and 2005. The Company's independent auditors have not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the June 30, 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

June 30, 2006, with comparative figures for December 31, 2005

	2006 (unaudited)	2005 (audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 6,470,097	\$ 4,269,991
Marketable securities (market value, 2006 - \$183,334; 2005 - \$123,000)	83,333	50,666
Accounts receivable (note 2)	348,659	189,599
Prepaid expenses	70,755	12,862
	<u>6,972,844</u>	<u>4,523,118</u>
Resource property interests (note 3)	15,816,835	2,001,708
Capital assets, net (note 4)	1,550,844	123,780
Intangibles	2,807,000	—
Goodwill (note 5)	7,796,080	—
	<u>\$ 34,943,603</u>	<u>\$ 6,648,606</u>
Liabilities and Shareholders' Equity		
Liabilities:		
Accounts payable and accrued liabilities	\$ 674,716	\$ 253,474
Due to related parties (note 6)	2,568	24,902
Current portion of long-term debt	260,000	—
	<u>937,284</u>	<u>278,376</u>
Deferred revenue	3,026,999	—
Future income tax (note 5)	3,677,194	—
Shareholders' equity:		
Share capital (note 7)	38,495,827	17,372,074
Contributed surplus (note 8)	2,872,552	1,201,779
Deficit	(14,066,253)	(12,203,623)
	<u>27,302,126</u>	<u>6,370,230</u>
Commitments (note 13)		
	<u>\$ 34,943,603</u>	<u>\$ 6,648,606</u>

See accompanying notes to the interim consolidated financial statements.

Approved on behalf of the Board:

"Ken MacDonald" Director

"Dave Carnell" Director

ERDENE GOLD INC.

Interim Consolidated Statements of Operations and Deficit
(unaudited)

	3 months ended June 30, 2006	3 months ended June 30, 2005	6 months ended June 30, 2006	6 months ended June 30 2005
Revenue:				
Lab Services	\$ 22,929	\$ -	\$ 22,929	\$ -
Royalties	21,230	-	21,230	-
Interest revenue	65,891	52,329	109,768	87,535
	110,050	52,329	153,927	87,535
Expenses:				
Exploration and Operating expenses				
Drilling	143,127	623,918	144,950	626,176
Analytical and assaying	70,157	49,261	79,380	95,139
Geological services	258,166	334,284	566,207	465,672
Geo-technical surveys	34,510	185,503	34,510	194,611
Logistical and field support	148,715	335,469	207,259	440,529
Professional services	-	71,398	-	101,937
Travel	96,132	49,418	116,954	109,206
Lab operating expenses	17,955	-	17,955	-
Depletion of resource property interests	4,720	-	4,720	-
Other	1,503	3,463	1,563	4,671
Exploration partner recovery	(139,693)	(294,128)	(180,431)	(294,128)
	635,292	1,358,586	993,067	1,743,813
General and administrative expenses				
Depreciation	8,462	6,124	15,888	15,435
Insurance	17,067	9,889	29,390	19,830
Investor relations and marketing	77,703	34,053	141,258	80,075
Office	23,526	28,301	53,589	40,944
Professional services	108,436	81,388	162,052	104,141
Regulatory compliance	119,562	51,707	141,787	72,324
Salaries and benefits	139,995	107,431	239,648	188,743
Stock-based compensation	-	61,268	52,920	61,268
Travel	36,642	14,861	93,279	42,204
Interest on long-term debt	1,026	-	1,026	-
Other	3,957	9,482	7,115	10,400
	536,376	404,504	937,952	635,364
Other income (expenses)				
Gain on sale of resource properties	-	(5,501)	32,667	9,166
Foreign Exchange	(33,311)	18,902	(27,470)	77,525
Write down of resource property interests	(90,898)	-	(90,898)	-
Other	163	5,818	163	6,021
	(124,046)	19,219	(85,528)	92,712
Loss for the period	1,185,664	1,691,542	1,862,630	2,198,930
Deficit, beginning of period	12,880,589	7,669,697	12,203,623	7,162,309
Share issue costs	-	(65,500)	-	(65,500)
Deficit, end of period	\$14,066,253	\$ 9,426,739	\$14,066,253	\$9,426,739
Basic and diluted loss per share (note 5)	\$ (0.04)	\$ (0.06)	\$ (0.06)	\$ (0.08)
Weighted average number of common shares outstanding	32,070,046	26,567,365	32,070,046	26,567,365

See accompanying notes to the interim consolidated financial statements.

ERDENE GOLD INC.

Interim Consolidated Statements of Cash Flows
(unaudited)

	3 months ended June 30, 2006	3 months ended June 30, 2005	6 months ended June 30, 2006	6 months ended June 30 2005
Cash provided by (used in):				
Operations:				
Loss for the period	\$(1,185,664)	\$(1,691,542)	\$(1,862,630)	\$(2,198,930)
Item not involving cash:				
Amortization of capital assets	10,363	9,127	18,789	19,487
Depletion of resource property interests	4,720	-	4,720	-
Deferred revenue earned	(21,231)	-	(21,231)	-
Stock-based compensation	-	145,743	127,008	145,743
Write down of resource properties	90,898	-	90,898	-
Gain on sale of resource properties	-	5,501	(32,667)	(9,166)
Change in non-cash working capital	226,618	(242,634)	149,288	(893,216)
	(874,296)	(1,773,805)	(1,525,825)	(2,936,082)
Financing:				
Issue of common shares for cash	-	1,000,000	3,000,000	1,000,000
Share issue costs	-	(65,500)	-	(65,500)
Issue of common shares on exercise of options and warrants	17,000	-	849,789	28,241
	17,000	934,500	3,849,789	962,741
Investments:				
Proceeds on sale of resource properties	-	(5,501)	32,667	9,166
Resource property interests	71,906	(44,986)	(151,229)	(51,465)
Purchase of capital assets	(2,321)	(28,718)	(5,296)	(49,373)
Other assets	20,925	(142,920)	-	(142,920)
	90,510	(164,689)	(123,858)	(234,592)
Increase (decrease) in cash	(766,786)	(1,003,994)	2,200,106	(2,207,933)
Cash, beginning of period	7,236,883	7,375,350	4,269,991	8,579,289
Cash, end of period	\$ 6,470,097	\$ 6,371,356	\$ 6,470,097	\$6,371,356

See accompanying notes to the interim consolidated financial statements.

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements

Six months ended June 30, 2006
(unaudited)

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 of large tonnage, low cost, gold, copper, molybdenum, uranium and coal deposits; and the development of its coal and industrial mineral interests in North America with near-term cash flow potential. To date the Company has not yet earned any significant 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). Its 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. (Barbados); Erdene Mongol XXK and Erdene Energy XXK (Mongolia); and Erdene Resources Inc (formerly Kaoclay Resources Inc) and Sparta Kaolin Corporation (United States). 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.

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 2

Six months ended June 30, 2006
(unaudited)

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
Building	Declining balance	10%
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, Erdene Energy XXK, Erdene Resources Inc. (formerly Kaoclay Resources Inc.) and Sparta Kaolin Corporation 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.

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 3

Six months ended June 30, 2006
(unaudited)

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 7. 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.

(j) Goodwill:

Goodwill is tested for impairment annually. The fair value of each reporting unit that includes goodwill is compared to the total carrying amount (including goodwill) of that reporting unit. If the fair value exceeds the carrying value, goodwill is not considered to be impaired. If the fair value is less than the carrying value, the fair values of the assets and liabilities within the reporting unit are estimated. The difference between the fair value of the assets and liabilities within the reporting unit and the fair value of the entire reporting unit represents the deemed fair value of the goodwill of the reporting unit. When the carrying value of goodwill exceeds the deemed fair value, the excess is charged to earnings in the period in which the impairment is determined.

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 4

Six months ended June 30, 2006

2. Accounts receivable:

	Jun 30, 2006	Dec 31, 2005
Trade Receivables	\$ 39,660	\$ -
Exploration partner recovery	241,058	114,338
Other	67,941	75,261
	<u>\$ 348,659</u>	<u>\$ 189,599</u>

Other receivables includes an amount receivable of \$45,000 (2005 - \$45,000) from 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. On July 8, 2006 the Mongolian Parliament passed proposed amendments to the 1997 Mongolian Mineral Law that is yet to be ratified. The amendments would serve to increase the annual renewal fees, the maximum license period from seven to nine years and would invoke minimum work requirements as a condition of renewal. The Company's mineral exploration licenses in Georgia are held by its subsidiary, Sparta Kaolin Corporation and in Nova Scotia the Company's interest in the Donkin coal project is held through its subsidiary, Erdene Resources Inc. (formerly Kaoclay Resources Inc. "Kaoclay"). Resource property interests are recorded at the cost of acquisition.

	January 1, 2006 To June 30, 2006	January 1, 2005 to Dec. 31, 2005
Balance, beginning of period	\$ 2,001,708	\$ 648,297
Additions during period	884,472	1,411,502
Acquired during period (see note 5)	13,038,000	-
Write-downs	(90,898)	(26,729)
Exploration partner contributions	(16,447)	(31,362)
Balance, end of period	<u>\$ 15,816,835</u>	<u>\$ 2,001,708</u>

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 that has the potential to be mined by underground methods.

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 5

Six months ended June 30, 2006

3. Resource property interests (continued):

The Donkin Alliance was formed by or on behalf of Xstrata Coal Pty Limited (66%), Kaoclay Resources Inc. ("Kaoclay") (20%), American Transbridge Technologies LLC (9.3%) and PDC Resources Corporation (4.67%) to submit a proposal to the Province of Nova Scotia to secure the exclusive right to the Donkin Coal Project; namely, the project to explore, assess, study and, if feasible, develop the Donkin Coal Resource Block into an operating coal mine. Effective June 12, 2006, Kaoclay amalgamated with Erdene Resources Inc., a wholly-owned subsidiary of Erdene, under a court approved Plan of Arrangement and Kaoclay is now a wholly-owned subsidiary of Erdene which will operate under the name of Erdene Resources Inc (see note 5).

The members of the Donkin Alliance signed an agreement ("Alliance Agreement") effective March 11, 2005, and an amending agreement dated April 23, 2006. They are presently negotiating the terms of a definitive joint venture agreement and sales agency agreement. Pursuant to the April 23, 2006 amending agreement, Erdene's interest in the Donkin Alliance is held by 6531954 Canada Inc., a wholly owned subsidiary of Erdene Resources Inc., and Xstrata Coal Pty Limited's interest is held by Xstrata Coal Donkin Limited, a related party to Xstrata Coal Pty Limited. Xstrata Coal Donkin Management Limited, a related party to Xstrata Coal Donkin Ltd, is acting as manager for the Donkin Coal Project. If the Donkin Coal Project is approved to proceed to development, the manager will be responsible for mine development, including infrastructure, coal mining and processing, and coal distribution and sales programs.

On December 14, 2005, the NSDNR announced that the Donkin Alliance was the successful proponent in the call for proposals. On December 16, 2005, an application was submitted to the NSDNR on behalf of the Donkin Alliance for a special exploration license and a supporting work proposal and budget was submitted on February 20, 2006. The special exploration license was issued by the Province of Nova Scotia in May 2006. In June 2006, Xstrata Coal Donkin Management Limited acquired the surface lands relating to the Donkin Coal Resource Block from the Cape Breton Development Corporation ("CBDC"). The Donkin Alliance began its exploration program and evaluation and scoping study ("Exploration Program") in June 2006.

Pursuant to the Alliance Agreement, the Company is committed to fund up to \$10,000,000 ("Initial Funding") of the expenditures incurred during the Exploration Program of the Donkin Coal Project provided such expenses qualify as CEE. Xstrata Coal Donkin Limited agreed to pay any other costs up to a maximum of \$5,000,000 but if the Company only pays a portion of the Initial Funding, Xstrata Coal Donkin Limited is only obliged to pay a corresponding portion of the \$5,000,000. The Company is responsible to fund 20% of any additional expenditures incurred in the Exploration Program if it is to maintain its 20% interest in the Donkin Coal Project. The remaining members of the Donkin Alliance are not required to fund any portion of the expenditures unless a development decision is made. A preliminary estimate of the total budget for the Exploration Program is approximately \$17,200,000 and it is expected to take 24 months to complete. The Company estimates that it will be required to expend \$3 to \$5 million in 2006 in connection with the Donkin Coal Project and, in July 2006, completed a \$6.0 million flow-through financing to fund its obligation.

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 6

Six months ended June 30, 2006

3. Resource property interests (continued):

The Company, through its subsidiary Sparta Kaolin Corporation, has entered into lease agreements and exploration agreements with options to lease and/or purchase kaolin properties in the United States. The aggregate commitment associated with the cancelable agreements over the next twelve months is U.S. \$731,000. These agreements also provide that the Company will pay a royalty based on either the production of finished product or crude tons extracted from the related properties. The majority of the payments to land-owners pursuant to these agreements are creditable against future royalty payments or, where applicable, the purchase price of the property.

The Maddox property, which is owned by Sparta, is under long term lease to Rinker Materials Corporation and is in the process of permit approval for commencement of production.

4. Capital assets:

			June 30 2006	December 31 2005
	Cost	Accumulated depreciation	Net book value	Net book value
Land	\$1,130,376	-	\$ 1,130,376	-
Building	386,830	192,721	194,109	-
Equipment, furniture and fixtures	621,137	\$ 473,387	147,750	\$ 59,148
Software and computer	116,016	38,846	77,170	64,632
Vehicles	12,000	10,561	1,439	-
	\$ 2,266,359	\$ 715,515	\$ 1,550,844	\$ 123,780

5. Acquisition:

Effective June 12, 2006 the Company concluded by way of Plan of Arrangement, the acquisition of Kaoclay (incorporated under the laws of Canada) and its wholly owned subsidiaries, Sparta Kaolin Corporation ("Sparta", incorporated under the laws of Delaware) and 6531954 Canada Inc. (incorporated under the laws of Canada). Based in Halifax, Nova Scotia, Kaoclay, through its subsidiaries, controlled three advanced-stage projects including an interest in 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. Under the Plan of Arrangement the Company issued 1.65 common shares and a half warrant for each Kaoclay share (14,816,917 shares and 4,489,975 warrants for the 8,979,850 Kaoclay shares outstanding). Each warrant entitles the holder to purchase one common share of the Company for \$1.60 per share until June 15, 2009. The purchase price has been determined to be \$18,346,144, including acquisition costs of \$63,415.

In the process of completing the Arrangement, the Company first acquired the shares of Sparta and then amalgamated Kaoclay with Erdene Resources Inc. resulting in both Sparta and Erdene Resources Inc. becoming wholly owned subsidiaries of the Company.

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 7

Six months ended June 30, 2006

5. Acquisition (continued):

The purchase has been accounted for by the purchase method with the fair value of the consideration paid being allocated to the fair value of the identifiable assets acquired and liabilities assumed on the closing date as set out below.

Assets and liabilities acquired:

Cash and cash equivalents	\$	387,548
Other working capital, net		(416,361)
Capital assets		1,438,070
Resource property interests		13,038,000
Deferred revenue		(3,026,999)
Goodwill		7,796,080
Other intangibles		2,807,000
Future income tax liability		<u>(3,677,194)</u>
	\$	<u>18,346,144</u>

Consideration paid:

Common shares	\$	16,537,998
Warrants		1,744,731
Acquisition costs		<u>63,415</u>
	\$	<u>18,346,144</u>

6. 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:

	June 30 2006	December 31 2005
Fisher Transport Limited	\$ 2,568	\$ 16,013
J.C. Cowan	–	8,889
	<u>\$ 2,568</u>	<u>\$ 24,902</u>

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 8

Six months ended June 30, 2006

7. Share capital:

Authorized and issued

	Three Months Ended June 30, 2006		Six Months Ended June 30, 2006	
	Number of shares	\$	Number of shares	\$
Authorized:				
Unlimited number of common shares without par value				
Issued:				
Balance, beginning of period	31,868,210	\$21,946,907	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 purchase of subsidiary	14,816,917	16,537,998	14,816,917	16,537,998
Issued on exercise of options and warrants	20,000	10,922	1,118,575	1,050,755
Balance, end of period	46,705,127	\$38,495,827	46,705,127	\$ 38,495,827

The following table summarizes the continuity of the warrants for June 30, 2006 and 2005.

Warrants

	Three months ended June 30, 2006		Six months ended June 30, 2006	
	Number of Warrants	Weighted Avg. Exercise Price	Number of Warrants	Weighted Avg. Exercise Price
Opening balance	1,580,000	\$0.65	2,589,275	\$ 0.70
Issued	4,489,975	\$1.60	4,489,975	\$ 1.60
Exercised	-	-	(1,008,575)	0.77
Expired	-	-	(700)	0.85
Closing balance	6,069,975	\$1.35	6,069,975	\$ 1.35

The following is a summary of the warrants outstanding as of June 30, 2006:

Exercise Price	Expiry Date	Number of Warrants
\$ 0.87	March 1, 2007	800,000
0.43	January 23, 2008	780,000
\$ 1.60	June 11, 2009	4,489,975
\$ 1.35		6,069,975

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 9

Six months ended June 30, 2006

7. Share Capital (continued):

The following table summarizes the continuity of the stock options for June 30, 2006 and 2005.

Options

	Three Months Ended June 30, 2006		Six Months Ended June 30, 2006	
	Number of Options	Weighted Avg. Exercise Price	Number of Options	Weighted Avg. Exercise Price
Opening balance	2,420,000	\$0.72	2,330,000	\$0.69
Granted	-	-	180,000	1.05
Exercised	(20,000)	\$0.85	(110,000)	\$0.63
Closing balance	2,400,000	\$0.72	2,400,000	\$0.72

The following is a summary of the options outstanding and exercisable as of June 30, 2006:

Exercise price	Expiry date	Number of options
\$0.85	July 19, 2006	40,000
\$0.43	May 8, 2008	400,000
\$0.43	November 18, 2008	330,000
\$0.85	March 31, 2009	100,000
\$0.85	April 6, 2009	740,000
\$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
\$0.72		2,400,000

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

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 10

Six months ended June 30, 2006

7. Share Capital (continued):

Stock Based Compensation (continued):

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	<u>\$ 74,088</u>
General and administrative	<u>\$ 52,920</u>

8. Contributed surplus:

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

	June 30 2006	December 31 2005
Opening balance	\$ 1,201,779	\$ 513,095
Warrants relating to acquisition of subsidiary	1,744,731	–
Warrants relating to resource property option agreement	–	396,831
Warrants/option recovery on exercise	(200,966)	(5,748)
Options granted and expensed	127,008	297,601
	<u>\$ 2,872,552</u>	<u>\$ 1,201,779</u>

9. 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.

10. 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.

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 11

Six months ended June 30, 2006

11. Foreign currency risks:

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

12. 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 any significant revenue from operations.

(b) Geographic information:

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

The following tables present the geographic origin of the Company's resource properties and capital assets at the end of the period.

Resource properties:

	June 30 2006	December 31 2005
United States	\$13,038,000	\$ -
Canada	-	-
Mongolia	2,778,835	2,001,708
	<u>\$15,816,835</u>	<u>\$ 2,001,708</u>

Capital assets:

	June 30 2006	December 31 2005
United States	\$ 1,438,070	\$ -
Canada	56,926	62,821
Mongolia	55,848	60,959
	<u>\$ 1,550,844</u>	<u>\$ 123,780</u>

ERDENE GOLD INC.

Notes to the Interim Consolidated Financial Statements, page 12

Six months ended June 30, 2006

14. Commitments:

The Company has an operating lease for office premises until August 31, 2011. The Company has the right to terminate the lease by giving notice prior to the anniversary date, after 2007. The Company also assumed a lease of its subsidiary Erdene Resources Inc (formerly Kaoclay Resources Inc) which expires February 28, 2007. Annual rental commitments are as follows:

2006	\$	41,255
2007		61,104
2008		57,733
2009		58,888
2010		60,065
2011		30,633
	\$	309,678

15. Comparative figures:

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