# CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2018 and 2017

*(Canadian dollars)*

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# INDEPENDENT AUDITORS' REPORT

To the Shareholders of Erdene Resource Development Corporation

### *Opinion*

We have audited the consolidated financial statements of Erdene Resource Development Corporation (the Entity), which comprise:

- the consolidated statements of financial position as at December 31, 2018 and December 31, 2017
- the consolidated statements of comprehensive loss for the years then ended
- the consolidated statements of changes in equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 2018 and December 31, 2017, and its consolidated results of operations, and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

### *Basis for Opinion*

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other responsibilities in accordance with these requirements.

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

### *Material Uncertainty Related to Going Concern*

We draw attention to Note 2 in the financial statements, which indicates that the Entity has experienced losses and negative cash flows from operations in 2018 and 2017, and does not have sufficient capital to fund its operations and planned expenditures beyond the second quarter of 2019 without additional financing.

As stated in Note 2 in the financial statements, these events or conditions, along with other matters as set forth in Note 2 in the financial statements, indicate that a material uncertainty exists that may cast significant doubt on the Entity's ability to continue as a going concern.

Our opinion is not modified in respect of this matter.

### *Other Information*

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report. We have nothing to report in this regard.

### *Responsibilities of Management and Those Charged with Governance for the Financial Statements*

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

### *Auditors' Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group Entity to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

The engagement partner on the audit resulting in this auditors' report is Douglas Reid.

Halifax, Canada

March 27, 2019

# ERDENE RESOURCE DEVELOPMENT CORPORATION

**Consolidated Statements of Financial Position**
(Canadian dollars)

| | Notes | | December 31, 2018 | | December 31, 2017 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and cash equivalents | | **$** | **1,748,249** | $ | 3,225,202 |
| Receivables | | | **113,412** | | 148,069 |
| Prepaid expenses | | | **34,633** | | 47,479 |
| Current assets | | | **1,896,294** | | 3,420,750 |
| | | | | | |
| Exploration and evaluation assets | **6** | | **15,687,348** | | 11,394,843 |
| Property, plant and equipment | **7** | | **125,277** | | 130,283 |
| Non-current assets | | | **15,812,625** | | 11,525,126 |
| | | | | | |
| **Total Assets** | | **$** | **17,708,919** | **$** | 14,945,876 |
| | | | | | |
| **Liabilities and Equity** | | | | | |
| Trade and other payables | | **$** | **224,387** | $ | 191,600 |
| **Total Liabilities** | | **$** | **224,387** | $ | 191,600 |
| | | | | | |
| **Shareholders' Equity** | | | | | |
| Share capital | **10** | **$** | **104,003,644** | $ | 99,890,270 |
| Contributed surplus | | | **16,110,116** | | 13,775,386 |
| Accumulated other comprehensive loss | | | **(955,713)** | | (894,855) |
| Deficit | | | **(101,673,515)** | | (98,016,525) |
| **Total Shareholders' Equity** | | | **17,484,532** | | 14,754,276 |
| | | | | | |
| **Total Liabilities and Equity** | | **$** | **17,708,919** | $ | 14,945,876 |

Commitments (Note 8)
Subsequent Events (Note 15)

The accompanying notes are an integral part of these consolidated financial statements.

Approved on behalf of the Board:

*Signed "Peter C. Akerley"*
________________________________ Director

*Signed "John P. Byrne"*
________________________________ Director

# ERDENE RESOURCE DEVELOPMENT CORPORATION

**Consolidated Statements of Comprehensive Loss**
(Canadian dollars)

| | Notes | For the year ended December 31, 2018 | 2017 |
|---|---|---|---|
| **Operating Expenses** | | | |
| Exploration and evaluation | **11** | **$ 1,595,675** | $ 1,631,628 |
| Corporate and administration | **12** | **2,120,390** | 2,450,152 |
| Loss from operating activities | | **3,716,065** | 4,081,780 |
| | | | |
| Finance income | | **(50,816)** | (91,505) |
| Foreign exchange loss (gain) | | **(8,259)** | 37,190 |
| **Net Loss** | | **$ 3,656,990** | $ 4,027,465 |
| | | | |
| Other comprehensive loss: | | | |
| Foreign currency translation difference arising on translation of foreign subsidiaries | | **60,858** | 258,572 |
| **Other comprehensive loss** | | **60,858** | 258,572 |
| | | | |
| **Total comprehensive loss** | | **$ 3,717,848** | $ 4,286,037 |
| | | | |
| Basic loss per share | | **$ 0.02** | $ 0.03 |
| | | | |
| Basic weighted average number of shares outstanding | | **155,104,960** | 142,916,756 |

The accompanying notes are an integral part of these consolidated financial statements.

# ERDENE RESOURCE DEVELOPMENT CORPORATION

**Consolidated Statements of Changes in Equity**
**(Canadian dollars)**

| | Notes | Number of shares | | Share capital | | Contributed surplus | | Accumulated other comprehensive loss | | Deficit | | Total equity |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance at January 1, 2017** | | 126,810,031 | $ | 86,783,669 | $ | 11,952,465 | $ | (636,283) | $ | (93,989,060) | $ | 4,110,791 |
| **Total comprehensive loss for the period:** | | | | | | | | | | | | |
| Net loss | | - | | - | | - | | - | | (4,027,465) | | (4,027,465) |
| Other comprehensive loss | | - | | - | | - | | (258,572) | | - | | (258,572) |
| Private placements, net of share issue costs | 10 | 18,465,555 | | 12,925,316 | | - | | - | | - | | 12,925,316 |
| Compensation warrants | 10 | - | | - | | 322,597 | | - | | - | | 322,597 |
| Options exercised | 10 | 687,500 | | 181,285 | | (55,310) | | | | | | 125,975 |
| Share-based compensation | | - | | - | | 1,555,634 | | | | | | 1,555,634 |
| **Total transactions with owners** | | 19,153,055 | | 13,106,601 | | 1,822,921 | | - | | - | | 14,929,522 |
| **Balance at December 31, 2017** | | 145,963,086 | $ | 99,890,270 | $ | 13,775,386 | $ | (894,855) | $ | (98,016,525) | $ | 14,754,276 |
| **Balance at January 1, 2018** | | **145,963,086** | **$** | **99,890,270** | **$** | **13,775,386** | **$** | **(894,855)** | **$** | **(98,016,525)** | **$** | **14,754,276** |
| **Total comprehensive loss for the period:** | | | | | | | | | | | | |
| **Net loss** | | **-** | | **-** | | **-** | | **-** | | **(3,656,990)** | | **(3,656,990)** |
| **Other comprehensive loss** | | **-** | | **-** | | **-** | | **(60,858)** | | **-** | | **(60,858)** |
| **Private placements, net of share issue costs** | **10** | **14,834,580** | | **3,706,199** | | **1,301,176** | | **-** | | **-** | | **5,007,375** |
| **Options exercised** | **10** | **1,628,750** | | **407,175** | | **(152,450)** | | | | | | **254,725** |
| **Share-based compensation** | | **-** | | **-** | | **1,186,004** | | **-** | | **-** | | **1,186,004** |
| **Total transactions with owners** | | **16,463,330** | | **4,113,374** | | **2,334,730** | | **-** | | **-** | | **6,448,104** |
| **Balance at December 31, 2018** | | **162,426,416** | **$** | **104,003,644** | **$** | **16,110,116** | **$** | **(955,713)** | **$** | **(101,673,515)** | **$** | **17,484,532** |

The accompanying notes are an integral part of these consolidated financial statements.

# ERDENE RESOURCE DEVELOPMENT CORPORATION

**Consolidated Statements of Cash Flows**

(Canadian dollars)

| | Notes | For the year ended December 31, 2018 | 2017 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Net loss | | **$ (3,656,990)** | $ (4,027,465) |
| Items not involving cash: | | | |
| Depreciation and amortization | | **20,904** | 18,285 |
| Share-based compensation | | **1,186,004** | 1,555,634 |
| Finance income | | **(50,816)** | (91,505) |
| Foreign exchange not related to cash | | **(8,259)** | 37,190 |
| Gain on wind-up of Barbados subsidiaries | | **-** | (242) |
| Change in non-cash working capital | | **74,124** | (70,469) |
| Cash flows from operating activities | | **(2,435,033)** | (2,578,572) |
| **Cash flows from financing activities:** | | | |
| Issue of common shares, net of issue costs | **10** | **5,007,375** | 13,247,913 |
| Proceeds on exercise of stock options | **10** | **254,725** | 125,975 |
| Cash flows from financing activities | | **5,262,100** | 13,373,888 |
| **Cash flows from investing activities:** | | | |
| Expenditures on exploration and evaluation assets | | **(4,363,017)** | (8,613,147) |
| Expenditures on property, plant and equipment | | **(16,077)** | (77,025) |
| Interest received | | **50,816** | 91,505 |
| Cash flows from investing activities | | **(4,328,278)** | (8,598,667) |
| Effect of exchange rate changes | | **24,258** | (42,656) |
| Increase (decrease) in cash and cash equivalents | | **(1,476,953)** | 2,153,993 |
| Cash and cash equivalents, beginning of period | | **3,225,202** | 1,071,209 |
| Cash and cash equivalents, end of period | | **$ 1,748,249** | $ 3,225,202 |

The accompanying notes are an integral part of these consolidated financial statements.

**1. Nature of operations:**

Erdene Resource Development Corporation (“Erdene” or the “Corporation”) is a Canadian based resource company focused on the exploration of precious and base metal deposits in Mongolia. The Corporation’s common shares are listed on the Toronto Stock Exchange under the symbol "ERD" and the Mongolian Stock Exchange under the symbol “ERDN”. The address of the Corporation’s registered office is 1300-1969 Upper Water Street, Halifax, Nova Scotia, B3J 2V1.

The Corporation has not yet determined whether its properties contain mineral reserves that are economically recoverable. The continued operations of the Corporation and the recoverability of the amounts capitalized for mineral properties is dependent upon the existence of economically recoverable reserves, the ability of the Corporation to obtain the necessary financing to complete the exploration and development of such properties and upon future profitable production or proceeds from the disposition of the properties.

**2. Going concern:**

These consolidated financial statements have been prepared on a going concern basis, which assumes the Corporation will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. However, in making its assessment, management is aware of material uncertainties related to events or conditions that cast significant doubt upon the Corporation’s ability to continue as a going concern, as described in the following paragraphs.

The Corporation experienced significant losses and negative cash flows from operations in 2018 and 2017 and has a deficit of $101,673,515 at December 31, 2018. The Corporation had working capital of $1,671,907 at December 31, 2018, compared to $3,229,150 at December 31, 2017, representing a $1,557,243 decrease. With the receipt of Private Placement gross proceeds of $2,533,345 on February 28, 2019 (see subsequent event), management estimates current working capital is sufficient to fund the Corporation’s planned expenditures into June of 2019. The ability of the Corporation to continue as a going concern, realize its assets and discharge its liabilities in the normal course of business and continue with, or expand upon its exploration programs is contingent upon securing equity financing, entering joint venture agreements or monetizing assets. The timing and availability of additional financing will be determined largely by market conditions and the results of the Corporation’s ongoing exploration programs. There is no certainty that the Corporation will be able to raise funds as they are required.

These consolidated financial statements do not reflect the adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis was not appropriate, then adjustments would be necessary to the carrying amounts of the assets, the reported expenses, and the statement of financial position classifications used.

## 3. Basis of presentation

a) Statement of compliance

The Corporation prepares their annual consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS"). The significant accounting policies are presented in Note 4 and have been consistently applied in each of the periods presented, except as disclosed in Note 5.

The consolidated financial statements were authorized for issue by Erdene's Board of Directors on March 27, 2019.

b) Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for financial assets classified as available-for-sale and fair value through profit and loss which are measured at fair value. These consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

c) Critical judgments and estimates in applying accounting policies

The preparation of financial statements in conformity with IFRS requires the Corporation's management to make estimates, judgments and assumptions that materially affect the amounts reported in the consolidated financial statements and accompanying notes. Judgments and estimates are regularly evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ materially from these estimates. Further information on management's judgments, estimates and assumptions and how they impact accounting policies are described below and also in the relevant notes to the consolidated financial statements.

*Judgments*

In the process of applying the Corporation's accounting policies, management has made the following judgments, which have the most significant effect on the amounts recognized in the consolidated financial statements.

i) *Functional currency*: The functional currency for the parent entity, and each of its subsidiaries, is the currency of the primary economic environment in which the entity operates. The Mongolian subsidiaries have a Mongolian Tugrik functional currency, while the parent entity has a Canadian dollar functional currency.

ii) *Review of asset carrying values and impairment assessment:* Each asset is evaluated every reporting period to determine whether there are indications of impairment. If any indication exists, a formal estimate of recoverable amount is performed, and an impairment loss is recognized to the extent that the carrying amount exceeds the recoverable amount. The recoverable amount of an asset is the greater of value in use and fair value less costs to sell.

Value in use is generally determined as the present value of future cash flows expected to arise from the continued use of the asset in its present form and its eventual disposal. Present values are determined using a risk-adjusted pre-tax discount rate appropriate to the risks inherent in the asset. Future cash flow estimates are based on expected production and sales volumes, mineral prices (considering current and historical prices, price trends and related factors), resources, operating costs,

**3. Basis of presentation (continued)**

*Judgements (continued)*

restoration and rehabilitation costs and future capital expenditure. The most significant assets assessed for impairment are exploration and evaluation assets. Indications of impairments include judgement on whether exploration will continue to be funded and if the projects are commercially viable.

iii) *Exploration and evaluation assets and expenditures:* The application of the Corporation's accounting policy for exploration and evaluation assets and expenditures requires judgment to determine whether future economic benefits are probable, from either future exploitation or sale, or whether activities have not reached a stage that permits a reasonable assessment of the existence of reserves. There is no assurance the Corporation has, or will have, commercially viable ore bodies. There is no assurance that the Corporation will be able to arrange sufficient financing to bring ore bodies into production.

*Estimates and assumptions*

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Corporation based its assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market change or circumstances arising beyond the control of the Corporation. Such changes are reflected in the assumptions when they occur.

i) *Exploration and evaluation assets and expenditures:* In addition to applying judgment to determine whether it is probable that future economic benefits will arise from the Corporation's exploration and evaluation assets and expenditures, or whether activities have not reached a stage that permits a reasonable assessment of the existence of reserves, the Corporation has to apply a number of estimates and assumptions. The publication of a resource pursuant to National Instrument 43-101, Standards of Disclosure for Mineral Projects ("NI 43-101"), is itself an estimation process that involves varying degrees of uncertainty depending on how the resources are classified (i.e. measured, indicated or inferred). The estimates directly impact when the Corporation defers its exploration and evaluation expenditures. Any such estimates and assumptions may change as new information becomes available. If information becomes available suggesting the recovery of acquisition costs is unlikely, the relevant capitalized amount is written off in the statement of profit or loss and other comprehensive income or loss in the period when the new information becomes available. The Corporation provides for such differences, where known, based on management's best estimate of the probable outcome of these matters.

ii) *Share-based compensation:* Equity-settled share-based compensation is measured at fair value at the date of grant. Fair value is measured using the Black-Scholes pricing model and requires the exercise of judgment in relation to variables such as expected volatilities and expected lives based on information available at the time the fair value is measured.

iii) *Provision for site restoration:* Management's assessment that there are currently no provisions required for site restoration is based on facts and circumstances that existed during the year.

**4. Summary of significant accounting policies**

The principal accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements:

a) Basis of consolidation

For the years ended December 31, 2018 and 2017, the consolidated financial statements include those of Erdene Resource Development Corporation and its subsidiaries: Erdene Mongol LLC and Anian Resources LLC (Mongolian exploration companies).

Subsidiaries are entities controlled by the Corporation. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intercompany balances and transactions are eliminated in preparing the consolidated financial statements. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that this is no evidence of impairment.

On February 6, 2017 the Corporation wound-up its Barbados holding companies Erdene Gold International Inc. and Erdene International Exploration Inc. resulting in a net gain of $242 which has been recorded as an offset to Corporate and Administration expenses.

b) Foreign currencies

Items included in the financial statements of the Corporation and its subsidiaries are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). In preparing the financial statements of the individual entities, transactions in currencies other than Erdene's functional currency (foreign currencies) are recorded at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date, giving rise to foreign exchange gains and losses in the statement of loss.

Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuated significantly during that period; in this case, the exchange rates at the dates of the transactions are used. Equity transactions are translated using the exchange rate at the date of the transaction. Exchange differences arising from assets and liabilities held in foreign currencies, are recognized in other comprehensive income (loss) as cumulative translation adjustments.

On the loss of control of a foreign operation, all the exchange differences accumulated in equity in respect of that operation attributable to the owners of the Corporation are recognized in the income statement as part of the gain or loss on sale.

c) Financial instruments

Financial instruments are accounted for, presented, and disclosed in accordance with IFRS 7, Financial Instruments: Disclosures, IAS 32 and IFRS 9, Financial Instruments. Erdene recognizes financial assets and financial liabilities when it becomes a party to a contract. Financial assets and financial liabilities, with the exception of financial assets classified as FVTPL, are measured at fair value, plus transaction costs on initial recognition. Financial assets classified at FVTPL are measured at fair value on initial recognition and transaction costs are expensed when incurred.

**4. Summary of significant accounting policies (continued)**

c) Financial instruments (continued)

Each type of fair value is categorized based on the lowest level of input that is significant to the fair value measurement in its entirety. The following summarizes the Corporation's classification and measurement of financial assets and liabilities:

| Type | Classification | Measurement |
|---|---|---|
| Cash and cash equivalents | Financial Assets | Fair value |
| Receivables | Financial Assets | Amortized cost |
| Trade and other payables | Financial Liabilities | Amortized cost |

The Corporation classifies and measures financial assets and liabilities as described below:

i) Cash and equivalents include cash, term deposits, treasury bills and money market investments with original maturities of less than 90 days and are classified as and measured at fair value through profit or loss.

ii) Receivables are classified and measured at amortized cost.

iii) Trade and other payables are classified and measured at amortized cost. A financial liability is derecognized when the obligation specified in the contract is discharged, cancelled or expired.

d) Exploration and evaluation assets

Pre-exploration expenditures are expensed as incurred. 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 a property, or an area's potential has been determined, as approved by the Board, in which case subsequent exploration and evaluation costs are capitalized.

Exploration and evaluation assets are initially measured at cost and classified as tangible assets. Exploration and evaluation assets include expenditures on acquisition of rights to explore, studies, exploratory drilling, trenching, sampling, and other direct costs related to exploration or evaluation of a project. Where a project is determined to be technically or commercially feasible and a decision has been made to proceed with development, the relevant exploration and evaluation asset is tested for impairment and the balance is reclassified as a resource property in property, plant and equipment.

An impairment review of exploration and evaluation assets is performed, either individually or at the cash-generating unit level, when there are indicators the carrying amount of the assets may exceed their recoverable amounts. To the extent this occurs, the excess is fully provided against the carrying amount, in the financial year in which this is determined.

**4. Summary of significant accounting policies (continued)**

d) Exploration and evaluation assets (continued)

Exploration and evaluation assets are reassessed on a regular basis and these costs are carried forward provided at least one of the conditions below is met:

i) such costs are expected to be recouped in full through successful development and exploration of the area of interest or alternatively, by its sale; or

ii) exploration and evaluation activities in the area of interest have not yet reached a stage that permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in relation to the area are continuing or planned for the future.

e) Property, plant and equipment

Property, plant and equipment is measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour and any other costs directly attributable to bringing the assets to working condition for their intended use.

Depreciation of property, plant and equipment is calculated using the declining balance method to allocate cost, net of residual value, over the estimated useful life or in the case of certain leased plant and equipment, lease term, at the following rates:

| Asset | Basis | Rate |
|---|---|---|
| Vehicles & field equipment | Declining balance | 30% |
| Equipment, furniture & fixtures | Declining balance | 20% |
| Software & computers | Declining balance | 33% |

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted prospectively, if appropriate.

f) Share-based compensation

Equity-settled share-based awards to employees and others providing similar services are measured at the fair value of the equity instruments at the grant date using the Black-Scholes pricing model. The fair value determined at the grant date is expensed as services are rendered over the vesting period, based on the Corporation's estimate of the shares that will eventually vest and adjusted for the effect of non-market-based vesting conditions.

Equity-settled share-based payment transactions with parties other than employees and those providing similar services are measured at the fair value of the goods or services received, except where the fair value cannot be estimated reliably, in which case they are measured at the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders the service.

## 4. Summary of significant accounting policies (continued)

g) Loss per share

The Corporation presents basic and diluted loss per share data for its common shares. Basic loss per share is calculated by dividing the profit or loss attributable to common shareholders of the Corporation by the weighted average number of common shares outstanding during the period. Diluted loss per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of shares outstanding adjusted for the effects of all dilutive potential common shares. All share options are currently anti-dilutive to loss per share. As a result, basic and diluted loss per share are the same.

## 5. Changes in accounting policies

Erdene has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2018. These changes were made in accordance with the applicable transitional provisions.

<u>IFRS 9 – Financial Instruments</u>

IFRS 9 introduces new requirements for the classification and measurement of financial assets. Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The standard introduces additional changes relating to financial liabilities and amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment. IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management.

The Corporation adopted IFRS 9 in its financial statements for the annual period beginning on January 1, 2018. The adoption of this standard had no financial impact to Erdene. Refer to accounting policies and Note 13 in the Consolidated Financial Statements.

*New accounting standards not yet adopted*

The following new standards, and amendments to standards and interpretations under IFRS, are not yet effective for the year ended December 31, 2018, and have not been applied in preparing these consolidated statements:

<u>IFRS 16 – Leases</u>

On January 13, 2016, the IASB issued IFRS 16 Leases, which specifies how to recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Consistent with its predecessor, IAS 17 the new lease standard continues to require lessors to classify leases as operating or finance. IFRS 16 is to be applied retrospectively for annual periods beginning on or after January 1, 2019. As the Corporation does not have significant lease commitments, Erdene will not see a material impact from the adoption of the standard.

(Canadian dollars)

## 6. Exploration and evaluation assets

| | Khundii Gold Project | Zuun Mod Moly/Copper | Ulaan & Other | Total |
|---|---|---|---|---|
| Balance, January 1, 2017 | $ 2,337,466 | $ 728,164 | $ 581 | $ 3,066,211 |
| Additions | 7,589,759 | 74,062 | 949,326 | 8,613,147 |
| Effect of movements in exchange rates | (226,393) | (36,431) | (21,691) | (284,515) |
| Balance, December 31, 2017 | $ 9,700,832 | $ 765,795 | $ 928,216 | $ 11,394,843 |
| | | | | |
| **Balance, January 1, 2018** | **$ 9,700,832** | **$ 765,795** | **$ 928,216** | **$ 11,394,843** |
| **Additions** | **4,291,555** | **70,074** | **1,388** | **4,363,017** |
| **Effect of movements in exchange rates** | **(62,077)** | **(4,143)** | **(4,292)** | **(70,512)** |
| **Balance, December 31, 2018** | **$ 13,930,310** | **$ 831,726** | **$ 925,312** | **$ 15,687,348** |

The Corporation's mineral exploration and mining licenses in Mongolia are held by its subsidiaries, Erdene Mongol LLC, Anian Resources LLC and Leader Exploration LLC. Mineral exploration licenses are valid for a period of three years and, through renewals, can be extended to a maximum of twelve years, subject to minimum work requirements. Mining licenses are issued for an initial term of 30 years with two 20-year extensions possible. These rights are held in good standing through the payment of annual license fees.

Khundii Gold Project

The Khundii Gold Project is located in Bayankhongor province in Mongolia, and is comprised of the 4,514 hectare Khundii license, including the Bayan Khundii and Altan Arrow gold prospects, and the 4,669 hectare Tsenkher Nomin license including the Altan Nar gold, silver, lead, zinc prospect. Prior to December 31, 2018 Exploration and evaluation expenditures on the Khundii license and the Tsenkher Nomin license were disclosed separately. Erdene made the decision in late 2018 to develop these licenses concurrently, and therefore Erdene has elected to aggregate associated Exploration and evaluation assets and expenditures.

The Khundii license is in its eighth year of a maximum 12-year term and can be converted to a mining license at any time prior to the end of the twelfth year by meeting the requirements prescribed under the Minerals Law of Mongolia. On July 1, 2016, the Corporation began capitalizing exploration costs on the property in accordance with its capitalization policy. Prior to this, the Corporation only capitalized the license costs associated with Khundii.

The Tsenkher Nomin exploration license is in its ninth year of a maximum 12-year term and can be converted to a mining license at any time prior to the end of the twelfth year by meeting the requirements prescribed under the Minerals Law of Mongolia. On January 1, 2015, having received the initial resource estimate for the Altan Nar prospect, the Corporation began capitalizing exploration costs on the property in accordance with its capitalization policy. Prior to 2015, the Corporation only capitalized the license costs associated with Altan Nar.

Zuun Mod/Khuvyn Khar

The property is located in Bayankhongor Province in Mongolia. The 6,041 hectare Zuun Mod property contains a molybdenum-copper resource. The mining license was issued in 2011 and is valid for an initial 30-year term with provision to renew the license for two additional 20-year terms.

(Canadian dollars)

## 6. Exploration and evaluation assets (continued)

Ulaan & Other

The Ulaan exploration license covers an area of approximately 1,780 hectares, situated immediately adjacent to the Khundii license. The exploration license is in its fourth year of a maximum 12-year term and can be converted to a mining license at any time prior to the end of the twelfth year by meeting the requirements prescribed under the Minerals Law of Mongolia. On August 30, 2017, Erdene acquired 51% of the outstanding shares of Leader Exploration LLC, a private Mongolian company that holds the property. Erdene evaluated the acquisition considering IFRS 3, Business Combinations, and concluded that the transaction constituted the acquisition of a collection of assets, not a business.

Provided Erdene spends a minimum of US$600,000 on work expenditures on the property over three years, it has the right to acquire the remaining 49% of the shares of Leader, or at Erdene's option, a portion of the property, for the then fair market value of the property or the portion to be acquired. Erdene may extend the option beyond three years by spending a minimum of US$100,000 per annum thereafter.

In April 2013, the Corporation entered into an agreement with Teck Resources Limited ("Teck"), to fund and explore the Corporation's mineral tenements in the Trans Altai region of southwest Mongolia. Under the Teck Alliance, two licenses were staked in early 2015, totaling 1,552 hectares. No major exploration work has been completed on these licenses to date.

## 7. Property, plant and equipment

| | Vehicles & field equipment | Equipment, furniture & fixtures | Software & computers | Total |
|---|---|---|---|---|
| Cost | | | | |
| Balance, January 1, 2017 | $ 37,752 | $ 102,976 | $ 194,040 | $ 334,768 |
| Additions | 67,528 | 6,680 | 2,817 | 77,025 |
| Effect of movements in exchange rates | (7,175) | (1,982) | (899) | (10,056) |
| Balance, December 31, 2017 | $ 98,105 | $ 107,674 | $ 195,958 | $ 401,737 |
| Depreciation & depletion | | | | |
| Balance, January 1, 2017 | $ (3,775) | $ (74,596) | $ (176,979) | $ (255,350) |
| Depreciation | (7,953) | (4,451) | (5,881) | (18,285) |
| Effect of movements in exchange rates | 363 | 971 | 847 | 2,181 |
| Balance, December 31, 2017 | $ (11,365) | $ (78,076) | $ (182,013) | $ (271,454) |
| Carrying amounts | | | | |
| At January 1, 2017 | $ 33,977 | $ 28,380 | $ 17,061 | $ 79,418 |
| At December 31, 2017 | $ 86,740 | $ 29,598 | $ 13,945 | $ 130,283 |

(Canadian dollars)

**7. Property, plant and equipment (continued)**

| | | Vehicles & field equipment | | Equipment, furniture & fixtures | | Software & computers | | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| **Balance, January 1, 2018** | $ | 98,105 | $ | 107,674 | $ | 195,958 | $ | 401,737 |
| **Additions** | | - | | 3,497 | | 12,580 | | 16,077 |
| **Effect of movements in exchange rates** | | (233) | | (110) | | (189) | | (532) |
| **Balance, December 31, 2018** | $ | 97,872 | $ | 111,061 | $ | 208,349 | $ | 417,282 |
| | | | | | | | | |
| **Depreciation & depletion** | | | | | | | | |
| **Balance, January 1, 2018** | $ | (11,365) | $ | (78,076) | $ | (182,013) | $ | (271,454) |
| **Depreciation** | | (9,938) | | (4,463) | | (6,503) | | (20,904) |
| **Effect of movements in exchange rates** | | 178 | | 103 | | 72 | | 353 |
| **Balance, December 31, 2018** | $ | (21,125) | $ | (82,436) | $ | (188,444) | $ | (292,005) |
| | | | | | | | | |
| **Carrying amounts** | | | | | | | | |
| **At January 1, 2018** | $ | 86,740 | $ | 29,598 | $ | 13,945 | $ | 130,283 |
| **At December 31, 2018** | $ | 76,747 | $ | 28,625 | $ | 19,905 | $ | 125,277 |

**8. Commitments**

Operating commitments are as follows:

| | | December 31, 2018 | | December 31, 2017 |
|---|---|---|---|---|
| Less than 1 year | | **41,957** | | 62,936 |
| Between 1 and 5 years | | **-** | | 41,957 |
| **Total** | **$** | **41,957** | $ | 104,893 |

The Corporation's operating lease for office space in Dartmouth, Nova Scotia expires August 31, 2019.

In 2019, minimum exploration expenditures of USD$1.50 per hectare are required on the Corporation's Tsenkher Nomin and Khundii licenses (USD$7,004 and USD$6,771 respectively).

The Corporation must spend a total of USD$600,000 over three years to have the right to purchase any (or all) of the remaining 49% of Leader (Ulaan). The Corporation can extend the option period beyond three years by spending an additional USD$100,000 per year on exploration work (see Note 6).

On April 21, 2016 the Corporation granted Sandstorm Gold Ltd. ("Sandstorm") a 2% net smelter returns royalty ("NSR Royalty") on Erdene's Tsenkher Nomin and Khundii licenses. Erdene has an option to buy-back 50% of the NSR Royalty for $1.2 million, to reduce the NSR Royalty to 1%, which expires April 14, 2019.

(Canadian dollars)

### 8. Commitments (continued)

Sandstorm has been given a right of first refusal on future stream or royalty financings related to the Khundii and Tsenkher Nomin licenses.

Gallant Minerals Limited is entitled to a 1.5% NSR Royalty on the Zuun Mod License, subject to a buy-down provision. There are no minimum exploration work commitments for the Zuun Mod mining license.

### 9. Income taxes

The Corporation's provision for income taxes differs from the amount computed by applying the combined Canadian federal and provincial income tax rates to income (loss) before income taxes as a result of the following:

| | | **December 31, 2018** | | **December 31, 2017** |
|---|---|---|---|---|
| Statutory tax rates | | 31% | | 31% |
| Income taxes (recovery) computed at the statutory rates | **$** | **(1,134,000)** | $ | (1,249,000) |
| Benefit of temporary differences not recognized | | **551,000** | | 577,000 |
| Expenses not deductible for tax purposes | | **384,000** | | 499,000 |
| Effect of foreign tax rates | | **199,000** | | 173,000 |
| Provision for income taxes | **$** | **-** | $ | - |

The enacted tax rates in Canada 31% (31% in 2017) and Mongolia 25% (25% in 2017) where the Corporation operates are applied in the tax provision calculation.

The following temporary differences, non-capital losses and capital losses have not been recognized in the consolidated financial statements.

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | | Canada | | Mongolia | | Total |
| Non-capital losses carried forward | $ | 14,983,000 | $ | 1,620,000 | $ | 16,603,000 |
| Property, plant and equipment | | 222,000 | | - | | 222,000 |
| Share issuance costs | | 1,225,000 | | - | | 1,225,000 |
| Intangible assets | | 378,000 | | - | | 378,000 |
| Exploration and evaluation assets | | 5,737,000 | | 8,569,000 | | 14,306,000 |
| | $ | 22,545,000 | $ | 10,189,000 | $ | 32,734,000 |

(Canadian dollars)

**9. Income taxes (continued)**

| | December 31, 2018 | | |
|---|---|---|---|
| | Canada | Mongolia | Total |
| **Non-capital losses carried forward** | **$ 16,845,000** | **$ 1,694,000** | **$ 18,539,000** |
| **Property, plant and equipment** | **228,000** | **-** | **228,000** |
| **Share issuance costs** | **1,305,000** | **-** | **1,305,000** |
| **Intangible assets** | **378,000** | **-** | **378,000** |
| **Exploration and evaluation assets** | **5,737,000** | **8,885,000** | **14,622,000** |
| | **$ 24,493,000** | **$ 10,579,000** | **$ 35,072,000** |

As at December 31 2018, the Corporation has non-capital losses to be carried forward and applied against taxable income of future years. The non-capital losses have expiry dates as follows:

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| 2018 | **$ -** | $ 424,000 |
| 2019 | **333,000** | 335,000 |
| 2020 | **381,000** | 384,000 |
| 2021 | **473,000** | 477,000 |
| 2022 | **507,000** | - |
| Thereafter | **16,845,000** | 14,983,000 |
| | **$ 18,539,000** | $ 16,603,000 |

**10. Share Capital and Contributed Surplus**

a) Authorized

An unlimited number of common shares with no par value.

b) Issued

*For the year ended 2018*

On June 8, 2018, the Corporation closed a non-brokered common share private placement for gross proceeds of $4.12 million, issuing 10,834,580 units at a price of $0.38 per unit. Each unit consisted of one common share of the Corporation and one common share purchase warrant. Each warrant entitles the holder to purchase one common share of the Corporation at a price of $0.60 for 30 months from the closing date. The Corporation paid finder’s fees in the aggregate of $182,400 and issued 480,000 finder’s warrants in connection with the private placement. Each finder’s warrant is exercisable into one common share of the corporation at $0.60 per share, for a period of 30 months from the closing date. The total fair value on the grant date of the 11,314,580 warrants issued was $1,301,176 ($0.115 per warrant). All securities issued pursuant to the private placement were subject to a four-month hold period from the closing date.

On June 14, 2018, the Corporation closed a financing in connection with a cross-listing of its common shares on the Mongolian Stock Exchange (MSE) for gross proceeds of $1.36 million. In this transaction, the

(Canadian dollars)

**10. Share Capital and Contributed Surplus (continued)**

Corporation issued 4,000,000 common shares at a price of $0.34 per share. The Corporation paid a cash commission of 7% of the gross proceeds to the underwriters of $95,200. The shares issued under the Mongolia offering commenced trading on the MSE on June 19, 2018. Under current Mongolian regulations, the shares listed on the MSE may only be traded through facilities of the MSE until de-listed or until cross-border trades are authorized by Mongolian authorities. In addition, all shares issued pursuant to the Mongolia offering were subject to a four-month hold period from the closing date of the Mongolia Offering.

For the year ended December 31, 2018, the Corporation charged a total of $1,186,004 of stock-based compensation expense to the statement of comprehensive loss (2017 – $1,555,634) of which $473,150 is attributable to exploration expenses (2017 – $607,092).

c) Stock options

The Corporation has a rolling 10% incentive stock option plan (the "Plan") under which options to purchase common shares of the Corporation may be granted to directors, officers, employees and consultants of the Corporation. Under the Plan, the terms and conditions of each grant of options are determined by the Board of Directors. If there are no terms specified upon grant, options vest immediately on the grant date. The number of common shares subject to options granted under the Plan is limited to 10% of the issued and outstanding common shares of the Corporation and no one person may receive in excess of 5% of the outstanding common shares of the Corporation at the time of grant (on a non-diluted basis).

During the year ended December 31, 2018, 3,360,000 options were granted at a weighted average exercise price of $0.39. Also 1,628,750 options were exercised at an average price of $0.16 generating proceeds of $254,725. During the year ended December 31, 2018, 100,000 options expired (2017 – 0 options).

The changes in stock options during the years ended December 31, 2018 and 2017 were as follows:

| | December 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Number of options | Weighted average exercise price | Number of options | Weighted average exercise price |
| Outstanding at January 1 | **9,703,750** | **$ 0.40** | 7,621,250 | $ 0.21 |
| Granted | **3,360,000** | **0.39** | 2,770,000 | 0.87 |
| Expired | **(100,000)** | **0.40** | - | - |
| Exercised | **(1,628,750)** | **0.16** | (687,500) | 0.18 |
| Outstanding at December 31 | **11,335,000** | **$ 0.43** | 9,703,750 | $ 0.40 |
| Exercisable at December 31 | **11,335,000** | **$ 0.43** | 9,703,750 | $ 0.40 |

(Canadian dollars)

**10. Share Capital and Contributed Surplus (continued)**

c) Stock options (continued)

All stock options granted in 2018 and 2017 vested immediately and have a five-year term. The following table summarizes information concerning outstanding options, all of which are exercisable at December 31, 2018.

| | **December 31, 2018** | | December 31, 2017 | |
|---|---|---|---|---|
| **Expiry date** | **Number of Options** | **Exercise price** | Number of Options | Exercise price |
| August 27, 2017 | **-** | **$ -** | 437,500 | $ 0.25 |
| June 28, 2018 | **-** | **-** | 1,071,250 | 0.12 |
| January 8, 2019 | **325,000** | **0.14** | 445,000 | 0.14 |
| June 18, 2019 | **935,000** | **0.16** | 935,000 | 0.16 |
| June 5, 2020 | **1,100,000** | **0.15** | 1,100,000 | 0.15 |
| July 2, 2020 | **100,000** | **0.15** | 100,000 | 0.15 |
| December 22, 2020 | **895,000** | **0.16** | 895,000 | 0.16 |
| June 15, 2021 | **1,950,000** | **0.36** | 1,950,000 | 0.36 |
| March 31, 2022 | **2,620,000** | **0.87** | 2,620,000 | 0.87 |
| July 18, 2022 | **150,000** | **0.89** | 150,000 | 0.89 |
| February 4, 2023 | **50,000** | **0.50** | - | - |
| March 13, 2023 | **100,000** | **0.40** | - | - |
| June 14, 2023 | **2,810,000** | **0.40** | - | - |
| October 15, 2023 | **150,000** | **0.27** | - | - |
| November 8, 2023 | **150,000** | **0.24** | - | - |
| | **11,335,000** | **$ 0.43** | 9,703,750 | $ 0.40 |

The fair value of each option granted is estimated at the time of grant using the Black-Scholes option pricing model with weighted-average assumptions for grants as follows:

| | **Year Ended December 31, 2018** | **Year Ended December 31, 2017** |
|---|---|---|
| Share price at grant date | **$ 0.49** | $ 0.88 |
| Exercise price | **$ 0.39** | $ 0.87 |
| Risk-free interest rate | **2.0%** | 0.9% |
| Expected life | **4.0 years** | 3.7 years |
| Expected volatility | **77%** | 85% |
| Expected dividends | **0.0%** | 0.0% |
| Weighted average grant date fair value | **$ 0.30** | $ 0.51 |

Expected volatility is estimated by considering historic average share price volatility.

Options issued in 2018 resulted in a charge of $1,019,110 (2017 – $1,424,360) to share based compensation included in exploration expenses and in corporate and administration expenses.

(Canadian dollars)

**10. Share Capital and Contributed Surplus (continued)**

c) Stock options (continued)

The remaining contractual lives of options outstanding at December 31, 2018, are as follows:

| Range of prices | Number of options exercisable | Weighted average remaining contractual life (years) | Weighted average exercise price of exercisable options | |
|---|---|---|---|---|
| $0.14 - $0.24 | **3,505,000** | **1.32** | **$** | **0.16** |
| $0.25 - $0.49 | **5,010,000** | **3.68** | | **0.38** |
| $0.50 - $0.89 | **2,820,000** | **3.28** | | **0.86** |
| | **11,335,000** | **2.85** | **$** | **0.43** |

d) Warrants

During the year ended December 31, 2018, 11,314,580 warrants were issued as part of the June 8, 2018 non-brokered common share private placement. Each warrant entitles the holder to purchase one common share of the Corporation at a price of $0.60 for 30 months and expires on December 8, 2020.

At the end of 2017, 1,075,324 compensation warrants were outstanding. Each compensation warrant entitles the holder to purchase one share for $1.20 per share until February 22, 2019.

The following table summarizes the continuity of the warrants for the years ended December 31, 2018 and 2017:

| | December 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | Number of warrants | Weighted average exercise price | | Number of warrants | Weighted average exercise price | |
| Outstanding at January 1 | **1,075,324** | **$** | **1.20** | - | $ | - |
| Issued | **11,314,580** | | **0.60** | 1,075,324 | | 1.20 |
| Exercised | **-** | | **-** | - | | - |
| Expired | **-** | | **-** | - | | - |
| Outstanding at December 31 | **12,389,904** | **$** | **0.65** | 1,075,324 | $ | 1.20 |

The remaining contractual lives of warrants outstanding at December 31, 2018, are as follows:

| Exercise price | Number of warrants outstanding | Weighted average remaining contractual life (years) |
|---|---|---|
| $0.60 | **11,314,580** | **1.94** |
| $1.20 | **1,075,324** | **0.15** |
| | **12,389,904** | **1.78** |

(Canadian dollars)

**10. Share Capital and Contributed Surplus (continued)**

e) Deferred Share Units

In 2013, the Corporation adopted a deferred share unit ("DSU") plan to align the long-term incentive compensation of certain officers, directors and senior management with the drivers of long-term shareholder value. Under the Erdene DSU plan, the Corporation may grant DSUs to eligible plan members in such number and at such times as is determined by the Board of Directors as a bonus or in respect of services rendered by the plan member or otherwise as compensation. On the grant date, DSUs vest immediately and plan members are credited with the DSUs granted to them. Upon termination or death of the plan member, the Corporation pays the then market value of the plan member's shares either in cash or in shares, at the sole discretion of the Corporation. Since the type of payout is at the discretion of the Corporation, and the Corporation does not intend to cash settle awards under the plan, the plan is accounted for as an equity settled plan.

During the year ended December 31, 2018, the Corporation granted 543,932 DSUs with a fair value of $0.31 per DSU (2017 – 173,727 DSUs with fair value of $0.76 per DSU). The fair value of $166,894 (2017 – $131,274) was charged to share based compensation included in exploration expenses and corporate and administration expenses.

| | Year Ended December 31, 2018 | | Year Ended December 31, 2017 | |
|---|---|---|---|---|
| Five day volume weighted average price at grant date | **$** | **0.31** | $ | 0.76 |

The following table summarizes information concerning DSUs at December 31, 2018 and 2017:

| | December 31, 2018<br>Number of DSUs | December 31, 2017<br>Number of DSUs |
|---|---|---|
| Outstanding at January 1 | **3,410,186** | 3,236,459 |
| Granted | **543,932** | 173,727 |
| Outstanding at December 31 | **3,954,118** | 3,410,186 |

**11. Exploration and evaluation expenses**

The following table summarizes exploration and evaluation expenses for the years ended December 31, 2018 and 2017:

| | For the year ended December 31<br>2018 | | 2017 | |
|---|---|---|---|---|
| Depreciation & amortization | **$** | **14,733** | $ | 11,747 |
| Direct costs | | **811,155** | | 719,183 |
| Employee compensation costs | | **296,637** | | 293,606 |
| Share-based compensation | | **473,150** | | 607,092 |
| | **$** | **1,595,675** | $ | 1,631,628 |

(Canadian dollars)

## 12. Corporate and administration expenses

The following table summarizes corporate and administration expenses for the years ended December 31, 2018 and 2017:

| | For the year ended December 31 | |
|---|---|---|
| | **2018** | **2017** |
| Administrative services | **$ 535,118** | $ 572,692 |
| Depreciation and amortization | **6,194** | 6,504 |
| Directors fees and expenses | **132,841** | 146,141 |
| Investor relations and marketing | **201,074** | 267,171 |
| Office and sundry | **123,271** | 115,299 |
| Professional fees | **236,394** | 131,525 |
| Regulatory compliance | **116,567** | 139,108 |
| Share-based compensation | **712,854** | 948,542 |
| Travel and accommodations | **56,077** | 123,170 |
| | **$ 2,120,390** | $ 2,450,152 |

## 13. Financial instruments

**Credit Risk:**

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

| | Carrying Amount | |
|---|---|---|
| | **December 31, 2018** | **December 31, 2017** |
| Cash and cash equivalents | **$ 1,748,249** | $ 3,225,202 |
| Receivables | **113,412** | 148,069 |
| | **$ 1,861,661** | $ 3,373,271 |

The Corporation manages credit risk by holding the majority of its cash and cash equivalents with high quality financial institutions in Canada, where management believes the risk of loss to be low. At December 31, 2018, $66,342 or 4% of the balance of cash was held in banks outside Canada (2017 - $113,555 or 4%).

**Liquidity Risk:**

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Corporation's approach to managing liquidity is to ensure, to the extent possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions.

The corporation does not have sufficient working capital to meet budgeted expenditures for 2019 and must obtain additional financing to avoid disruption to its operations (see note 2).

## 13. Financial instruments (continued)

**Market Risk:**

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

a) Interest rate risk

As of December 31, 2018, the Corporation has no interest-bearing debt and is not exposed to any significant interest rate risk.

b) Foreign currency risk

The Corporation operates in Mongolia, giving rise to foreign currency risk. To limit the Corporation's exposure to this risk, cash and cash equivalents balances are primarily held with Canadian financial institutions in Canadian dollars. Based on the timing of the Corporation's forecasted cash needs, foreign currencies may be purchased in advance of expenditures to lock in favorable rates in line with the Corporation's budgets, otherwise the Corporation does not use any form of hedging against fluctuations in foreign exchange.

The Corporation's exposure to US dollar currency risk was as follows:

| | | **December 31, 2018** | | **December 31, 2017** |
|---|---|---|---|---|
| Cash and cash equivalents | **$** | **96,157** | $ | 212,116 |
| Trade and other receivables | | **-** | | 7,424 |
| Trade and other payables | | **(24,244)** | | (13,767) |
| | **$** | **71,913** | $ | 205,773 |

A 10% change in the US dollar exchange rate would affect net and comprehensive loss and deficit by approximately $7,200 (December 31, 2017 - $20,600).

The Corporation's exposure to Mongolian Tugrik currency risk was as follows:

| | | **December 31, 2018** | | **December 31, 2017** |
|---|---|---|---|---|
| Cash and cash equivalents | **$** | **3,432** | $ | 25,328 |
| Trade and other receivables | | **7,218** | | 7,158 |
| Trade and other payables | | **(22,159)** | | (71,012) |
| | **$** | **(11,509)** | $ | (38,526) |

A 10% change in the Mongolian Tugrik exchange rate would affect net and comprehensive loss and deficit by approximately $1,200 (December 31, 2017 - $3,900).

c) Price risk

The Corporation's financial instruments are not exposed to direct price risk other than that associated with commodities fluctuations impacting the mineral exploration and mining industries as the Corporation has no significant revenues.

(Canadian dollars)

## 13. Financial instruments (continued)

### Fair Value:

The fair value hierarchy of assets and liabilities measured at fair value on the consolidated statements of financial position or disclosed in the notes to the financial statements is as follows:

| | December 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Level 1** | **Level 2** | **Level 3** |
| Assets measured at fair value: | | | | | | |
| Cash and cash equivalents | **$ 1,748,249** | **$ -** | **$ -** | $ 3,225,202 | $ - | $ - |
| Receivables | **-** | **113,412** | **-** | - | 148,069 | - |

## 14. Related Parties

The Corporation has defined key management personnel as senior executive officers, as well as the Board of Directors. The total remuneration of key management personnel and the Board of Directors was as follows:

| | Year ended December 31, | |
|---|---|---|
| | **2018** | **2017** |
| Directors' fees | **$ 111,500** | $ 60,000 |
| Share-based compensation to directors | **343,600** | 528,250 |
| Key management short-term benefits | **386,892** | 523,536 |
| Share-based compensation to key management | **440,573** | 353,071 |
| | **$ 1,282,565** | $ 1,464,857 |

## 15. Subsequent Events

On February 28, 2019 the Corporation closed a non-brokered private placement financing for gross proceeds to the Corporation of $2,533,345. The Corporation issued an aggregate of 11,014,544 Units of the Corporation at a price of $0.23 per Unit. Each Unit consists of one common share and one Warrant. Warrants are exercisable by the holder into one common share of the Corporation within two years of the closing date, at a price of $0.40 if exercised within twelve months of the closing date and at a price of $0.50 if exercised more than twelve months after the closing date. The Corporation paid finder’s fees of $62,116 and issued 270,070 finder’s warrants in connection with the Offering. The finder's warrants are exercisable on the same terms as the unit Warrants.

On March 26, 2019, Erdene notified Sandstorm of its intention to buy-back 50% of the NSR Royalty for $1.2 million. The buy-back will reduce the NSR Royalty payable to Sandstorm to 1%. The Corporation intends to close this transaction by April 14, 2019. Erdene will fund the repurchase from cash on hand.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Year ended December 31, 2018

## Contents



*This Management Discussion and Analysis ("**MD&A**"), dated March 27, 2019, relates to the operating results and financial condition of Erdene Resource Development Corporation ("**Erdene**" or the "**Company**" or the "**Corporation**") and should be read in conjunction with the Corporation's audited consolidated financial statements for the years ended December 31, 2018 and 2017 and the notes thereto. The consolidated financial statements of the Corporation have been prepared in Canadian dollars in accordance with International Financial Reporting Standards ("**IFRS**").*

*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, budgeted financial results and events or developments that the Corporation expects, are forward-looking statements. Although the Corporation believes the expectations expressed in such forward-looking statements are based on reasonable assumptions (including, but not limited to, assumptions in connection with the continuance of the Corporation and its subsidiaries as a going concern, general economic and market conditions, mineral prices, and the accuracy of mineral resource estimate), 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, exploration and evaluation results, continued availability of capital and financing and general economic, market or business conditions.*

*The risk factors identified above are not intended to represent a complete list of the factors which could affect the Corporation. Additional factors are noted under "Risk Factors" in the Corporation's Annual Information Form for the year ended December 31, 2018, a copy of which is available on the Corporation's SEDAR document page at www.sedar.com.*

*Any financial outlook or future-oriented financial information in this MD&A, as defined by applicable securities legislation, has been approved by management of the Corporation as of the date of this MD&A. Such financial outlook or future oriented financial information is provided for the purpose of providing information about management's current expectations and plans relating to the future. Readers are cautioned that such outlook or information should not be used for purposes other than for which it is disclosed in this MD&A.*

## Company Overview

Erdene Resource Development Corporation is a Canadian based resource company focused on the acquisition, exploration, and development of precious and base metal deposits in underexplored and highly prospective Mongolia. The Company has interests in four exploration licenses as well as a mining license in Southwest Mongolia, where exploration success has led to the discovery of the Khundii Gold District. Erdene is listed on the Toronto Stock Exchange (TSX: ERD) and the Mongolian Stock Exchange (MSE: ERDN).

Erdene's deposits are located in the Edren Terrane, within the Central Asian Orogenic Belt, host to some of the world's largest gold and copper-gold deposits. Although epithermal gold and porphyry copper-gold deposits are well documented across the border in China and along the Belt's westward trend, exploration in Mongolia was limited until the mid-1990's, when the country opened to foreign investment. Since that time, exploration in southeast Mongolia led to the discovery of the world-class Oyu Tolgoi gold-copper deposit. Erdene has been the leader in exploration in Mongolia's southwest and is responsible for the discovery of the Khundii Gold District. Within the Khundii Gold District, the Company has discovered multiple high-grade gold and base metal prospects, two of which are being considered for development: Bayan Khundii and Altan Nar. In addition, the Company discovered and defined a large molybdenum-copper resource on its 100% owned Zuun Mod project, 40 kilometres to the east.

In December 2018, Erdene announced a positive Preliminary Economic Assessment ("PEA") study for the Khundii Gold Project, comprised of its Bayan Khundii and Altan Nar deposits. Prepared by RPM Global, this independent study confirmed the high-return, low-capital and low-operating cost potential of the project, that will form the cornerstone development in the emerging Khundii Gold District.

While focused on development of the Khundii Gold Project, Erdene continues to explore the broader Khundii Gold District. The region hosts the full spectrum of arc-related base and precious metal systems, including copper-molybdenum porphyries, intermediate sulphidation / carbonate base metal gold deposits, and low sulphidation epithermal gold and gold-silver systems. Exploration of the district remains in the early stages, however, results to date demonstrate the potential for additional discoveries.

## Highlights and Significant Subsequent Events

**Khundii Gold Project – 100% Erdene**

- Delivered the Khundii Gold Project PEA:
    - After-tax Net Present Value at a 5% discount rate ("NPV5%") and a US$1,200/oz gold price of US$99 million and Internal Rate of Return ("IRR") of 56%.
    - Pre-tax NPV5% of US$135 million and IRR of 70%.
    - Initial capital expenditure of US$32 million, using a contract mining fleet.
    - All-in sustaining cash cost ("AISC") of US$714/ounce of gold recovered.
    - Life of mine head grade of 3.42 g/t gold.
    - Average annual gold production of 51,200 ounces.
    - Eight year mine life plus one-year pre-production and two-year mine closure periods.
    - Payback of 1.8 years.
- Reported the maiden mineral resource estimate for the Khundii Gold Project:
    - At a cut-off grade of 0.7 g/t gold, Measured and Indicated resource of 751,000 ounces gold at an average grade of 2.3 g/t gold and Inferred resource of 291,000 ounces gold at an average grade of 1.8 g/t gold.
    - At a higher cut-off grade of 1.4 g/t gold, Measured and Indicated resource of 642,000 ounces of gold at an average grade of 3.7 g/t gold, (including 357,000 ounces gold at an average grade of 5.2 g/t gold at the Bayan Khundii deposit) and an Inferred resource total of 250,000 ounces at 2.3 g/t for the Khundii Gold Project.
    - Including precious and base metals, 886,000 ounces gold equivalent ("AuEq") at an average grade of 2.7 g/t AuEq Measured and Indicated and 382,000 ounces AuEq at an average grade of 2.3 g/t AuEq, Inferred.

- Drilled 4,900 metres in 2018 at the Bayan Khundii license to support the maiden mineral resource:
  - Extended the gold mineralization zone to the north with the intersection of 81.4 metres of 2.6 g/t gold and 17 metres of 9.2 g/t gold at hole BKD-254 in the North Midfield Zone.

**Regional Exploration**

- Completed the 2018 exploration campaign, drilling 25 holes totaling 3,452 metres at seven targets along the 11.4 kilometre Khundii license, focused at Altan Arrow and Khundii North:
  - Approximately 70% of drill holes on the Bayan Khundii license intersected anomalous gold mineralization (>0.1 g/t). Three holes intersected more than 20 g/t gold over 1 to 2 metre intervals.
  - Extended the western extension of the Altan Arrow main gold mineralized structure by 500 metres, indicating a broad corridor of anomalous gold over a 1.2 kilometre trend (open along strike) up to 400 metres south of the main structure.
  - Testing of structural splays south of the main Altan Arrow zone returned anomalous gold mineralized intersects at depth (approximately 100 metres vertical depth).
  - Three shallow holes in the southern portion of Khundii North intersected wide zones of intense multi-phase, epithermal quartz stockwork and breccia from surface to a vertical depth of 66 metres within an altered monzonite with associated anomalous gold mineralization, up to 2.1g/t.
  - Completed a high-density magnetic survey to refine targets based on improved definition of alteration zones, structural intersections and zones of dilation in advance of future drilling.
- Concluded an initial scout drill program at its 51% owned Ulaan license totaling 1,050 metres in three widely spaced holes over a 1.3 kilometre area in the central portion of the license:
  - Intersected volcanic rocks locally hosting sheeted to stockwork quartz-pyrite veining, associated with elevated copper values and a distinct zonation from propylitic alteration at surface to phyllic alteration at depth.
- Assembled the largest proprietary geologic database in southwest Mongolia and has identified 22 high-priority targets for acquisition that the company will pursue aggressively:
  - Participated in the first land tender in Southwest Mongolia in almost a decade.

**Corporate**

- Became the first foreign company to cross-list on the Mongolian Stock Exchange in June 2018:
  - Approximately 6,000 Mongolians hold shares representing 6% of Erdene's stock.
  - More than 1,500,000 shares have traded in Mongolia since the listing.
  - Concurrent with the cross-listing, the Corporation raised a further $4.12 million in a Private Placement.
- Raised C$2.53 million in February 2019 to launch the NI 43-101 Pre-Feasibility Study for the Khundii Gold Project, mining license applications, potential acquisitions, including through the Mongolian Government's recently re-opened license tender process and general working capital:
  - At the date of this MD&A, the Corporation had $3.2 million in working capital.
- Notified Sandstorm of its intention to buy-back 50% of the NSR Royalty on March 26, 2019:
  - The transaction is expected to close by April 14, 2019.

## Strategy and Outlook

Erdene is focused on two strategic priorities – advancing the Khundii Gold Project toward production and expanding precious and base metal resources in the Khundii Gold District through exploration and acquisition.

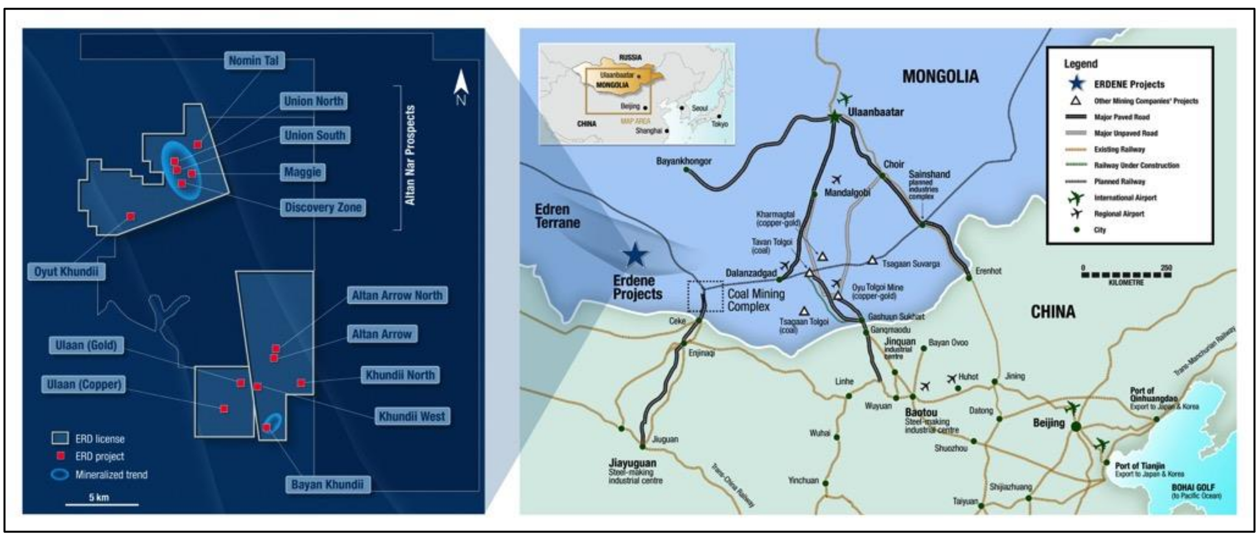
In February 2019, Erdene filed a positive PEA study for the Khundii Gold Project, comprised of its Bayan Khundii and Altan Nar deposits. Prepared by RPM Global, this independent study confirmed the high-return, low-capital and low-operating cost potential of the project, that will form the cornerstone development in the emerging Khundii Gold District. The Khundii Gold Project's initial development is expected to focus on a high grade, open-pit mine beginning at the Bayan Khundii Striker Zone, expanding into adjacent zones within Bayan Khundii, prior to incorporating resources from the Altan Nar deposit.

Erdene has received proposals from global engineering firms to lead a NI 43-101 Pre-Feasibility Study, which is scheduled to be completed in 2019. Concurrently, the Corporation's Mining Studies Team is undertaking mining, geotechnical, metallurgical, waste management and hydrogeological studies to support development and mining license applications, which are expected to be approved in 2019.

The Khundii District offers exceptional discovery potential, which would create significant shareholder value. This District lies within the Central Asian Orogenic Belt, host to some of the world's largest gold and copper-gold deposits. Modern exploration along the trend in Southwest Mongolia has been limited to shallow holes but results to date are compelling and a testament to the high probability of additional discovery. Erdene is drilling prospects on its Bayan Khundii license at Altan Arrow and Khundii North and evaluating opportunities for acquisition throughout the Khundii District. Over the past decade Erdene has developed a proprietary geologic database of Southwest Mongolia's mineralization that has led to the identification of more than 20 high-priority targets for acquisition. Mongolia's Ministry of Mining and Heavy Industry re-opened the region to tenders in late 2018, and Erdene intends to bid aggressively as its target parcels come to auction.

## Development and Exploration Projects

### Erdene's Khundii Gold District in Southwest Mongolia




Erdene has been the exploration leader in Southwest Mongolia over the past decade and is responsible for the discovery of the Khundii Gold District. The District is comprised of multiple high-grade gold and base metal prospects, two of which are being considered for the Khundii Gold Project development: Bayan Khundii and Altan Nar. In addition, the Company discovered and defined a large molybdenum-copper resource on its 100% owned, Zuun Mod project, 40 kilometres to the east.

On September 15, 2018, the Company announced a maiden resource estimate for the Khundii Gold Project. Apart from Zuun Mod, the Company's other targets are early stage and do not contain any mineral resource estimates as defined by National Instrument 43-101 Standards of Disclosure for Mineral Projects ("NI 43-101"). With the exception of those deposits already delineated, potential quantities and grades disclosed in this MD&A are conceptual in nature, and there has been insufficient exploration to define a mineral resource estimate for other targets disclosed herein. It is uncertain if further exploration will result in these targets being delineated as a mineral resource. Additional information about our projects is also summarized in our AIF and the respective NI 43-101 Technical Reports and can be viewed under the Company's issuer profile on SEDAR at www.sedar.com.

## Khundii Gold Project

The Khundii Gold Project is comprised of the Company's high-grade Bayan Khundii and Altan Nar deposits. The Bayan Khundii ("Rich Valley") gold project is located on Erdene's 100%-owned, 4,514 hectare, Khundii exploration license in southwest Mongolia, 16 kilometres south of the Corporation's Altan Nar gold-polymetallic project. The license is in its eighth year of a maximum 12-year term and can be converted to a mining license at any time prior to the end of the twelfth year by meeting the requirements prescribed under the Minerals Law of Mongolia.

The resource was discovered in Q2 2015, with initial drill results reported in Q4 2015; the first hole returned 7 metres of 27.5 g/t gold at 14 metres depth. Bayan Khundii has become the highest priority project for the Corporation based on its high grades, proximity to surface, and favorable metallurgy. The Corporation has completed 42,656 metres of diamond drilling at Bayan Khundii, comprised of 255 diamond drill holes. Drilling has identified three main areas of very high-grade gold mineralization with strong continuity, the Striker Zone, where mineralization starts from surface, and Midfield and North Midfield Zones that extend to the northeast under younger, post-mineralization Jurassic cover. The high-grade gold zones within these three areas can be very wide, grading in excess of 5 g/t gold over more than 50 metres. Step-out drilling in 2017 indicated that mineralization encountered in the Midfield Zone, located 200 metres northeast from Striker Zone, extends for at least 280 meters further to the northeast under younger cover. The Midfield and North Midfield Zones have returned some of the highest grades and the longest mineralized intervals at Bayan Khundii; BKD-98 returned 80 metres of 6.0 g/t gold from 42 metres depth, and BKD-231 returned 14 metres of 158 g/t gold, including one metre of 2,200 g/t gold.

The 100%-owned Altan Nar ("Golden Sun") deposit is located on the Corporation's 4,669 hectare Tsenkher Nomin exploration license, 16 kilometres northwest of Bayan Khundii. The exploration license is in its ninth year of a maximum 12-year term and can be converted to a mining license at any time prior to the end of the twelfth year by meeting the requirements prescribed under the Minerals Law of Mongolia. The license hosts 18 mineralized (gold, silver, lead, zinc) target areas within a 5.6 by 1.5 kilometre mineralized corridor. Two of the early discoveries, Discovery Zone ("DZ") and Union North ("UN"), are the most advanced targets. These properties host wide zones of high-grade, near-surface mineralization, and were the focus of an updated resource estimate released in Q2 2018, as well as detailed metallurgical processing test-work. Some of the updated mineral resources announced in Q2 2018 were from the remaining 16 targets, however, most of these are still considered early-stage and are interpreted by the Corporation as having good potential for hosting additional resources.

### *Mineral Resources*

Erdene announced the maiden resource estimate for the Khundii Gold Project, dated September 12, 2018, prepared in accordance with NI 43-101 by RPMGlobal Asia Limited ("RPM"). The Khundii Gold Project Resource includes the Maiden Mineral Resource estimate for the Bayan Khundii deposit and incorporates the significant increase in the NI 43-101 Mineral Resource for the Altan Nar deposit reported in May 2018. The Bayan Khundii Mineral Resource incorporates 255 diamond drill holes totaling 42,656 metres, completed between Q4 2015 and Q2 2018. The Mineral Resource is contained within a near-surface, shallow-dipping and strongly mineralized system (intercepts up to 2,200 g/t gold over a 1 metre interval as previously reported) that extends over an area of 1.2 kilometres (NE-SW) by 200 to 400 metres (NW-SE). Grade capping for the purposes of the Bayan Khundii deposit resource estimate averaged 51 g/t gold for high-grade domains (range from 8 g/t to 250 g/t gold) and a maximum of 1.5 g/t gold for the low and medium grade domains.

A summarized sensitivity analysis of the grade and tonnage relationships at various cut-off grades is shown in the table below[1]:

| Cut-Off Grade [2] | Resource Classification | Quantity (Mt) | Gold Grade (g/t) | Gold Ounces (000) | AuEq Grade (g/t) | AuEq Ounces (000) |
|---|---|---|---|---|---|---|
| 0.2 | Measured & Indicated | 23.6 | 1.2 | 904 | 1.4 | 1,046 |
| | Inferred | 16.8 | 0.8 | 416 | 1.0 | 511 |
| 0.4 | Measured & Indicated | 15.1 | 1.7 | 824 | 2.0 | 965 |
| | Inferred | 8.6 | 1.2 | 342 | 1.6 | 436 |
| **0.6 / 0.7 [3]** | **Measured & Indicated** | **10.1** | **2.3** | **751** | **2.7** | **886** |
| | **Inferred** | **5.2** | **1.8** | **291** | **2.3** | **382** |
| 1.0 | Measured & Indicated | 6.8 | 3.1 | 678 | 3.7 | 803 |
| | Inferred | 3.9 | 2.1 | 261 | 2.9 | 349 |
| **1.4** | **Measured & Indicated** | **5.5** | **3.7** | **642** | **4.3** | **755** |
| | **Inferred** | **3.4** | **2.3** | **250** | **3.0** | **333** |

*(1) Combined resources from Bayan Khundii and Altan Nar.*
*(2) Cut-off grades for Altan Nar are AuEq and for Bayan Khundii are gold only.*
*(3) RPM recommended cut-off grade for Bayan Khundii is 0.6 g/t gold and Altan Nar is 0.7 g/t AuEq above a pit and 1.4 g/t AuEq below the same pit shell.*

***Preliminary Economic Assessment***

On December 18, 2018, Erdene announced results of an independent Preliminary Economic Assessment ("PEA") study for its 100%-owned Khundii Gold Project (the "Project") in southwest Mongolia. The PEA was prepared in accordance with National Instrument 43-101 Standards of Disclosure for Mineral Projects ("NI 43-101") by RPMGlobal Asia Limited.

The PEA envisions a high-grade, open-pit mine beginning at the Bayan Khundii Striker Zone, expanding into adjacent zones within Bayan Khundii, prior to incorporating resources from the Altan Nar deposit. The development incorporates a conventional gravity separation circuit and a carbon in pulp plant with processing capacity of 1,800 tonnes per day.

The PEA includes 2.7 million minable tonnes from the Bayan Khundii resource at an average head grade of 3.65 g/t gold, of which 98% are Measured and Indicated Resources. The Altan Nar deposit contributes 1.9 million minable tonnes at an average head grade of 3.11 g/t gold, of which 70% are Measured and Indicated Resources.

The PEA is by nature, a preliminary economic study, based in part on Inferred Resources. Inferred Resources are considered too speculative geologically to have the economic considerations applied to them that would enable them to be categorized as mineral reserves which is required for a prefeasibility or feasibility study. Mineral resources that are not mineral reserves do not have demonstrated economic viability and there is no certainty that the PEA will be realized.

Key Project metrics are presented in the following table:

| Assumptions | | |
|---|---|---|
| Gold Price | US$/oz | 1,200 |
| **Production Profile** | | |
| Average Head Grade Over Life of Mine [1] | g/t gold | 3.42 |
| Project Life [2] | years | 11 |
| Operating Life | years | 8 |
| Target Production Rate Per Day [3] | tpd | 1,800 |
| Average Annual Saleable Gold | oz | 51,200 |
| Peak Annual Saleable Gold | oz | 68,100 |
| Total Gold Production LOM | oz | 412,000 |
| Average Gold Recovery Rate Over Life of Mine | % | 82% |
| Strip Ratio | tonne:tonne | 10.5:1 |
| LOM Cash Cost plus Sustaining Cost (AISC) [4] | US$/oz | 714 |

| Project Economics | | |
|---|---|---|
| **Pre-Tax Net Present Value** | | |
| 5% discount rate | US$M | 135 |
| 7.5% discount rate | US$M | 119 |
| 10% discount rate | US$M | 105 |
| **After-Tax Net Present Value** | | |
| 5% discount rate | US$M | 99 |
| 7.5% discount rate | US$M | 86 |
| 10% discount rate | US$M | 76 |
| **Internal Rate of Return and Payback** | | |
| Pre-Tax Internal Rate of Return | % | 70% |
| After-Tax Internal Rate of Return | % | 56% |
| Payback Period Post-Construction [5] | years | 1.8 |
| **Capital Requirements** | | |
| Pre-production Capital Cost, including contingency | US$M | 32 |
| LOM Sustaining Capital Cost | US$M | 8 |

*(1) Average diluted head grade of mineralised rock fed to process plant.*
*(2) Project life includes one year pre-production period, eight year operating life and two year mine closure.*
*(3) Assumes process plant operates for 8,000 hours per annum to achieve the target production rate of 600 ktpa.*
*(4) Operating costs reported in terms of saleable gold ounces, including Royalty and Refining Charges of US$62/oz.*
*(5) Payback period calculated on an undiscounted, after-tax cash flow basis.*

The following table shows the change in the after-tax NPV and IRR over a range of gold prices and discount rates, demonstrating the impact of higher gold prices and the Project's resiliency to lower prices:

| Gold Price Sensitivity Analysis | Units | US$1,150 | US$1,200 | US$1,250 | US$1,300 |
|---|---|---|---|---|---|
| NPV (5% discount rate) | US$M | 86 | 99 | 111 | 124 |
| NPV (7.5% discount rate) | US$M | 75 | 86 | 98 | 110 |
| NPV (10% discount rate) | US$M | 65 | 76 | 86 | 97 |
| IRR | % | 50% | 56% | 62% | 68% |

The PEA is based on an open-pit mining operation targeting 600,000 tonnes per year of feed material for the process plant. The total mineable mineralised plant feed is 4.6 million tonnes at an average diluted head grade of 3.42 g/t and strip ratio of 10.5:1 (waste tonne:plant feed tonne).

The PEA study assumes processing of ROM material via a conventional gravity separation circuit and a carbon in pulp plant. The ore-processing plant will be located adjacent to the Bayan Khundii open pit and throughput will target 1,800 tonnes per day. Using an estimated mill recovery of 82%, total recovered gold over the project life is 412,000 ounces.

Operating costs are based on the mining and processing scenario outlined above and assumes contract mining. All other activities are assumed to be owner-operated. The contingency is estimated at 10% and applied to all cost centres except "Royalty and Charges". The all-in sustaining cost (that is, operating cost and sustaining capital cost) is estimated at US$714/oz.

| Cost Centre | Life of Mine | | |
|---|---|---|---|
| | (US$millions) | US$/oz | US$/tonne |
| Mine Operating Cost | 134 | 326 | 29 |
| Processing Cost | 76 | 183 | 16 |
| Site G&A | 30 | 73 | 7 |
| Product Cost | 2 | 6 | 1 |
| Royalty (5% NSR) and Charges | 26 | 62 | 6 |
| Contingency | 24 | 58 | 5 |
| Total Operating Costs | 292 | 708 | 64 |
| Sustaining Capital | 3 | 6 | 1 |
| All-In Sustaining Cost | 295 | 714 | 65 |

The initial capital cost (Year 0), primarily comprising construction of the process plant and supporting infrastructure, is estimated at US$32 million. The PEA contemplates a mining contractor utilizing mining equipment which if purchased outright would add $38 million to capital costs. All major facilities including the process plant are proposed to be located at the Bayan Khundii site. In Year 3 the supporting infrastructure for the Altan Nar site is constructed at an estimated cost of US$1 million, including the upgrade of the road to Bayan Khundii. The infrastructure and process plant estimates include a 20% contingency.

Sustaining capital of US$3 million is included in the mine plan and mine closure costs are estimated at US$4 million. Total capital expenditures over the life of mine are estimated at US$40 million.

| Item | Bayan Khundii (US $millions) | Altan Nar (US $millions) | Total (US $millions) |
|---|---|---|---|
| Process Plant | 16 | - | 16 |
| Site Buildings | 3 | - | 3 |
| Accommodation Village | 2 | - | 2 |
| Airstrip | 1 | - | 1 |
| Roads | 1 | 1 | 2 |
| Engineering & Support | 4 | - | 4 |
| Engineering Contingency | 5 | - | 5 |
| **Subtotal Plant & Infrastructure** | **32** | **1** | **33** |
| Mine Closure | 3 | 1 | 4 |
| Sustaining Capital | 2 | 1 | 3 |
| **Total** | **37** | **3** | **40** |

The Company sees the following opportunities to increase value at the Khundii Gold Project:

- Higher Grade Upside: The very high-grade nature of the deposit provides upside should continuity of the ultra high-grade zones be established during mining. The highest gold values in the block model supporting the PEA are 55 g/t, while more than 40 intersections ranging from 50 g/t to 2200 g/t gold were encountered during drilling.
- Additional Resources at Bayan Khundii: Approximately 60,000 ounces of Indicated Resources and 70,000 ounces of Inferred Resources grading more than 4 g/t are located outside the mineable open-pit for the PEA. The majority of these resources are contained within the West Striker Area, approximately 100 metres from the ultimate pit wall, situated at around 100 metres depth. Accessing these resources by underground methods will be considered in a future study.
- Additional Resources at Altan Nar: The majority of the resource contained at the Altan Nar Project remains undeveloped in the current PEA. Further drilling and metallurgical work is required to incorporate this material into development scenarios.
- Exploration Potential: The Bayan Khundii and Altan Nar deposits are situated in a highly prospective region that has received minimal historical exploration. The Company, through its proprietary regional database and experience in the region, is well positioned to add resources through exploration.
- Recovery Upside: The Bayan Khundii mineralized material has an average recovery of 92% in the PEA. However, master composite sample testing indicates that recoveries of up to 99% are possible for high-grade material. For Altan Nar material, an average recovery of 62% has been applied due to arsenopyrite content of the ore. Master composite testing of representative samples from the Discovery Zone pit has returned recoveries of up to 88%. Further metallurgical testing could support higher recoveries.
- Mine Planning: The PEA represents the first step toward addressing the viability of a mining operation at the Khundii Gold Project. Further work may identify cost saving opportunities such as improved pit sequencing through pit phasing, waste haul optimization including in-pit dumping, reduced dilution and loss through application of more selective mining techniques and interim pit design targeting improved early grades.
- Mine Equipment Selection: There is opportunity to consider Tier 2 suppliers for non-critical equipment, reducing capital and operating costs.
- Land Acquisition: The Mongolian Ministry of Mining and Heavy Industry has recently reopened the tender licensing system, and the Company expects prospective licenses to be released in 2019. The Company has identified multiple priority targets surrounding the district and will be an active participant in the tender processes for these properties.

## District Scale Exploration

Erdene continues to evaluate opportunities throughout the Edren Terrane, within our licenses and elsewhere in the mineralized belt. This has led to the identification of prospects that are being explored through surface surveys on the company's five licenses, drilling of selected targets and evaluation of acquisition targets on private and government held ground.

Exploration within the licenses has identified significant gold mineralization. Approximately 70% of regional drill holes have intersected anomalous gold mineralization (defined as >0.1 g/t), with three holes intersecting greater than 20 g/t gold over 1 to 2 metre intervals. Regional drilling has been restricted to shallow targets with average drill depths of about 100 metres. Success has been driven by the abundance of untested, near surface geochemical and geophysical targets in a region that has had no previous modern exploration. Recent exploration successes testing shallow targets, and the definition of three deposits, exposed at surface, are testament to the discovery potential of this new district.

### *Altan Arrow Gold Target*

The Altan Arrow target is located 3.5 kilometres north of the Bayan Khundii gold deposit, along a gold bearing structure in the central portion of the Bayan Khundii license. Drilling has concentrated in an area along and south of the main structure, where several high-grade zones have been intersected, including 39 g/t over 1m and 24 g/t and 70 g/t over 2 metres. Overall, 85% of the 20 holes (2,552 metres) drilled at Altan Arrow have intersected anomalous gold.

Erdene drilled 10 holes at Altan Arrow in 2018, totaling 1,412 metres, to test extension along trend of the main structure and at depth. Current year drilling extended the mineralized structure 500 metres to the west where AAD-18 intersected multiple 2 to 4 metre wide zones of anomalous gold in epithermal quartz adularia veins and stockwork breccias zones containing up to 1.3 g/t gold. Current exploration drill testing of the main mineralized structure indicates a broad corridor of anomalous gold over a 1.2 kilometre trend (open along strike) and up to 400 metres south of the main structure in what is interpreted as secondary structural splays. In addition, drill testing of these structural splays, south of the main zone, returned multiple intersects at deeper levels then typically tested (approximately 100 metres vertical depth) with gold grades ranging from 0.2 to 2.6 g/t with anomalous Ag, Mo, Pb, Zn and Sb (AAD-25). Exploration results suggest gold mineralization within the greater district is controlled by a structure typically hosted by zones of major dilatancy and structural intersections. Such zones commonly have associated alteration events that are magnetite destructive, resulting in zones of low magnetic response. In advance of future drilling the company has initiated a high-density magnetic survey to refine targets within these alteration zones.

### *Khundii North Gold Target*

The Khundii North target is located 4 kilometres northeast of the Bayan Khundii gold deposit, on the Bayan Khundii license, and was drill tested for the first time in 2018. The area was identified in surface exploration mapping in late 2017, when sampling of quartz vein material returned high grade gold mineralization of up to 22 g/t gold from a structurally controlled quartz vein stockwork and breccia zone traced over 650 metres. Five holes, totaling 656 metres and averaging 93 metres vertical depth have now tested the structure, comprised of three in the south and two in the north, separated by approximately 500 metres. Although the northern holes returned only minor levels of anomalous gold, the southern holes intersected wide zones of intense multi-phase epithermal quartz stockwork and breccia at depth within an altered monzonite. These stockwork zones are continuous, with up to 35 metre widths (AAD-29) and have associated anomalous gold, locally up to 2.1 g/t over 1 metre intervals (AAD-30) and locally anomalous copper (>500ppm). The Khundii North target provides a new high priority exploration area.

### *Central Structure Zone Gold Target*

In Q3 2018 the company tested a new target on the Bayan Khundii license, 800 metres northwest of the Bayan Khundii deposit. The Central Structure Zone ("CSZ") target has very limited surface exposure and was identified as a drill target based on similar geophysical features to the Bayan Khundii deposit. Three shallow holes (AAD-31-33) testing an average vertical depth of 75 metres were collared along a 500 metre trend. Although the style of quartz veining and the hematite/speculurite veinlets in the volcanic host intersected display similar characteristics to that of the main zones at Bayan Khundii, gold content was not anomalous. Clay alteration in this area was identified as smectite suggesting the area is marginal to the higher temperature illite bearing gold zones observed at Bayan Khundii. Given this zone is separated from the main Bayan Khundii zone by an unaltered volcanic host, it is proposed that CSZ occurs at shallower paleo setting above the higher temperature gold mineralized illite zone. Additional structural, geophysical and spectral mapping is underway to determine whether drilling of deeper targets should be undertaken within the CSZ target.

### *Ulaan Copper-Gold Porphyry Target*

On August 30, 2017 the Corporation acquired a 51% interest in the Ulaan exploration license (“Ulaan Property”), immediately west of its high-grade Bayan Khundii deposit. The Ulaan Property covers approximately 1,780 hectares and hosts a 3-kilometre diameter, intense alteration zone with characteristics thought to be related to a porphyry intrusion at depth. The exploration license is in its fourth year of a maximum 12-year term and can be converted to a mining license at any time prior to the end of the twelfth year by meeting the requirements prescribed under the Minerals Law of Mongolia. Provided Erdene spends a minimum of US$600,000 on the Ulaan Property over the next three years, it has the right to acquire the remaining 49% of the property for the then fair market value. Erdene may extend the option beyond three years by spending a minimum of US$100,000 per annum thereafter.

Rock chip and stream sediment geochemical sampling identified anomalous concentrations of gold, copper and molybdenum in the surrounding area, and recently completed geophysical surveys have produced a number of follow-up targets.

Three wide spaced holes were drilled during Q3 2018, totaling 1,050 metres over a 1.3 kilometre area in the central portion of the license. The holes intersected volcanic to sub-volcanic rocks exhibiting propylitic to phyllic quartz-sericite-pyrite (“QSP”) alteration with varying concentrations of pyrite and locally low-level copper mineralization. The most westerly hole tested a positive gravity anomaly and coincident IP chargeability anomaly to 300 metres depth. The two other holes tested coincident moderate to high chargeability and magnetic high signatures associated with high temperature sericite clay alteration. Pyrite mineralization was observed throughout with most intense concentrations coincident with the zones of high chargeability. The most easterly hole, UDH-02 provided the most encouraging results exhibiting sheeted to stockwork quartz-pyrite veining locally, associated with elevated copper values (100 to 300ppm over 60m) relative to the background copper levels established in UDH-01 and UDH-03. UDH-02 also exhibits a distinct zonation from propylitic into phyllic alteration at depth. The phyllic alteration coincides with an increase in pyrite mineralization occurring both as disseminations and veinlets as well as increasing magnetic intensity. Continued work including spectral analysis of clay minerals and age dating is underway. A comprehensive review of all results will be completed prior to decisions on future exploration.

### *Zuun Mod Molybdenum Project*

The Zuun Mod Molybdenum Project is a porphyry molybdenum-copper deposit located in southwest Mongolia on the Company’s Khuvyn Khar license. This project is approximately 950 kilometres southwest of Ulaanbaatar and 215 kilometres from railhead on the Mongolia-China border at Ceke. The railhead is located 50 kilometres south of the Nariin Sukhait and Ovoot Tolgoi coal mines. The property consists of a mining license totaling 6,041 hectares. The mining license is registered in the name of Anian Resources LLC**,** a wholly owned subsidiary of the Corporation, and has an initial term of 30 years. This project was acquired from Gallant Minerals Limited in 2005 and is subject to a net smelter returns royalty (“NSR Royalty”) of 1.5%, subject to a buy-down provision.

In Q2 2011, the Corporation released a NI 43-101 compliant resource estimate for Zuun Mod containing a Measured and Indicated Resource of 218 million tonnes ("Mt") at an average grade of 0.057% molybdenum, and 0.069% copper at a cut-off grade ("COG") of 0.04% molybdenum. This equates to 273.5 million pounds ("M lbs") of contained molybdenum metal and 330.7 M lbs of contained copper metal. In addition, there is a 168 Mt Inferred Resource at an average grade of 0.052% molybdenum and 0.065% copper, equating to a further 191.8 M lbs of contained molybdenum metal and 240.5 M lbs of contained copper metal.

The Zuun Mod molybdenum-copper deposit has significant potential for development provided the molybdenum price improves. Market demand for molybdenum has recently improved, with the price of molybdenum oxide rising to approximately US$12.00 per pound from approximately US$7.25 per pound in 2017. The Corporation will continue to evaluate its options in light of technological and market factors. Discovery of additional copper mineralization at Khuvyn Khar could provide synergies for the advancement of the Zuun Mod molybdenum deposits.

Further details on the Zuun Mod resource can be found in the "Technical Report Zuun Mod Porphyry Molybdenum-Copper Project, South-Western Mongolia, National Instrument 43-101 Independent Technical Report" dated June 2011, filed on SEDAR.

***Khuvyn Khar Copper-Silver Project***

The Khuvyn Khar copper-silver project is located on the Zuun Mod property, approximately 2.2 kilometres northwest of the Zuun Mod molybdenum-copper porphyry deposit on the Company's Khuvyn Khar license. Exploration work at Khuvyn Khar has included geological mapping, vein density mapping, geochemical sampling, geophysical surveys, and wide spaced drilling. Previous drilling intersected 34 metres of 1.3% copper and 9.24 g/t silver from 308 to 342 metres. The Project has a very large copper mineralized zone trending over 900 metres with multiple zones in three drill holes returning assays in excess of 0.2% copper over significant widths (12 to 42 metres).

### Acquisitions

Mongolia's Ministry of Mining and Heavy Industry announced a re-opening of the licensing system during Q3 2018. Erdene has established the largest proprietary geologic database of Southwest Mongolia with a priority list of acquisition targets. The Company will participate in the tendering process as its priority targets are released. The Company has also been evaluating privately held licenses for acquisition. Erdene's alliance with Teck remains active and the companies continue to work together in Southwest Mongolia.

## Selected Annual Financial Information

The following financial data (in Canadian $ thousands, except per share amounts) are derived from the Corporation's audited consolidated financial statements for the years ended December 31, 2018, 2017 and 2016 respectively:

| **Fiscal Year Ended December 31** | **2018** | **2017** | **2016** |
|---|---|---|---|
| Revenues | Nil | Nil | Nil |
| Loss for the year | $ 3,657 | $ 4,027 | $ 2,500 |
| Basic and diluted loss per share | $ 0.02 | $ 0.03 | $ 0.02 |
| Total assets | $ 17,709 | $ 14,946 | $ 4,293 |
| Total long-term liabilities | Nil | Nil | Nil |

## Discussion of Operations

### *Year ended December 31, 2018 and 2017*

The tables below detail exploration and evaluation expenditures for the years ended December 31, 2018 and 2017. Exploration efforts during the period were focused on the Khundii Gold Project and Ulaan licenses.

| Year ended December 31, 2018 | Khundii Gold Project | Zuun Mod | Ulaan & Other | Total |
|---|---|---|---|---|
| **Exploration expenditures** | | | | |
| Mining studies and permitting | $ 1,343,667 | $ - | $ - | $ 1,343,667 |
| Drilling, trenching, sampling and assaying | 1,279,068 | 2,823 | 244,812 | 1,526,703 |
| Exploration, camp and field | 1,133,027 | 49,792 | 535,630 | 1,718,449 |
| Stakeholder relations | 343,697 | - | 17,666 | 361,363 |
| Travel and other | 169,629 | 1,072 | 20,687 | 191,388 |
| License costs | 22,467 | 70,074 | 1,388 | 93,929 |
| Mongolian office costs | - | - | 250,043 | 250,043 |
| Share-based compensation | - | - | 473,150 | 473,150 |
| Total exploration expenditures | 4,291,555 | 123,761 | 1,543,376 | 5,958,692 |
| Capitalized expenditures | (4,291,555) | (70,074) | (1,388) | (4,363,017) |
| **Expensed exploration costs 2018** | **$ -** | **$ 53,687** | **$ 1,541,988** | **$ 1,595,675** |
| | | | | |
| **E&E assets, January 1, 2018** | **$ 9,700,832** | **$ 765,795** | **$ 928,216** | **$ 11,394,843** |
| Additions | 4,291,555 | 70,074 | 1,388 | 4,363,017 |
| Effect of movements in exchange rates | (62,077) | (4,143) | (4,292) | (70,512) |
| **E&E assets, December 31, 2018** | **$ 13,930,310** | **$ 831,726** | **$ 925,312** | **$ 15,687,348** |

| Year ended December 31, 2017 | Khundii Gold Project | Zuun Mod | Other | Total |
|---|---|---|---|---|
| **Exploration expenditures** | | | | |
| Drilling, trenching, sampling and assaying | $ 5,017,084 | $ 2,697 | $ 90,751 | $ 5,110,532 |
| Exploration, camp and field | 1,880,644 | 45,226 | 450,879 | 2,376,749 |
| Mining studies and permitting | 424,787 | - | - | 424,787 |
| Travel and other | 153,253 | 80 | 141,260 | 294,593 |
| Stakeholder relations | 103,196 | - | 12,217 | 115,413 |
| Licence costs | 10,795 | 74,062 | 949,326 | 1,034,183 |
| Mongolian office costs | - | - | 281,426 | 281,426 |
| Share-based compensation | - | - | 607,092 | 607,092 |
| Total exploration expenditures | 7,589,759 | 122,065 | 2,532,951 | 10,244,775 |
| Capitalized expenditures | (7,589,759) | (74,062) | (949,326) | (8,613,147) |
| **Expensed exploration costs 2017** | **$ -** | **$ 48,003** | **$ 1,583,625** | **$ 1,631,628** |
| | | | | |
| **E&E assets, January 1, 2017** | **$ 2,337,466** | **$ 728,164** | **$ 581** | **$ 3,066,211** |
| Additions | 7,589,759 | 74,062 | 949,326 | 8,613,147 |
| Effect of movements in exchange rates | (226,393) | (36,431) | (21,691) | (284,515) |
| **E&E assets, December 31, 2017** | **$ 9,700,832** | **$ 765,795** | **$ 928,216** | **$ 11,394,843** |

Exploration expenditures totaled $5,958,692 for the year ended December 31, 2018, compared to $10,244,775 for the same period in 2017. Drilling, trenching, sampling and assaying expenditures for the year ended December 31, 2018 were $3,583,829 less than the prior year as Erdene drilled approximately

9,400 metres in the current year compared to 32,211 metres in 2017, as the Company focused efforts on the NI 43-101 Resource Estimates and PEA studies for the Khundii Gold Project in 2018. Exploration, camp and field costs and travel costs for the year ended December 31, 2018 were respectively $658,300 and $103,205 less than the preceding year due to the reduction in drilling activity.

Mining studies and permitting expenses of $1,343,667 for the year ended December 31, 2018 were $918,880 higher than the prior year due to professional fees associated with the NI 43-101 Resource Estimates and PEA for the Khundii Gold Project completed in 2018. License costs of $93,929 for the year ended December 31, 2018, were $940,254 less than 2017, as Erdene purchased the 51% of the outstanding shares of Leader Exploration LLC in August 2017, for US$750,000, and recognized the transaction as a Capitalized exploration expenditure. Stakeholder relations expenditures of $361,363 for the year ended December 31, 2018 were higher than those of $115,413 incurred during the prior year as the company increased its community partnership efforts in advance of mining license applications. Share-based compensation was $133,942 less than 2017 due to the impact of a lower share price.

Erdene began capitalizing exploration costs for its Khundii Gold Project on January 1, 2015, with the receipt of the initial resource estimate for the Khundii Gold Project's Altan Nar deposit. For the years ended December 31, 2018 and 2017, Erdene has capitalized all exploration costs associated with this Project. Only license costs associated with its other properties have been capitalized in 2018 or 2017.

| | For the years ended December 31, | | |
|---|---|---|---|
| | **2018** | **2017** | **Change** |
| Administrative services | **$ 535,118** | $ 572,692 | $ (37,574) |
| Depreciation and amortization | **6,194** | 6,504 | (310) |
| Directors fees and expenses | **132,841** | 146,141 | (13,300) |
| Investor relations and marketing | **201,074** | 267,171 | (66,097) |
| Office and sundry | **123,271** | 115,299 | 7,972 |
| Professional fees | **236,394** | 131,525 | 104,869 |
| Regulatory compliance | **116,567** | 139,108 | (22,541) |
| Share-based compensation | **712,854** | 948,542 | (235,688) |
| Travel and accommodations | **56,077** | 123,170 | (67,093) |
| | **$ 2,120,390** | $ 2,450,152 | $ (329,762) |

Corporate and administrative expenses totaled $2,120,390 for the year ended December 31, 2018, compared to $2,450,152 for the year ended December 31, 2017. The reduction in Administrative services compared to 2017 was primarily attributable to lower incentive compensation in 2018. Investor relations and marketing expenditures decreased by $66,097 year over year as the corporation participated in fewer conferences during the current year. Travel and accommodations expenses were also lower than the prior year as a result of attending fewer events. Professional fees for the year ended December 31, 2018 were $104,869 higher than the prior year due to higher financial advisory fees associated with strategic financial planning, partially offset by lower risk consulting fees, as Erdene completed a controls review in 2017. Non-cash share-based compensation was $235,688 less than 2017 due to the impact of a lower share price.

## Fourth Quarter

Exploration expenditures totaled $1,168,626 for the three months ended December 31, 2018. Mining studies and permitting expenditures of $477,833 were incurred towards the NI 43-101 Resource Estimate and PEA studies for the Khundii Gold Project. Drilling, trenching, sampling and analysis expenditures of $446,145 were attributable to the conclusion of the 2018 drill program. Non-cash share-based compensation expenditures attributable to exploration staff were $113,737 for the fourth quarter of 2018. Other exploration expenditures of $130,911 include travel expenses, license costs, and other general expenses related to the Corporation's Mongolian field operations.

Corporate and administrative expenses totaled $507,104 for the three months ended December 31, 2018, including $279,157 of salaries and administrative expenditures, $117,118 of public company operating costs and miscellaneous administrative expenditures, including travel and investor relations totaling $110,829.

There were no unusual events during the fourth quarter of 2018 that materially affected the Corporation's financial condition, cash flows or results of operations.

## Summary of Quarterly Results

*Expressed in thousands of Canadian dollars except per share amounts*

| | Fiscal 2018 | | | | Fiscal 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| | Dec | Sep | Jun | Mar | Dec | Sep | Jun | Mar |
| Net loss | $772 | $744 | $1,439 | $702 | $649 | $713 | $2,069 | $596 |
| Basic loss per share | $0.01 | $0.00 | $0.01 | $0.00 | $0.00 | $0.01 | $0.02 | $0.00 |
| Total assets | $17,709 | $18,136 | $19,500 | $14,879 | $14,946 | $15,592 | $16,730 | $17,208 |

For the three months ended December 31, 2018, the Corporation recognized a net loss of $772,371 compared to a loss of $649,434 for the same period in 2017.

For the year ended December 31, 2018, the Corporation recognized a net loss of $3,656,990, or $0.02 per share, compared to a loss of $4,027,465, or $0.03 per share for the same period in 2017.

The Corporation's expenditures vary from quarter to quarter largely depending on the timing of its Mongolian exploration programs. The Corporation is not aware of any other specific trends which account for fluctuations in financial results from period to period.

## Liquidity and Capital Resources

At the date of this MD&A, the Corporation had approximately $3.2 million in working capital.

On June 8, 2018, the Corporation closed a non-brokered common share private placement for gross proceeds of $4.12 million. On June 14, 2018, the Corporation closed a financing in connection with a secondary listing of its common shares on the Mongolian Stock Exchange (MSE) for gross proceeds of $1.36 million.

Funds raised have been used to advance the Corporation's projects in Mongolia and to meet administrative costs in support of those programs (see Development and Exploration Projects and Discussion of Operations).

With the receipt of Private Placement proceeds of $2.53M on February 28, 2019 (see Subsequent Event note in December 31, 2018 Consolidated Financial Statements), management estimates current working capital is sufficient to fund the Corporation's planned expenditures to June 2019. The ability of the Corporation to continue with its exploration and development programs beyond this point is contingent upon securing additional funds through asset sales, formation of alliances, option, and/or joint venture agreements, equity financing and/or expenditure reductions. The timing and availability of additional equity financing will be determined largely by market conditions and the results of the Corporation's ongoing exploration programs.

The Corporation has minimal sources of income. It is therefore difficult to identify any meaningful trends or develop an analysis from the Corporation's cash flows. The Corporation is dependent primarily on the issuance of share capital to finance its exploration and development programs.

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

## Outstanding Share Data

### Authorized

An unlimited number of common shares with no par value.

### Issued and Outstanding Share Capital

| | March 27, 2019 | December 31, 2018 |
|---|---|---|
| Common shares issued and outstanding | 173,941,029 | 162,426,416 |
| Options outstanding | 11,010,000 | 11,335,000 |
| Warrants outstanding | 22,599,194 | 12,389,904 |
| DSU's oustanding | 3,954,118 | 3,954,118 |
| Total instruments outstanding at end of period | 211,504,341 | 190,105,438 |

## Contractual Obligations

The following table summarizes the Corporation's contractual obligations at December 31, 2018:

| | Total | Less than one year | 1 - 3 years | 4 - 5 years | More than 5 years |
|---|---|---|---|---|---|
| Office leases | $41,957 | $41,957 | $0 | $0 | $0 |
| Accounts payable and accrued liabilites | 224,387 | 224,387 | - | - | - |
| | **$266,344** | **$266,344** | **$0** | **$0** | **$0** |

## Other Financing Arrangements and Commitments

### Sandstorm Gold Ltd. Royalty Agreement

On April 14, 2016 the Corporation granted Sandstorm Gold Ltd. ("Sandstorm") a 2% NSR Royalty on Erdene's Tsenkher Nomin (Altan Nar) and Khundii (Bayan Khundii) licenses. Erdene has an option to buy-back 50% of the NSR Royalty for $1.2 million, to reduce the NSR Royalty to 1%, which expires April 14, 2019. Sandstorm was given a right of first refusal on future stream and/or royalty financings related to the Khundii and Tsenkher Nomin licenses. On March 26, 2019, Erdene notified Sandstorm of its intention to buy-back 50% of the NSR Royalty. The Corporation intends to close this transaction in April of 2019.

### Alliance with Teck Resources Limited

In April 2013, an alliance was formed with Teck Resources to explore Erdene's mineral tenements in the Trans Altai region of southwest Mongolia. Under the terms of the alliance, Teck agreed to invest $3 million or acquire 19.9% of the outstanding shares of the Corporation, with eighty-five percent of the proceeds committed to exploration work. In return, Erdene granted Teck the option to acquire up to 75% interest in designated projects through a two-stage option process by funding additional expenditures.

Between Q2 2013 and Q1 2017, Teck invested $3 million, fulfilling its commitment under the Alliance. During this period, Teck did not elect to acquire direct interests in any Erdene projects explored. However, Teck maintains the right through to Q1 2020, to enter into joint venture agreements on certain properties explored under the Alliance.

### Other

Gallant Minerals Limited is entitled to a 1.5% NSR Royalty on the Zuun Mod License, subject to a buy-down provision. There are no minimum exploration work commitments for the Zuun Mod mining license.

In 2018, minimum exploration expenditures of USD$1.50 per hectare were required on the Corporation's Tsenkher Nomin and Khundii licenses (USD$7,004 and USD$6,771 respectively).

The Corporation must spend a total of USD$600,000 by August 30, 2020 to have the right to purchase any (or all) of the remaining 49% of Leader Exploration LLC (Ulaan license). The Corporation can extend the option period beyond three years by incurring an additional USD$100,000 per year on exploration work. If Erdene fails to incur the minimum expenditures, its 51% ownership interest will revert to Leader Exploration LLC.

## Off-Balance Sheet Arrangements

As at December 31, 2018, the Corporation had no off-balance sheet arrangements such as guarantee contracts, contingent interests in assets transferred to an entity, derivative instruments obligations or any obligations that trigger financing, liquidity, market or credit risks to the Corporation.

## Critical Accounting Estimates

**Estimate of recoverability for non-financial assets**

Events or changes in circumstances, may give rise to significant impairment charges or reversals of impairment in a particular year.

In accordance with the Corporation's accounting policy, each non-financial asset or cash generating unit is evaluated every reporting period to determine whether there are any indications of impairment. If any such indication exists, a formal estimate of recoverable amount is performed and an impairment loss recognized to the extent that the carrying amount exceeds the recoverable amount. The recoverable amount of an asset or cash generating unit is measured at the higher of fair value less costs to sell and value in use.

Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties and is generally determined as the present value of the estimated future cash flows expected to arise from the continued use of the asset, including any expansion prospects, and its eventual disposal. Value in use is also generally determined as the present value of the estimated future cash flows, but only those expected to arise from the continued use of the asset in its present form and its eventual disposal. Present values are determined using a risk-adjusted pre-tax discount rate appropriate to the risks inherent in the asset.

Future cash flow estimates are based on expected production and sales volumes, mineral prices (considering current and historical prices, price trends and related factors), resources, operating costs, restoration and rehabilitation costs and future capital expenditures. This policy requires management to make these estimates and assumptions which are subject to risk and uncertainty; hence there is a possibility that changes in circumstances will alter these projections, which may impact the recoverable amount of the assets. In such circumstances, some or all of the carrying value of the assets may be impaired and the impairment would be charged against the income statement.

**Share-based payments**

Equity-settled share-based payments issued to employees are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. Fair value is measured using the Black-Scholes pricing model and requires the exercise of judgment in relation to variables such as expected volatilities and expected lives based on information available at the time the fair value is measured. The Corporation recognized a total of $1,186,004 in non-cash share-based compensation in the twelve months ended December 31, 2018 (2017 - $1,555,634).

**Taxation**

The Corporation's accounting policy for taxation requires management's judgment in assessing whether deferred tax assets and certain deferred tax liabilities are recognized on the balance sheet. Deferred tax assets, including those arising from tax loss carry-forwards, capital losses and temporary differences are recognized only where it is considered probable that they will be recovered, which is dependent on the generation of sufficient future taxable profits. Assumptions about the generation of future taxable profits depend on management's estimates of future cash flows. These depend on estimates of future production and sales volumes, mineral prices, reserves, operating costs, restoration and rehabilitation costs, capital expenditures, dividends and other capital management transactions.

Judgments are also required about the application of income tax legislation. These judgments and assumptions are subject to risk and uncertainty, hence there is a possibility that changes in circumstances will alter expectations, which may impact the amount of deferred tax assets and deferred tax liabilities recognized on the balance sheet and the amount of other tax losses and temporary differences not yet recognized. In such circumstances, some or all of the carrying amount of recognized deferred tax assets and liabilities may require adjustment, resulting in a corresponding credit or charge to the income statement.

No changes have been made the Corporation's critical accounting estimates in the past two years.

## Adoption of New Accounting Standards

Erdene adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2018. These changes were made in accordance with the applicable transitional provisions.

**IFRS 9 – Financial Instruments**

IFRS 9 introduces new requirements for the classification and measurement of financial assets. Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The standard introduces additional changes relating to financial liabilities and amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment. IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. The Corporation adopted IFRS 9 in its financial statements for the annual period beginning on January 1, 2018. The adoption of this standard had no financial impact to Erdene.

## Future Changes in Accounting Policies

The following new standards, and amendments to standards and interpretations under IFRS, are not yet effective for the year ended December 31, 2018, and have not been applied in preparing Erdene's consolidated statements:

**IFRS 16: Leases**

On January 13, 2016, the IASB issued IFRS 16 Leases, which specifies how to recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Consistent with its predecessor, IAS 17 the new lease standard continues to require lessors to classify leases as operating or finance. IFRS 16 is to be applied retrospectively for annual periods beginning on or after January 1, 2019. As the Corporation does not have significant lease commitments, Erdene will not see a material impact from the adoption of the standard.

## Financial Instruments and Other Risks

**Financial Instruments**

The fair values of the Corporation's financial instruments are considered to approximate the carrying amounts. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy establishes levels to classify the inputs to valuation techniques used to measure fair value.

Level 1: Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data or other means.

Level 3: Inputs are unobservable (supported by little or no market activity).

**Fair Value**

During the periods ended December 31, 2018 and December 31, 2017, there were no transfers between level 1, level 2 and level 3 classified assets and liabilities. The following table provides the disclosures of the fair value of financial assets and liabilities and the level in the hierarchy.

| | **December 31, 2018** | | | **December 31, 2017** | | |
|---|---|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Level 1** | **Level 2** | **Level 3** |
| Financial assets: | | | | | | |
| Cash and cash equivalents | **$ 1,748,249** | **$ -** | **$ -** | $ 3,225,202 | $ - | $ - |
| Receivables | | **113,412** | | | 148,069 | |

**Risks**

In conducting its business, the principal risks and uncertainties faced by the Corporation relate primarily to exploration results and, to a lesser extent, metal and commodity prices. Exploration for minerals and development of mining operations involve many risks, many of which are outside the Corporation's control. In addition to the normal and usual risks of exploration and mining, the Corporation works in remote locations that lack the benefit of infrastructure and easy access. More information on risks is available in the Corporation's Annual Information Form available on SEDAR at www.sedar.com.

**Credit Risk**

The Corporation manages credit risk by holding the majority of its cash and cash equivalents with a Canadian Schedule I bank, where management believes the risk of loss to be low. At December 31, 2018, $66,342 or 4% of the balance of cash and cash equivalents was held in banks outside Canada (December 31, 2017 - $113,555 or 4%).

**Liquidity Risk**

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Corporation's approach to managing liquidity is to ensure, to the extent possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions. As of December 31, 2018, the Corporation had a cash and cash equivalents balance of $1,748,249 (December 31, 2017 - $3,225,202) to settle current liabilities of $224,387 (December 31, 2017 - $191,600).

The Corporation is in the exploration stage and is subject to the risks and challenges similar to other companies in a comparable stage of exploration. These risks include, but are not limited to, dependence on key individuals, successful exploration results and the ability to secure adequate financing to meet the minimum capital required to successfully advance the projects and continue as a going concern.

**Foreign Currency Risk**

The Corporation operates in Mongolia, giving rise to foreign currency risk. To limit the Corporation's exposure to this risk, cash and cash equivalents are primarily held with high quality financial institutions in Canada. Based on the timing of the Corporation's exploration programs, foreign currencies may be purchased in advance of expenditures to lock in favorable rates in line with the Corporation's budgets, otherwise the Corporation does not use any form of hedging against fluctuations in foreign exchange.

The Corporation's exposure to US dollar currency risk was $71,913 as at December 31, 2018 (December 31, 2017 - $205,773). A 10% change in the US dollar exchange rate would affect net loss and comprehensive loss and deficit by approximately $7,200 (December 31, 2017 - $20,600).

The Corporation's exposure to Mongolian Tugrik currency risk was $11,510 as at December 31, 2018 (December 31, 2017 - $38,526). A 10% change in the Mongolian Tugrik would affect net loss and comprehensive loss and deficit by approximately $1,200 (December 31, 2017 - $3,900).

**Price Risk**

The Corporation's financial instruments are not exposed to any direct price risk other than that associated with commodities and how fluctuations impact companies in the mineral exploration and mining industries as the Corporation has no significant revenues.

## Disclosure Controls and Internal Controls over Financial Reporting

Erdene has established and maintains disclosure controls and procedures over financial reporting, as defined under the rules adopted by the Canadian Securities Regulators in instrument 52-109. The Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have evaluated the design and effectiveness of Erdene's disclosure controls and procedures as of December 31, 2018 and have concluded that such procedures are adequate and effective to provide reasonable assurance that material information relating to Erdene and its consolidated subsidiaries would be made known to them by others within those entities to allow for accurate and complete disclosures in annual filings.

The Management of Erdene, with the participation of the CEO and CFO (collectively "Management"), is responsible for establishing and maintaining adequate internal controls over financial reporting. Erdene's internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements in accordance with IFRS.

Management evaluated the design and effectiveness of Erdene's internal controls over financial reporting as of December 31, 2018. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in its report "Internal Control – Integrated Framework (2013). This evaluation included reviewing controls in key risk areas, assessing the design of these controls, testing these controls to determine their effectiveness, reviewing the results and then developing an overall conclusion.

Based on management's evaluation, the CEO and the CFO have concluded that as of December 31, 2018, Erdene's internal controls over financial reporting were effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS.

However, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness in future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

## Qualified Person

Michael A. MacDonald, P.Geo. (Nova Scotia) is a qualified person under NI 43-101 and supervises all of the Corporation's exploration programs. Samples are assayed at SGS Laboratory in Ulaanbaatar, Mongolia or Tianjin China, Central Geological Laboratory in Ulaanbaatar, Blue Coast Research Ltd in Parksdale British Columbia, Canada, or ALS Chemex in Vancouver, Canada. In addition to internal checks by SGS Laboratory, Central Geological Laboratory and ALS Chemex, the Corporation incorporates a QA/QC sample protocol utilizing prepared standards, field and laboratory splits, and blanks.

The disclosure in this MD&A of scientific or technical information about mineral projects on the Corporation's properties has been reviewed and approved by Michael A. MacDonald, P. Geo, who is not independent of the Corporation.

## Other Information

Additional information regarding the Corporation, including the Corporation's Annual Information Form, is available on SEDAR at www.sedar.com and on the Corporation's website at www.erdene.com.