Interim Consolidated Financial Statements of

ERDENE GOLD INC.

Third Quarter 2006

Three and nine months ended September 30, 2006 and 2005
(unaudited)

Prepared by Management - See Notice to Reader

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November 8, 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 September 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 nine months ended September 30, 2006 and 2005. The Company's independent auditors have not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the September 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

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

	2006 (unaudited)	2005 (audited)
Assets		
Current assets:		
Cash and cash equivalents (note 2)	$ 10,138,666	$ 4,269,991
Marketable securities (market value, 2006 - $266,667; 2005 - $123,000)	164,333	50,666
Accounts receivable (note 3)	308,281	189,599
Prepaid expenses	67,737	12,862
	10,679,017	4,523,118
Resource property interests (note 4)	15,858,624	2,001,708
Capital assets, net (note 5)	2,029,532	123,780
Intangibles	2,807,000	–
Goodwill (note 6)	7,796,080	–
	$ 39,170,253	$ 6,648,606
Liabilities and Shareholders' Equity		
Liabilities:		
Accounts payable and accrued liabilities	$ 393,334	$ 253,474
Due to related parties (note 7)	2,881	24,902
	396,215	278,376
Deferred revenue	2,904,968	–
Future income tax (note 6)	3,677,194	–
Shareholders' equity:		
Share capital (note 8)	44,659,492	17,372,074
Contributed surplus (note 9)	3,759,954	1,201,779
Deficit	(16,227,570)	(12,203,623)
	32,191,876	6,370,230
Commitments (note 14)		
Subsequent event (note 15)		
	$ 39,170,253	$ 6,648,606

See accompanying notes to the interim consolidated financial statements.

Approved on behalf of the Board:

Ken MacDonald, Director

Stuart Rath, Director

ERDENE GOLD INC.

Interim Consolidated Statements of Operations and Deficit
(unaudited)

	3 months ended Sept 30, 2006	3 months ended Sept 30, 2005	9 months ended Sept 30, 2006	9 months ended Sept 30 2005
Revenue:				
Lab Services	$ 76,004	$ -	$ 98,933	$ -
Royalties	122,032	-	143,262	-
Interest revenue	103,325	36,205	213,093	123,740
	301,361	36,205	455,288	123,740
Expenses:				
Exploration and Operating expenses				
Drilling	324,466	616,603	469,416	1,242,779
Analytical and assaying	48,669	116,557	128,049	211,696
Geological services	245,521	245,192	811,728	710,864
Geo-technical surveys	6,035	21,697	40,545	216,308
Logistical and field support	114,523	319,758	321,782	760,287
Professional services	-	-	-	101,937
Travel	21,786	39,563	138,740	148,769
Lab operating expenses	95,285	-	113,240	-
Depletion of resource property interests	28,519	-	33,239	-
Other	393	9,966	1,956	14,637
Exploration partner recovery	(171,722)	(149,887)	(352,153)	(444,015)
	713,475	1,219,449	1,706,542	2,963,262
General and administrative expenses				
Depreciation	12,984	6,034	28,872	21,469
Insurance	22,009	10,100	51,399	29,930
Investor relations and marketing	38,555	41,355	179,813	121,430
Office	34,528	16,363	88,117	57,307
Professional services	57,659	42,649	219,711	146,790
Regulatory compliance	77,098	26,224	218,885	98,548
Salaries and benefits	129,454	100,032	369,102	288,775
Stock-based compensation	713,400	147,202	766,320	208,470
Travel	50,291	25,964	143,570	68,168
Interest on long-term debt	5,242	-	6,268	-
Other	(4,228)	5,203	2,887	15,603
	1,136,992	421,126	2,074,944	1,056,490
Other income (expenses)				
Gain on sale of resource properties	81,000	13,333	113,667	22,499
Foreign Exchange	(9,950)	13,385	(37,420)	90,910
Write down of resource property interests	(28,647)	-	(119,545)	-
Other	2,850	4,441	3,013	10,462
	45,253	31,159	(40,285)	123,871
Loss for the period	1,503,853	1,573,211	3,366,483	3,772,141
Deficit, beginning of period	14,066,253	9,426,739	12,203,623	7,162,309
Share issue costs	657,464	(5,500)	657,464	60,000
Deficit, end of period	$ 16,227,570	$10,994,450	$16,227,570	$10,994,450
Basic and diluted loss per share (note 10)	$ (0.04)	$ (0.06)	$ (0.09)	$ (0.14)
Weighted average number of common shares outstanding	38,777,839	26,794,824	38,777,839	26,794,824

See accompanying notes to the interim consolidated financial statements.

ERDENE GOLD INC.

Interim Consolidated Statements of Cash Flows
(unaudited)

	3 months ended Sept 30, 2006	3 months ended Sept 30, 2005	9 months ended Sept 30, 2006	9 months ended Sept 30 2005
Cash provided by (used in):				
Operations:				
Loss for the period	$(1,503,853)	$(1,573,211)	$ (3,366,483)	$(3,772,141)
Item not involving cash:				
Amortization of capital assets	18,197	7,946	36,986	27,433
Depletion of resource property interests	28,519	-	33,239	-
Deferred revenue earned	(122,031)	-	(143,262)	-
Stock-based compensation	766,905	151,858	893,913	297,601
Write down of resource properties	28,647	-	119,545	-
Gain on sale of resource properties	(81,000)	(13,333)	(113,667)	(22,499)
Change in non-cash working capital	(386,670)	203,100	(237,382)	(690,116)
	(1,251,286)	(1,223,640)	(2,777,111)	(4,159,722)
Financing:				
Issue of common shares pursuant to flow through subscription agreements	6,000,000	-	6,000,000	-
Issue of common shares for cash	-	-	3,000,000	1,000,000
Share issue costs	(516,102)	5,500	(516,102)	(60,000)
Issue of common shares on exercise of options and warrants	142,800	31,875	992,589	60,116
	5,626,698	37,375	9,476,487	1,000,116
Investments:				
Proceeds on sale of resource properties	81,000	13,333	113,667	22,499
Resource property interests	(288,471)	(121,007)	(439,700)	(172,472)
Purchase of capital assets	(499,372)	(10,647)	(504,668)	(60,020)
Other assets	-	-	-	(142,920)
	(706,843)	(118,321)	(830,701)	(352,913)
Increase (decrease) in cash	3,668,569	(1,304,586)	5,868,675	(3,512,519)
Cash, beginning of period	6,470,097	6,371,356	4,269,991	8,579,289
Cash, end of period	$10,138,666	$ 5,066,770	$10,138,666	$5,066,770

See accompanying notes to the interim consolidated financial statements.

Nature of business:

Erdene Gold Inc. (formerly 3779751 Canada Inc.) (the “Company”) was incorporated by Articles of Incorporation dated June 27, 2000, pursuant to the provisions of the Canada Business Corporations Act. The principal business of the Company is the exploration and development of mineral deposits. The Company is principally focused on the discovery 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); Erdene Resources Inc. (formerly Kaoclay Resources Inc) and 6531954 Canada Limited (Canada); 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.

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.), 6531954 Canada Limited, 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.

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 8. 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.

2. Cash and cash equivalents:

	Sept 30, 2006	Dec 31, 2005
Cash on hand, held in trust and in banks	$ 141,371	$ 81,191
Temporary money market instruments	3,997,295	4,188,800
Flow through funds	6,000,000	-
	$ 10,138,666	$ 4,269,991

On July 14, 2006 The Company closed a $6,000,000 flow through financing to fund the exploration and evaluation of the Donkin Coal Resource Block located in Cape Breton, Nova Scotia. The use of these funds is restricted to qualifying Canadian Exploration Expenditures (“CEE”) under the Income Tax Act (Canada).

3. Accounts receivable:

	Sept 30, 2006	Dec 31, 2005
Trade Receivables	$ 52,680	$ -
Exploration partner recovery	173,479	114,338
Other	82,122	75,261
	$ 308,281	$ 189,599

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.

4. 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 Erdene Resources Ltd.’s wholly owned subsidiary 6531954 Canada Limited. Resource property interests are recorded at the cost of acquisition.

4. Resource property interests (continued):

	January 1, 2006 to Sept 30, 2006	January 1, 2005 to Dec. 31, 2005
Balance, beginning of period	$ 2,001,708	$ 648,297
Additions during period	954,908	1,411,502
Acquired during period (see note 6)	13,038,000	-
Write-downs	(119,545)	(26,729)
Exploration partner contributions	(16,447)	(31,362)
Balance, end of period	$ 15,858,624	$ 2,001,708

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.

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 6).

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

4. Resource property interests (continued):

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.

On October 26, 2006 the Company entered into agreements with minority partners in the Donkin Alliance to increase its interest in the Alliance from 20% to 25%. See note 15.

The Company, through it’s 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 US $365,000. 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.

5. Capital assets:

			September 30 2006	December 31 2005
	Cost	Accumulated depreciation	Net book value	Net book value
Land	$1,625,447	$ -	$ 1,625,447	-
Building	386,830	197,574	189,256	-
Equipment, furniture and fixtures	628,427	489,015	139,412	$ 59,148
Software and computers	117,576	43,490	74,086	64,632
Vehicles	12,000	10,669	1,331	-
	$ 2,770,280	$ 740,748	$ 2,029,532	$ 123,780

6. 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.

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.

6. Acquisition (continued):

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)
	$ 18,346,144

Consideration paid:

Common shares	$ 16,537,998
Warrants	1,744,731
Acquisition costs	63,415
	$ 18,346,144

7. 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:

	September 30 2006	December 31 2005
Fisher Transport Limited	$ 69	$ 16,013
J.C. Cowan	2,812	8,889
	$ 2,881	$ 24,902

8. Share capital:

Authorized and issued

	Three Months Ended September 30, 2006		Nine Months Ended September 30, 2006	
	Number of shares	$	Number of shares	$
Authorized:				
Unlimited number of common shares without par value				
Issued:				
Balance, beginning of period	46,705,127	$ 38,495,827	27,269,635	$ 17,372,074
Issued for cash	-	-	3,000,000	3,000,000
Flow through shares issues	6,000,000	6,000,000	6,000,000	6,000,000
Issued pursuant to option agreement	-	-	500,000	535,000
Issued on purchase of subsidiary	-	-	14,816,917	16,537,998
Issued on exercise of options and warrants	336,000	163,665	1,454,575	1,214,420
Balance, end of period	53,041,127	$ 44,659,492	53,041,127	$ 44,659,492

The following table summarizes the continuity of the warrants for September 30, 2006.

Warrants

	Three months ended September 30, 2006		Nine months ended September 30, 2006	
	Number of Warrants	Weighted Avg. Exercise Price	Number of Warrants	Weighted Avg. Exercise Price
Opening balance	6,069,975	$1.35	2,589,275	$ 0.70
Issued	395,750	$1.00	4,885,725	$ 1.55
Exercised	-	-	(1,008,575)	0.77
Expired	-	-	(700)	0.85
Closing balance	6,465,725	$1.33	6,465,725	$ 1.33

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

Exercise Price	Expiry Date	Number of Warrants
$ 0.87	March 1, 2007	800,000
1.00	January 14, 2008	395,750
0.43	January 23, 2008	780,000
1.60	June 11, 2009	4,489,975
$ 1.33		6,465,725

8. Share capital (continued):

The following table summarizes the continuity of the stock options for September 30, 2006.

Options

	Three Months Ended September 30, 2006		Nine Months Ended September 30, 2006	
	Number of Options	Weighted Avg. Exercise Price	Number of Options	Weighted Avg. Exercise Price
Opening balance	2,400,000	$0.72	2,330,000	$0.69
Granted	1,290,000	$0.85	1,470,000	$0.87
Exercised	(336,000)	$0.43	(446,000)	$0.48
Expired	(80,000)	$0.81	(80,000)	$0.81
Closing balance	3,274,000	$0.80	3,274,000	$0.80

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

Exercise price	Expiry date	Number of options
$0.43	May 8, 2008	104,000
$0.43	November 18, 2008	290,000
$0.85	March 31, 2009	100,000
$0.85	April 6, 2009	720,000
$0.85	August 26, 2009	100,000
$0.70	February 4, 2010	140,000
$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
$0.85	August 23 2011	1,290,000
$0.80		3,274,000

8. Share Capital (continued):

Stock Based Compensation:

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

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

The estimated fair value of the 1,470,000 options granted during the reporting period under the Black-Scholes model was $893,913 and is presented in these financial statements as follows:

Exploration expenses	$ 127,593
General and administrative	$ 766,320

9. Contributed surplus:

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

	September 30 2006	December 31 2005
Opening balance	$ 1,201,779	$ 513,095
Warrants relating to acquisition of subsidiary	1,744,731	–
Warrants relating to issue costs	141,362	–
Warrants relating to resource property option agreement	–	396,831
Warrants/option recovery on exercise	(221,831)	(5,748)
Options granted and expensed	893,913	297,601
	$ 3,759,954	$ 1,201,779

10. 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.

11. 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.

12. 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.

13. 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:

	September 30 2006	December 31 2005
United States	$ 13,012,558	$ -
Canada	-	-
Mongolia	2,846,066	2,001,708
	$ 15,858,624	$ 2,001,708

13. Segmented information (continued):

Capital assets:

	September 30 2006	December 31 2005
United States	$ 1,905,204	$ -
Canada	70,359	62,821
Mongolia	53,969	60,959
	$ 2,029,532	$ 123,780

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 was terminated on October 31, 2006. Annual rental commitments are as follows:

2006	$ 18,557
2007	56,771
2008	57,733
2009	58,888
2010	60,065
2011	30,633
	$ 282,647

15. Subsequent event:

On October 26, 2006 the Company entered into agreements with minority partners to increase it's ownership in the Donkin Coal Alliance from 20% to 25% in exchange for cash consideration of US$9,400 and 360,000 common shares of the Company. Closing of the transaction is subject to receipt of all necessary regulatory approvals, including approval of the Toronto Stock Exchange. Xstrata Coal Donkin Limited ("Xstrata Coal") has also increased its interest in the Donkin Coal Alliance from 66% to 75% in exchange for cash.

16. Comparative figures:

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

ERDENE GOLD INC.

Management Discussion and Analysis
Third Quarter - September 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 nine months ended September 30, 2006 and its financial position as at September 30, 2006. The following discussion and analysis provides a summary of selected consolidated financial information for the three and nine month period ended September 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 6531954 Canada Limited, 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 nine months ended September 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 November 8, 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 November 8, 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 Limited 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, to expand the scope of the kaolin operations and until 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 September 30, 2006 the Company held 62 mineral licenses in Mongolia representing 16 projects covering approximately 3.3 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		(3,677,194)
	$	18,346,144

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

Common shares	$	16,537,998
Warrants		1,744,731
Transaction costs		63,415
	$	18,346,144

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, 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 the Company, under a court approved Plan of Arrangement which will operate under the name of Erdene Resources Inc.

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.

On October 26, 2006 the Company entered into agreements with minority partners in the Donkin Alliance to increase its interest in the Alliance from 20% to 25% in exchange for cash consideration of US$9,400 and 360,000 common shares of the Company. Closing of the transaction is subject to receipt of all necessary regulatory approvals, including approval of the Toronto Stock Exchange. Xstrata Coal

Donkin Limited ("Xstrata Coal") has also increased its interest in the Donkin Coal Alliance from 66% to 75% in exchange for cash.

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. Xstrata's equity interest in the Company as at September 30, 2006 was 5.66%.

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 March 1, 2007 in exchange for 100% ownership of Tamerlane:

a) US$150,000;

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

c) 700,000 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 $4.3 million at September 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 September 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 $1,503,853 or $0.04 per share for the three months ended September 30, 2006 as compared to a loss of $1,573,211 or $0.06 per share during the same period last year. Revenues increased to $301,361 during the three months ended September 30, 2006 from $36,205 in the same period in 2005. The bulk of the increase is due to lab and royalty revenue earned from the Company's operations in Georgia. Interest revenue was substantially higher than the previous year due to higher average cash balances and higher interest rates compared to the prior year.

Total expenses for the third quarter were $1,850,467 compared to $1,640,575 in the same period in 2005. Exploration and operating expenses were $713,475 for the three months ended September 30, 2006 compared to $1,219,449 in 2005. The exploration budget for 2006 is just under $3 million compared with just under $4 million in 2005. The $505,974 decrease in the third quarter of 2006 is largely due to a $292,137 reduction in diamond drilling. Third quarter 2006 also showed corresponding reductions in analytical and assaying, geo-technical surveys, and logistical and field support costs. Geological services include $127,593 in stock based compensation, which if excluded, would also be lower than the same quarter in 2005.

General and administrative expenses for the third quarter of 2006 were $1,136,992 compared to $421,126 for the same period in 2005. The increase in 2006 is mainly due to stock based compensation of $713,400 in 2006 versus $147,202 in the same period the prior year. The company issued 1,290,000 options to certain officers, directors and management in the three months ended September 30, 2006 compared to 260,000 in 2005. The increase in options granted is largely due to an expanded board of directors as a result of the acquisition of Kaoclay and the partnership with Xstrata. Regulatory compliance costs in the third quarter of 2006 are $50,874 higher than the prior year due to costs associated with the listing of warrants and the exchange of shares issued to Kaoclay shareholders. The remainder of the increase in general and administrative costs is due to costs incurred as a result of the purchase of Kaoclay, many of which will decrease as the operations are integrated.

Other income amounted to $45,253 for the third quarter of 2006 compared with $31,159 for the same period in 2005. The primary reason for the $14,094 increase from 2005 was a result of a gain on the sale of resource properties of $81,000 compared to $13,333 in 2005; partially offset by a foreign exchange loss of $9,950 compared to a gain of $13,385 in 2005; and write-down of resource properties during the quarter of $28,647 with no write-down in the corresponding period in 2005.

Nine months ended September 30, 2006 and 2005

During the nine months ended September 30, 2006 the Company incurred a loss of $3,366,483 or $0.09 per share as compared to a loss of $3,772,141 or $0.14 per share in the corresponding period in 2005. Revenues increased to $455,288 during the nine months ended September 30, 2006 from $123,740 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 expenses for the nine months ended September 30, 2006 decreased to $3,781,486 from $4,019,752 in the same period in 2005. Exploration and operating expenses were $1,706,542 in the nine months ended September 30, 2006 compared with $2,963,262 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 the respective 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 nine months ended September 30, 2006 were $2,074,944 compared to $1,056,490 for the same period in 2005. The increase is in large part due to an increase in stock based compensation of $557,850. The company issued 1,470,000 options to certain officers, directors and management during the first nine months of 2006 compared to 260,000 in 2005. The remainder of the increase in general and administration is due to costs associated with concluding the Alliance and Joint Venture Agreements 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
	Q3 Sep-06	Q2 Jun-06	Q1 Mar-06	Q4 Dec-05	Q3 Sep-05	Q2 Jun-05	Q1 Mar-05	Q4 Dec-05
Revenue	$301	$110	$44	$28	$54	$53	$35	$43
Loss	$1,504	$1,185	$677	$1,209	$1,573	$1,692	$507	$1,110
Basic and diluted loss per share	$0.04	$0.04	$0.02	$0.05	$0.06	$0.06	$0.02	$0.04
Total Assets	$39,170	$34,944	$10,345	$6,649	$7,924	$9,375	$9,806	$9,426

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

1.06 Liquidity and Capital Resources

The Company had working capital at September 30, 2006 of $4.3 million as compared to $4.2 million at December 31, 2005. Funds of $6.0 million from the July 14, 2006 flow through financing (mentioned in the next paragraph) are excluded from the calculation of September 30, 2006 working capital as these funds are restricted to qualifying Canadian Exploration Expenditures (“CEE”) under the Income Tax Act (Canada). Working capital is effectively unchanged from the year ended December 31, 2005. The funds expended in the first nine months of the year, in support of the 2006 exploration program was offset by 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 $992,589 from the exercise of warrants and options during the same period. Current working capital is sufficient to fund the Company’s remaining 2006 budgeted expenditures and meet its property and contractual commitments for the next 24 months.

On July 14, 2006 and pursuant to the Donkin Coal Alliance agreement, 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.

During the nine months ended September 30, 2006 $439,700 was expended on additions to resource property interests, offset by a write-down of resource properties of $119,545. Also during the first nine months of the year, the Company spent $504,668 on capital assets compared to $60,020 for the same period the prior year. The bulk of the current year expenditure was the $495,071 purchase of land in McDuffie county Georgia.

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)
	$	18,346,144

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 September 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 assumed the lease of Kaoclay, which was terminated October 31, 2006.

- Total rental commitments to the end of these leases are $282,647.

- 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 September 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 7 to the unaudited interim consolidated financial statements at September 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 September 30, 2006.

The $893,913 of stock-based compensation recognized in the first nine months 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 September 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 September 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 8 to the September 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 nine months ended September 30, 2006.

Share Capital

During the nine months ended September 30, 2006 the Company issued 25,771,492 shares as follows:

- On February 16, 2006 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 sections 1.02 and 1.06.
- On July 14, 2006 the Company issued 6,000,000 common shares, pursuant to flow through subscription agreements, at $1.00/share to fund the exploration and evaluation of the Donkin Coal Resource Block located in Cape Breton, Nova Scotia.
- In the nine months ended September 30, 2006 the Company issued 1,454,575 shares on the exercise of options and warrants, as mentioned below.

Warrants

During the nine months ended September 30, 2006, 4,489,975 warrants were issued to Kaoclay shareholders pursuant to the Plan of Arrangement (section 1.02); 395,750 agent warrants were issued as part of the $6,000,000 flow through financing mentioned in section 1.06; 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 6,465,725.

Stock Options

During the nine months ended September 30, 2006, 1,470,000 options were granted to certain directors, employees and contractors; 446,000 options were exercised to purchase 446,000 common shares of the Company for total proceeds of $211,800; and 80,000 options expired, bringing the outstanding options at the date of this report to 3,274,000.

1.15 Exploration Results

Overview

By September 30, 2006 the Company had made significant progress with its 2006 exploration activities. The initial drilling program was completed on the Company’s Tsenkher Gol gold project and indicated the presence of a strong gold bearing hydrothermal system over a wide area on the property. Drilling programs were also underway for uranium, copper and coal. In addition, the extensive, country-wide coal evaluation program with its partner Xstrata Coal was continued during the quarter. In North America, exploration and development activities were being carried out on each of the Company’s projects through their respective partners. The following is an overview of those activities.

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 identify 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 3rd quarter the Company's exploration team carried out an extensive exploration-drilling program to test a number of targets identified by geophysical surveys (IP and magnetics) in association with geological and alteration mapping on the Erdene property adjacent to the EMC open pit. Nine diamond drill holes (ITDD 4 to ITDD 12) were completed for a total of 1,773.8 metres. At the present time analytical testing is incomplete with results available from selected holes. Drill hole, ITDD 4 in the South-Central Baglai area, located 200 metres from the EMC property boundary intersected a mineralized zone starting at 36 metres that returned 0.2% copper over 32 metres, including an 8 metre section of 0.3% copper and up to 0.65% copper over 2 metres. Occasionally samples exceeding 0.2% copper over 2 metres were returned deeper in the hole. 200 metres southeast of ITDD-04 a second hole, ITDD-08 has intersected 32 metres of 0.27% copper including 0.33% copper over 12 metres, starting at 34 metres from surface. In addition, sulfide zones were intersected deeper in the hole including 8 metres of 0.3% copper at 125 metres and 25 metres of 0.23% copper from 215 metres to the bottom of the hole. A broad high chargeability anomaly has been traced for 400 metres southeast of ITDD-08 along with surface porphyry style alteration. These preliminary drilling results now confirm the extension of porphyry copper mineralization onto the adjoining Erdene properties and demonstrate potential for the discovery of economic copper concentrations in near-surface oxide zones and deeper sulfide ore-bodies.

Tsagaan Chuluut Area

Additional geological mapping and sampling in the Tsagaan Chuluut area in the north central part of the Ikh Tal 1 license, 4 kilometres northwest of the Erdenet open pit has outlined an area of silicification and alunite alteration coincident with a large magnetic low, high chargeability and low resistivity. It is anticipated that this new target area will be drill tested in 2007 along with follow-up drilling on areas of interest generated by the 2006 drilling results.

Tsenkher Gol Gold Project

The Tsenkher Gol property is located in Khentii Province 180 kilometres 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).

The 2006 exploration program commenced in April and following additional mapping, an expanded soil geochemical survey and additional geophysical surveys (magnetic and IP), a Phase I drilling program consisting of a series of eight drill holes, totaling 1,363 metres was carried out to test coincident geochemical and geophysical anomalies.

Four target areas (Altan Suult and three in the Khond Uul area), 1 to 4 kilometres apart (see plan map at www.erdene.com), all returned anomalous gold intersections (0.2 g/t gold and higher) commonly over significant thicknesses (up to 68 metres) including 10 metres of 1.2g/t gold and 2 metres of 6.6g/t gold at Altan Suult.

This Phase I drilling program confirmed that gold mineralization is hosted in all granitic, volcanic and metasedimentary rock types and extends to depth in multiple gold mineralized zones over broad thicknesses. These broad zones of low grade gold mineralization typically envelop higher grade zones.

Gold bearing zones have been traced over 7 kilometers at Khond Uul and over an area approximately 1 kilometre by 1 kilometre at Altan Suult with both areas remaining open at depth and in all directions. These results support the presence of a strong gold bearing hydrothermal system over a wide area (5 by 10 kilometres).

A six hole Phase II diamond drill program of totaling approximately 1,200 metres was initiated in mid October to further test mineralized zones and structural targets in the Altan Suult area. This program is currently ongoing and results will be released upon completion of these holes and receipt of all analytical results.

Energy Project - Uranium

Erdene holds 31 exploration licenses in south eastern Mongolia totaling 992,011 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.

IUC has now completed a 164 hole rotary reconnaissance drilling program totaling 13,720 metres on the Galshar group of Licenses, the Yant License and the Tsagaan Del License. All holes were logged using radiometric geophysical equipment (cps natural gamma and resistivity) using an in-hole probe.

In July, 65 holes were drilled on the Galshar Licenses to depths of 70 to 120 metres totaling 5065 metres including 58.5 metres of diamond drilling to test 10 target areas (profiles) in 4 large depressions. Significant results were returned from the southern and central parts of the Ikh-Khet depression in the western Galshar area where uranium mineralization is hosted in grey sandy clayey sediments and sandy clayey carbonaceous sediments with associated surface and subsurface oxidation. One hole in the southern area intersected 0.01 to 0.02% uranium over 7 metres at a depth of 7 – 14 metres. Another hole in the central part of the basin intersected 0.01 to 0.02% uranium over 5 metres at a depth of 20 metres. Drilling on one profile in the Delger Khiid depression returned grey colored clayey samples which may have further potential for uranium mineralization.

A total of 49 rotary holes were drilled on the Tsagaan Del License to depths of 30 to 100 metres totaling 3431.6 metres to test 6 target areas (profiles) outlined by ground radiometric surveys in 2005 in the northern part of the Undershill basin. All holes intersected arkosic and pink colored sandy – clayey sediments of Upper Cretaceous age.

At Yant, a surface radiometric survey covering 1008 line kilometers was completed by IUC in the third quarter. Several weak 12 – 14 ppm uranium anomalies were outlined which were followed up by rotary drilling.

A total of 50 holes for 5223.4 metres were completed on 7 targets (profiles) in the northern and southern parts of the western Sainshand basin. Drilling in the northern part of the basin intersected red colored primary sediments of Upper Cretaceous age. In the southern part of the basin, drilling intersected grey colored lake sediment clays which are only shallowly oxidized. One previously outlined small (200 metre x 300 metre) surface radiometric anomaly returned very low level gamma intensities (500 – 1500) in the drilled profile.

As a result of the 2006 program, further work is warranted on three Licenses in the Ikh Khet and Delger Khiid depressions in the Galshar area.

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. All the Company's coal exploration in Mongolia is being fully funded by Xstrata (refer to section 1.02 for further information about the Xstrata agreement) and is being carried out in consultation with Xstrata personnel.

Compilation of geological information and field evaluations of coal opportunities in Mongolia continued during the quarter with the objective of identifying deposits with the greatest potential as targets for possible joint venture or acquisition. A total of 20 high priority targets have been identified for further study/exploration and discussions with several property owners are currently in progress.

One of the priority targets is the Galshar Coal property held 100% by Erdene. The property is located approximately 300 kilometres southeast of Ulaanbaatar, 250 kilometres north of the Chinese border and 65 kilometres east of a short spur rail line accessing the Trans-Mongolian rail road.

The Erdene exploration license (9383X) 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 441,560 hectares.

The Galshar Coal property covers the majority of a coal bearing Cretaceous sedimentary basin and surrounds a small coal mine which supplies coal to local towns. In late 2005, the Company drilled an initial hole (CDD-01) approximately 300 metres northwest of the existing mine which intersected multiple coal seams over a total of 49 metres. Analysis of the drill core indicated that the bottom 21.8 metres (79.8 metres to 101.6 metres) consisted of good quality sub-bituminous coal with low ash (6.25%), low sulfur (0.37%) and a thermal value of 11,404 Btu/lb.

During the third quarter, the Company carried out a widely spaced nine hole drill program totaling 895 metres on the Erdene owned Galshar property north and southeast of hole CDD-1 to test the extent of the Galshar coal seams. Results of this program show that the coal lithologies extend at least 3.6 kilometres northeast where hole GHR -11 intersected 2 coal seams 10 metres and 7 metres thick. This coal basin remains open to the northeast. Analysis of the drill core is currently in progress.

Zuun Mod Porphyry Molybdenum Project

The Zuun Mod property is a porphyry molybdenum prospect located in Bayankhongor Province approximately 950 kilometres southwest of Ulaanbaatar and 180 kilometres 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.

The opportunities for potential future development of the Zuun Mod molybdenum project continue to be evaluated.

Biger Copper-Gold-PGE Project

Biger is an early stage exploration project located in a highly prospective area for copper and gold in southwestern Mongolia. 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 1500 metres in diameter. Three scout diamond holes drilled in 2005 to test coincident geochemical and geophysical anomalies, intersected several copper mineralized intercepts hosted within potassic altered diorite and gabbrodiorite in the eastern part of the property and in an outlier of altered granosyenite and diorite in the center of the large Biger pediment called Altan Khad. The one hole in the mineralized Altan Khad outlier intersected a 24 metre section that assayed 0.5% copper with elevated gold (86 ppb) and palladium (89 ppb) values. An area of younger rocks and recent sediments with a radius of at least 6 kilometres from this drill intersection remains untested.

In October 2006, a 115 line-kilometre gradient induced polarization survey was completed over the main 5 by 9 kilometre Biger area including the central Altan Khad mineralized outlier in the buried pediment area and an adjacent mineralized gabbro/diorite located 7 kilometres to the east. This was followed by 5 by 2 kilometre long north-south oriented dipole–dipole lines designed to identify buried base metal and precious metal mineralization. One line was completed over the central Altan Khad mineralized zone, two lines on 400 metre centers were completed to test a gradient chargeability anomaly in the eastern portion of the pediment area and two lines were completed over a small mineralized outlier in the northwestern part of the pediment area. In addition, a two line mobile metal ion (MMI) geochemical orientation survey was also completed over the central Altan Khad mineralized outlier and the mineralized zone intersected in the 2005 drill hole in an attempt to identify buried mineralized bodies. No MMI analytical results have been received to date and the geophysical data is currently being plotted and analyzed to identify possible drill targets.

Bayan Kharaat Copper Porphyry Project

The Bayan Kharaat property was obtained by GMML in 2001 after a reconnaissance follow up of copper porphyry districts in Mongolia.

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 grained 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 two kilometre long and 800 metre 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 200 metre grid over the south western and south central portions of the property. A total of 473 soil samples on 50 metre centers and 24 scattered rock samples were collected and analyzed for copper and gold. Two target areas of co-incident silicification, sericite/pyrite alteration and elevated copper in soil, with associated resistivity and chargeability highs 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. Grab samples in the southwest central area have returned values up to 0.2% copper. Additional exploration including drilling is planned for 2007.

North American Projects

The Company's North American project portfolio includes two notable industrial mineral projects as well as a 25% interest in the Donkin coal project (pursuant to an agreement entered into on October 26, 2006, see below and section 1.02). 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

Erdene announced on October 31, 2006 that they have increased the Company's ownership in the Donkin Coal Alliance to 25 per cent from 20 per cent in exchange for cash consideration of US$9,400 and 360,000 common shares of the Company. Closing of the transaction is subject to receipt of all necessary regulatory approvals, including approval of the Toronto Stock Exchange. Xstrata Coal Donkin Limited ("Xstrata Coal") has also increased its interest in the Donkin Coal Alliance to 75 per cent from 66 per cent in exchange for cash.

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, Nova Scotia. In May 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 well located to serve domestic and Eastern U.S. markets. Approximately $100 million was spent on previous work that included the construction of two 3.7 kilometre access tunnels.

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.

During the quarter considerable work was carried out on the site in preparation for the dewatering and tunnel access program. The old tunnel entrances have been reopened, refurbished and secured. Excavation work has been carried out on the property to provide a settling pond for the water that will be pumped from the tunnels. Water samples have been taken to test the quality of the tunnel water with no significant concerns identified. Pumps and piping equipment was put in place in readiness for the dewatering process. A 'code of conduct' was submitted to provincial and federal regulatory departments for approval before the dewatering process could commence. Final approval has been received and the dewatering process was commenced on November 1, 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 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 third quarter, Huber mined 62,083 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 164,057 tons. In addition, Huber has cleared approximately 100 additional acres at Lucky Strike and is carrying out in-fill drilling at 100 ft centers, prior to the start of mining in this area. The permitting preparation process for several properties located in McDuffie County was ongoing during the quarter. Economic and environmental impact studies are being carried out in support of the requirement for special use permit applications to counter concerns expressed by residents within close proximity of the proposed pit development area.

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 volumes mined and produced.

Maddox Aggregate Project

As a result of the Kaoclay acquisition, the Company now owns the Maddox granite aggregate project in Georgia, USA. Rinker Materials Corporation ("Rinker") 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 granite quarry, primarily to serve the southeastern US markets by rail. Rinker has submitted permitting applications to Hancock County and expects the project to be approved by the County regulatory agencies in late November. A development decision by Rinker is anticipated in late 2006. Rinker 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 with a design capacity of 4 million tons per annum and anticipated first year production of 1 million tons per annum. Rinker has advised Erdene that it expects the pre-production development period to be nine to twelve months from the date development commences. The project has an estimated lifespan of at least 20 years.

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 September 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 sections 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.