Erdene Gold Inc.

Annual Report 2006

Erdene

Erdene is focused on creating shareholder value through the exploration of mineral prospects that lead to the discovery of world-class deposits. Recognizing that the discovery and development of world-class deposits requires significant time, resources and effort, the company has developed a strategy we believe to be a responsible one that ensures the longevity of the company.

CORPORATE PROFILE

Strategic Commodities

Erdene is concentrating on commodities that management believes provide strong, long-term growth potential based on supply and demand forecasts. These include gold, copper, nickel, molybdenum, coal, uranium and construction materials.

Growth Markets

Erdene is focused on regions that have highly prospective geology but are relatively unexplored while providing investors with maximum exposure to high growth markets, such as China and the United States.

Strong Partnerships

Erdene is establishing strong partnerships with industry leaders at the appropriate point in a project's development to strategically manage risk and provide access to the necessary capital required to advance a project to the production stage.

Stable Platform

Erdene is building a stable platform of assets that management has identified as having significant potential for modest appreciation or near-term cash-flow with low risk-reward exposure. These assets would be in the form of equity, minority interests, royalty, joint venture or other form of partnership but which require minimal financial or human resource contribution.

LETTER TO SHAREHOLDERS

Peter Akerley
– President & CEO

Dear Shareholders,

The past year was one of transition for our company. I firmly believe that the events of 2006 have provided Erdene with a better foundation to build much greater value than at any time in our existence. The commodities cycle bull remains in full run with the growth in China providing the fundamental support to maintain the upward momentum. Our expansion into the energy and construction materials sectors and maintenance of a strong metals exploration program all provide exposure to the growth in these sectors and to the key geographic regions driving growth, primarily China and the U.S. Over the longer term we will be evaluating opportunities to strengthen our three existing commodity divisions which include industrial minerals, metals and energy. Concurrently, we will be evaluating alternatives for the re-alignment of these divisions with the objective of realizing and enhancing the value of these assets.

REVIEW OF 2006

We began 2006 on a high note with the announcement of our best results to date from our Zuun Mod molybdenum project in Mongolia. These drill results further strengthened our view that Zuun Mod hosts a potentially economic molybdenum resource. The increasing grades near surface, significant thickness of mineralized zones and the remaining large untested areas, all attest to the potential of this exciting project. Zuun Mod's close proximity to Chinese markets and steel manufacturing facilities, and the build-up of infrastructure in the region related to mining activities at Naraan Sukhait and Oyu Tolgoi, all bode well for its potential development. The Company is entering the resource evaluation stage at Zuun Mod in 2007 with plans to implement a program designed to delineate an initial resource.

In mid-February, we announced the founding of a strategic relationship with Xstrata Coal Canada Limited (Xstrata Coal). This included Xstrata Coal's purchase of a 9.8% interest in Erdene and agreement to fund our coal exploration in Mongolia to earn a 75% interest in any future coal opportunity. During the year, Xstrata Coal fully funded exploration including the drilling of the Galshar coal seam with results indicating the potential for a very large resource. With discussions underway for the construction of three new coal-fired power plants in Mongolia to provide electric power to China, and Mongolian coal exports to China rising, we are excited about the future potential for the Erdene-Xstrata Coal partnership in the region's coal industry.

We also continued our joint venture with International Uranium Corporation, now Denison Mines Corp., with an extensive drill program resulting in the identification of new targets on the Galshar property. With China's plans to construct 40 new nuclear reactors over the next 20 years we anticipate the southern Mongolian uranium opportunities to continue to be aggressively explored and developed.

In late February, we announced our intention to acquire a private Canadian company with industrial mineral reserves consisting of high-brightness primary kaolin, a royalty interests in an aggregate project in the U.S. and a 20% interest in the Donkin Coal project in eastern Canada in partnership with Xstrata Coal Donkin Limited (Xstrata Coal Donkin) and other minority partners. These initiatives were pursued for a number of strategic reasons. First, our senior management team is very familiar with all of the assets and partnerships having been previously involved with the company. We are convinced that our experience, knowledge and relationships will allow us to help maximize the potential of each of the projects which are more advanced than those in Mongolia and are located in North America. This provides us with diversification and stability relative to the higher risk yet higher reward exploration we were carrying out in Mongolia. We believe that the relationships with Xstrata Coal Donkin, Rinker Materials (Maddox aggregate project) and Huber Engineered Materials (Sparta kaolin project) provide value with respect to future opportunities.

As we enter 2007 we have high expectations for each of the new acquisitions. The Donkin coal project, managed by Xstrata Donkin Coal Management Limited, is undergoing extensive evaluations as part of a feasibility study which will include underground drilling and bulk sampling in mid-2007. A positive decision in early 2008 could lead to the development of the largest coal export facility on the east coast of North America with Erdene now holding a 25% interest. On the industrial minerals front, production from the Sparta kaolin project continues with mining underway at Lucky Main and new mining and zoning applications being considered for McDuffie County properties this year. In addition, the demand for granite aggregate in the southeastern U.S. continues to drive the development of the Maddox Quarry in Georgia by Rinker Materials which is now in the final stages of the permitting process. The industrial mineral projects have the potential to provide strong future cash flow to help fund exploration and other opportunities over the long-term. More importantly, we believe the Donkin development, – which has the potential to produce 5 million tonnes of high quality coal annually – could move our company into another valuation level.

Exploration programs were carried out in Mongolia on a number of projects. Drilling adjacent to the Erdenet copper mine has indicated the presence of copper mineralization trending onto the Erdene property while a new prospect, Tsagaan Chuluut has been targeted for drilling during 2007. Drilling on the Tsenkher Gol gold prospect has further demonstrated that the property is underlain by an extensive low grade gold hydrothermal system which requires further exploration. Surface work was carried out on a number of other Erdene licenses and possible acquisitions during the year, many of which will see additional follow-up in 2007.

MONGOLIA UPDATE

Management continues to believe Mongolia provides significant opportunities to discover and develop mineral deposits, in spite of the recent changes to the country's mining laws. The world is becoming a much smaller arena for the discovery of new mineral deposits and when all factors are measured and you compare Mongolia to other unexplored under-developed nations, it still remains near the top of the list as an investment opportunity. With ten years of experience in Mongolia, I am convinced that the Mongolian government is composed of highly competent individuals who will ultimately realize they must find a way for the world's leading miners – with their expertise and financial resources – to be included in the development of the vast untapped resources of Mongolia. When this is achieved all stakeholders will benefit, including the people of Mongolia.

OUTLOOK FOR 2007

As a result of our 2006 exploration program, we entered 2007 in one of the strongest positions of any exploration company active in Mongolia. With an experienced and dedicated staff, including twelve experienced Mongolian technical and administrative personnel; one of the leading mineral and geologic databases in the country, having evaluated over 3000 prospects; great partnerships, and excellent projects, we are poised for exciting discoveries.

Our base and precious metals properties include the Zuun Mod molybdenum project expected to enter the resource evaluation stage in 2007 and two exciting new copper-gold properties acquired through our relationship with Xstrata. The Mogoit and Tsagaan Ovoo projects provide compelling surface evidence of significant copper and gold mineralization. Drilling will commence in the second quarter to test for the continuation of the mineralization at depth. The Biger copper-gold-platinum discovery, and the Erdenet and Bayan Kharaat copper-molybdenum porphyry projects provide exciting drill targets while further work is anticipated on the Temuujin copper-gold, Wild Mountain massive sulphide and Tsenkher Gol gold projects.

During 2006 we undertook a number of initiatives to diversify our asset base and position Erdene to exploit near-term cash flow opportunities. This diversification has fundamentally changed the complexion of our company, but it also better positions us for future growth. One of our priorities in 2007 is to help investors and the market fully appreciate the potential that is within Erdene's grasp. We believe these efforts will result in an enhanced valuation that is a better reflection of the value of our assets and the potential of our company.

We begin the new exploration year in a strong financial position, particularly in light of our recently announced financing expected to close in April providing us with a cash position of approximately $15 million, which will allow for a strong 2007 exploration program and the ability to react rapidly to new opportunities.

I would like to thank our partners, board of directors and excellent staff in Canada, the U.S. and Mongolia for their hard work and dedication in pursuit of our goals. I would also like to thank you, our shareholders, for your support as we continue to work on your behalf to create greater value.

Sincerely,

Peter C. Akerley
President and Chief Executive Officer

OPERATIONAL OVERVIEW

Base and Precious Metals

Erdene focuses its exploration initiatives on metals that management believes, provide strong, long-term growth potential based on supply and demand forecasts. These metals include copper, zinc, nickel, molybdenum, gold and platinum. The company's metal exploration projects are located in Mongolia, which borders China, hosts world class mines and new discoveries, yet remains largely unexplored.

MONGOLIA PROJECTS

Zuun Mod Molybdenum Project

The Zuun Mod molybdenum project is strategically located in southern Mongolia, proximal to the Chinese steel industry. Rail and power grids have been recently constructed, to within 175 kilometres of the project, to access Mongolian coal deposits for use by China's steel manufacturing industry to the south. Molybdenum is primarily used in the manufacturing of steel-alloys that are in high demand by sectors such as the growing oil and gas pipeline industry. In March of 2007, China announced plans to introduce a quota system for molybdenum product exports to conserve strategic mineral reserves, further tightening the supply of this increasingly valuable metal.

Extensive exploration at Zuun Mod has resulted in the delineation of a number of targets over the 3-kilometre long South Corridor zone. Multiple drill holes have intersected greater than 200 metres averaging 0.05 to 0.06% molybdenum with higher grade zones of 20 to 30 metres averaging greater than 0.10% molybdenum. The company is entering the resource evaluation stage in 2007 with plans to implement a program designed to delineate an initial resource.

Erdenet Ikh-Tal Copper Project

With China having to import 75 per cent of its copper demand, Mongolia has become increasingly important as a supplier of concentrate with four per cent of China's total supply provided by Erdenet Mining Corporation's (EMC) open pit copper-molybdenum mine operating in north-central Mongolia. The company's Erdenet Ikh-Tal project is a large 85.4 km^2 property immediately surrounding the EMC mine, the largest producing copper mine in the China-Mongolia region and the second largest porphyry copper deposit in Central Asia.

Exploration drilling, Mongolia

Erdene's 2006 drilling results indicate a copper-oxide zone ranging from 20 to 35 metres thick extending onto Erdene's licenses southeast and northwest of the main EMC mine. This zone averages 0.2 to 0.3% copper with higher grade intervals up to 0.71% copper over 5 metres. Highly anomalous copper-sulfide zones, underlying the copper-oxide zones, have also been identified on Erdene's property southeast of the EMC mine. In addition, a large alteration zone (Tsagaan Chuluut) with a coincident geophysical anomaly has been identified 4 kilometres northwest of the EMC mine. Exploration of this prospect area, as well as follow-up exploration on the encouraging results adjacent to the EMC mine, will be the focus of the 2007 program.

Mogoit/Tsagaan Ovoo Copper-Gold Project

The Mogoit and Tsagaan Ovoo properties were optioned from Xstrata Copper in early 2007 for back-in right consideration. The two optioned properties lie 30 kilometres apart in south central Mongolia within a group of contiguous exploration licenses covering approximately 990 km^2. The projects were originally the focus of Falconbridge Limited's work in Mongolia prior to Xstrata Copper's takeover of that company. Falconbridge identified porphyry-style copper-gold system target areas characterized by coincident geophysical (IP and magnetic) and geochemical (rock and soil) anomalies in widely spaced areas of historic shallow pits and trenching. Rock samples from these areas have returned significant values for copper (up to 14%) and gold (up to11g/t). Six high priority drill targets on the two properties were identified by Falconbridge. These will be included in the 2007 exploration program designed to investigate this large, highly prospective property.

Biger Copper-Gold-Platinum Project

The Biger project is an alkalic porphyry system with potential to host significant copper-gold-platinum mineralization located in southwestern Mongolia. Rock samples returned copper values up to 2.8%, accompanied by elevated palladium (1.37g/t), gold (0.5g/t), and platinum (0.29g/t). A drill hole testing an outlier protruding through a large area of pediment cover intersected a 24 metre section that assayed 0.5% copper with elevated gold (0.1g/t) and palladium (0.1g/t) values. In 2006, geophysical modeling (3D) of the ground magnetic data identified several large features beneath the extensive pediment cover that remain highly prospective for porphyry style copper-gold-PGE mineralization. Subsequent geophysical (gradient and dipole-dipole IP) and geochemical (mobile metal ion) surveys have further defined targets for 2007 drilling.

Tsenkher Gol Gold Project

The Tsenkher Gol project is located approximately 180 kilometres east of Mongolia's capital, Ulaanbaatar. The exploration target is an intrusive-hosted disseminated gold prospect located in the South Khentii gold belt, similar to Centerra Gold's Boroo Mine. High grade gold veins and lower gold values associated with disseminated sulfides in altered granite have been outlined over a target area of kilometric scale. Drilling on four target areas (Altan Suult and three in the Khond Uul area), 1 to 4 kilometres apart, all returned anomalous gold intersections (greater than 0.2g/t gold) commonly over significant thicknesses (up to 68 metres) including 10 metres of 1.2g/t gold and 2 metres of 6.6g/t gold at Altan Suult.

Other Copper-Gold Projects

Erdene has a number of other projects in areas of prospective geology where exploration work to date has identified significant alteration and mineralization related to possible deposits of copper and gold. These projects include the Virgin/Temuujin project in southeastern Mongolia which lies within the South Gobi porphyry belt that hosts known deposits including the world-class Oyu Tolgoi deposit. Drilling at Temuujin has confirmed porphyry related copper-gold mineralization and alteration interpreted to represent the distal portion of a zoned porphyry system. At Bayan Kharaat in northern Mongolia, surface mapping, geochemical sampling and geophysical surveys have identified new porphyry copper-molybdenum targets. At Wild Mountain in western Mongolia, exploration to date has identified significant copper, gold and silver mineralization associated with a massive sulphide occurrence. A 24-metre trench over the occurrence returned 1.85g/t gold, 11.92g/t silver and 1.54% copper. All of these projects will be evaluated further in 2007.

THE CHINA FACTOR

In the past few years, China's demand for metals and other raw material has lead to a supply shortage which has resulted in record high prices for many commodities, including copper, molybdenum, zinc, nickel, uranium and others.

China continues to drive this demand for raw materials by leading the world in economic growth. Initially fuelled by its burgeoning export business, China's economy is now also being driven by domestic growth led by an ever expanding middle class demanding consumer goods and rapid urbanization that has resulted in an unprecedented construction boom.

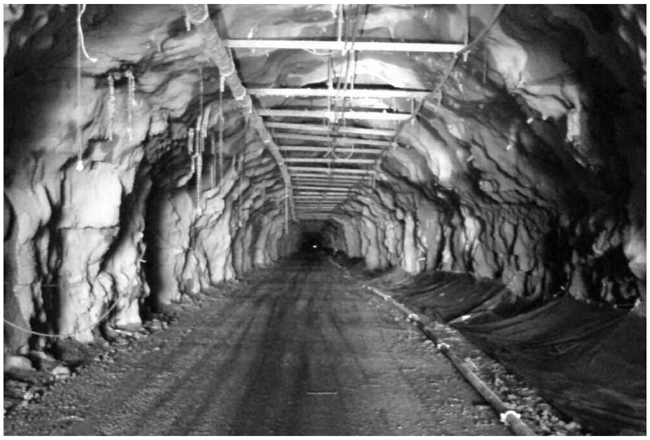
Mongolia, rich in mineral resources, is ideally situated to take advantage of the growing demand for raw material in China. This fact has not gone unnoticed by the world's major mining companies and the Chinese, who are rapidly building up their infrastructure to access Mongolia's emerging mineral resources.

Energy

STRATEGIC PARTNERSHIPS

While Erdene's exploration efforts are focused on base and precious metals, the company has pursued strategic partnerships at the exploration stage for other commodities, including coal and uranium, where outside expertise is most beneficial to the exploration, development and marketing of these commodities.

In February 2006, Erdene entered into an Alliance Agreement with Xstrata Coal Canada Limited (Xstrata Coal Canada), a wholly-owned subsidiary of Xstrata plc. Pursuant to the agreement, Xstrata Coal Canada has been granted a first option to enter into a joint venture and earn a 75% interest in any coal opportunity in Mongolia identified by Erdene by funding all work through completion of a feasibility study.



Main access tunnel at Donkin, 2006

With the acquisition of Kaoclay Resources Inc. and its interest in the Donkin Coal Allience in June 2006, Erdene reinforced its relationship with Xstrata. Erdene is a 25% joint venture partner in the Donkin Coal Alliance with Xstrata Coal Donkin Limited (Xstrata Coal Donkin). The Donkin Coal Alliance was formed to secure the rights to the Donkin coal project and to explore, assess, study and, if feasible, develop the high-grade Donkin coal resource. The Donkin Coal Project is located in Cape Breton, Nova Scotia, proximal to deep water ideal for seaborne shipping into the major markets on North America's east coast.

In addition to our Xstrata relationship, Erdene entered into an option agreement with International Uranium Corporation, now Denison Mines Corp. (IUC) in 2005 providing IUC with the exclusive right to earn a 65% interest in the uranium mineralization on Erdene's large license holding in Mongolia by spending $6,000,000 on eligible expenditures over a period of up to four years and by meeting other obligations.

NORTH AMERICA PROJECTS

Donkin Coal Project

During the late 1970s and 1980s, Cape Breton Development Corporation carried out an exploration and evaluation program to determine the potential of the coal resources at Donkin. Extensive work efforts and funds were used to conduct exploration programs, define the coal resource (Donkin Coal Resource Block), access the coal deposit, and evaluate potential mining operations. This work included the expenditure of approximately $100 million to develop two 3.5–kilometre long access tunnels down to the coal seams beneath the sea floor.

The Donkin Coal Alliance is targeting an estimated 200 million tonnes of thermal and metallurgical coal within the Harbour Seam of the Donkin Coal Resource Block which is considered to be the last remaining undeveloped block of high quality coal offshore Cape Breton. The Donkin Coal Alliance began its exploration program, and evaluation and scoping study in June, 2006. A key component of the exploration program is the dewatering of the two access tunnels. Pumping started on November 13, 2006, and as of early March 2007, 150 million litres had been safely discharged into the adjoining settling ponds. Clearing and refurbishment of the tunnels is well underway. Access to the targeted Harbour Seam coal face is anticipated during the second quarter of 2007 which will be followed by an extensive in-seam exploratory drilling and bulk sampling program. The evaluation program is being managed by Xstrata Coal Donkin Management Limited and is expected to be completed in the first quarter 2008. At that time, a decision will be made whether to develop the Donkin resource for commercial production. The continued growth of the Atlantic seaborne coal market bodes well for future marketing of Donkin coal.

MONGOLIA PROJECTS

Galshar Coal Project

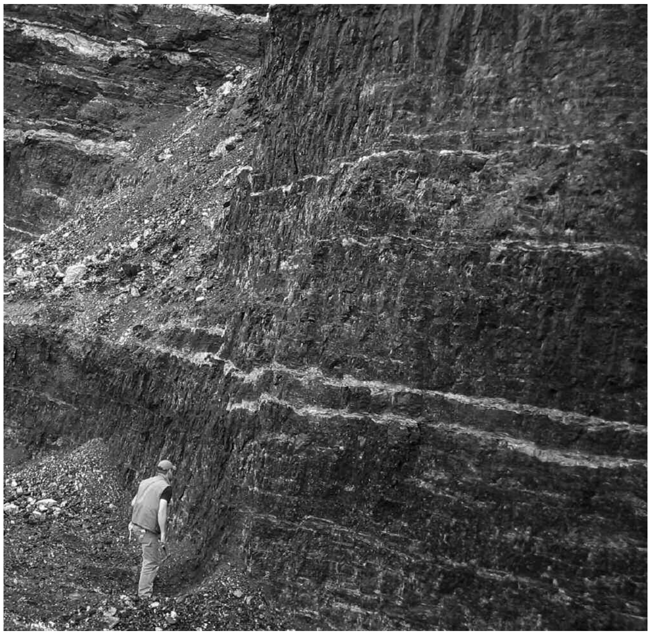
China is the world's largest consumer of coal and consumption is expected to double over the next 20 years to over 3 billion tonnes per annum. With Chinese imports growing rapidly, Mongolia is on the verge of becoming a major exporter of coal into this growing market. Mongolia has very large, high-quality resources conducive to open pit mining located near current and planned railway links to China. In teaming up with Xstrata Coal Canada, Erdene has partnered with a world-leading coal company focused on China's growing coal market.

Exploration drilling of Erdene's Galshar coal project in south-eastern Mongolia has indicated the potential for a large thermal coal resource amenable to open-pit mining. The target market is operating and planned power-generation facilities in the region. The Mongolian Government and Chinese interests have announced plans for the construction of three new coal fired generating plants in southeastern Mongolia to supply power to China. Coal consumption for these three facilities could reach 36 million tonnes per annum with much larger potential for export markets to China.

Exploration activities on the Galshar coal project have successfully traced a coal seam ranging in thickness from 4 to 47 metres over a distance of 3.6 kilometres. Drilling of the seam, which extends onto Erdene's property from the adjacent Khashaat Khudag opencast coal mine, has returned up to 22 metres of greater than 10,000 BTU/lb coal with low ash (6%) and low sulfur (0.4%). In 2006, the Galshar basin was tested by nine holes with an average spacing greater than 1 kilometre. One main coal seam with an average thickness of 21 metres (maximum thickness of 47 metres) has been identified and is overlain by an additional five to 10 coal seams, each 1 to 2 metres thick.

Based on the 2006 drilling results, Erdene and Xstrata Coal Canada are planning to move the project to the resource delineation stage. A 30-hole drilling program is planned for the second quarter of 2007 to further define the coal seams intersected to date and confirm the coal quality.

In addition to the Galshar program, Erdene continues to evaluate other coal opportunities on its licenses as well as on other properties located in central, southern and south-eastern Mongolia pursuant to the Alliance Agreement with Xstrata Coal Canada.



Thick seams of coal, Mongolia

Uranium Project

Erdene has a large land position in southeastern Mongolia, an area highly prospective for the discovery of sedimentary hosted uranium deposits amenable to in-situ leach mining. The 2006 exploration program was managed by IUC who initiated an extensive reconnaissance rotary drill program to evaluate the uranium potential of the Galshar block of licenses as well as on the Yant and Tsagaan Del Licenses. In part, this was a follow-up to the IUC funded exploration work carried out by Erdene in 2005 that identified several priority prospect areas.

In 2006, interesting results were returned from the Ikh Het depression (western Galshar area) where one hole intersected 0.01% to 0.02% uranium over 7 metres at a depth of 7 to 14 metres and another intersected 0.01% to 0.02% uranium over 5 metres at a depth of 20 metres. The scope of a follow up exploration program is under consideration.

Industrial Minerals

Erdene has a program to seek out and acquire small to mid-size mineral projects with near-term cash flow opportunities. It is expected that these projects will provide Erdene with long term financial resources that will allow the company to provide shareholders with exposure to ongoing exploration activities from a position of greater stability and one that minimizes dilution. To that end two projects were acquired in 2006 and are held in Erdene's wholly owned subsidiary Sparta Kaolin Corporation (SKC). Future investments in the construction aggregate industry in eastern North America for import into the east-coast U.S. market are being evaluated. Reserve depletion, coastal population growth, increased delays and restrictions due to permitting difficulties have all resulted in increased demand for imported construction aggregate material and increased prices.

NORTH AMERICA PROJECTS

Maddox Aggregate Project

SKC owns the surface and mineral rights to the Maddox property, a 342-acre property in Hancock County, Georgia. In May 2000, SKC entered into an agreement with Rinker Materials Corporation (Rinker) headquartered in West Palm Beach, Florida, for the development and production of an aggregate quarry on the Maddox property.

Rinker has been granted an exclusive right to mine, process, and sell aggregate from the Maddox property subject to a royalty, the greater of US$0.40 per ton mined or 7.5% of the selling price. Rinker is a major global company and one of the largest suppliers of construction aggregates in the southeast U.S. Maddox has an estimated start-up production of one million tonnes of granite aggregate per year with a design capacity of four million tonnes. Based on current production projections, the Maddox quarry would have a lifespan of at least 20 years.

Rinker has designed a quarry mining plan, processing plant and facilities, and produced an environmental impact plan. Rinker has also acquired additional land adjacent to the Maddox property to secure rail access to the site. A final permit decision is expected during 2007. The construction phase is expected to be completed nine to twelve months thereafter. Rinker is responsible for fully funding the development program.

SKC's Lucky Main kaolin mine, Georgia

Sparta Kaolin Project

SKC controls a multi-million tonne primary kaolin resource in Georgia. Kaolin, a white, high-brightness clay, is primarily used to coat high quality paper. It is also used in plastics, rubber, paints, pharmaceuticals and ceramics.

For the project's development stage, SKC partnered with industry leader Huber Engineered Materials (Huber), a subsidiary of J.M. Huber Corporation, a diversified multi-national company and one of the world's largest kaolin producers. The agreement provides Huber with the right to mine a limited tonnage of kaolin from specific deposits in exchange for a series of prepaid tonnage payments to SKC.

Huber started commercial production in 2005 and produces a special Light Weight Coater (LWC) product for the paper industry called Huber Prime™ LWC. This product has superior brightness and coverage properties and has received a favorable market response. Huber is producing its Huber Prime product exclusively from the SKC's kaolin deposits. Erdene's management is investigating a number of options to maximize the value of the resource.

CORPORATE GOVERNANCE

MANDATE OF BOARD

The guiding principles of Erdene's Board of Directors (Board) are to ensure the long-term viability and profitability of the company, as well as the well-being of its employees and of the communities in which it operates. The Board is responsible for the stewardship of the company through the appropriate supervision of the business and management of the company.

The strategic planning and business objectives developed by Management are submitted to and reviewed by the full Board. They also reviews and approves the annual financial statements, the annual report, the annual information form, the annual budget and changes thereto, management proxy information circulars, material press releases, decisions as to material acquisitions not within the budget, and the grant of stock options.

INDEPENDENCE FROM MANAGEMENT

Seven of the Board's ten directors are unrelated. An unrelated director is defined to be a director who is independent of management and is free from any interest which could materially interfere with the director's ability to act with a view to the best interests of the company and its shareholders.

The Board is satisfied that it maintains adequate and appropriate independence from management. All directors are expected and encouraged to exercise their independent judgment. To facilitate this, members of the Audit Committee, the Corporate Governance and Disclosure Policy Committee and the Compensation Committee are all unrelated directors. The Pre-Clearance Committee and the Technical Committee include directors who are also part of management.

CORPORATE SOCIAL RESPONSIBILITY

Erdene is committed to continually improving the lives of those who work for us, partner with us and host us in their communities. Our goal is to make a positive contribution to the communities in which we work with a community needs assessment completed on advanced projects with an aim to identifying sustainable economic development programs the company can contribute to or initiate. The company places a priority on hiring local workers whenever possible and the company is an active and enthusiastic sponsor of community-based efforts to promote health, education and culture.

Health, safety, environment and community responsibilities are integral to the way we do business. Working safely at Erdene is a condition of employment. We are committed to continual improvement in our performance, efficient use of natural resources and aspire to zero harm to people and the environment. We develop, implement and maintain management systems for health, safety, environment and the community that are consistent with internationally recognized standards.

MANAGEMENT'S DISCUSSION & ANALYSIS OF OPERATING RESULTS

YEAR ENDED DECEMBER 31, 2006

This Management Discussion and Analysis of Erdene Gold Inc. (the "Company") provides analysis of the Company's financial results for the years ended December 31, 2006 and 2005 and its financial position as at December 31, 2006 and December 31, 2005. The following discussion and analysis provides a summary of selected consolidated financial information for the years ended December 31, 2006 and 2005 and includes financial information relating to the Company and its wholly owned subsidiaries, Erdene Gold International Inc. and Erdene International Exploration Inc., both incorporated under the laws of Barbados, Erdene Resources Inc. and its wholly owned subsidiary 6531954 Canada Limited, both incorporated under the laws of Canada, Sparta Kaolin Corporation, incorporated under the laws of Delaware as well as Erdene Mongol XXK and Erdene Energy XXK, both of which are incorporated under the laws of Mongolia. The consolidated financial statements of the Company have been prepared by management, in Canadian dollars, in accordance with Canadian generally accepted accounting principles (see note 1: Summary of Significant Accounting Policies). The following information should be read in conjunction with the audited consolidated financial statements of the Company for the years ended December 31, 2006 and 2005, including all accompanying notes to the consolidated financial statements.

This discussion includes certain statements that may be deemed "forward-looking statements". All statements in this discussion, other than statements of historical fact, that address reserve potential, exploration drilling, exploitation activities and events or developments that the Company expects, are forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially from those in forward-looking statements include market prices, exploitation and exploration results, continued availability of capital and financing and general economic, market or business conditions. Investors are cautioned that any such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in the forward-looking statements. The information contained herein is stated as of March 23, 2007 and is subject to change after that date.

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

1.01 DATE OF MD&A

This MD&A is prepared as of March 23, 2007

1.02 NATURE OF BUSINESS AND OVERALL PERFORMANCE

General

Prior to the second quarter of 2006, the Company was a resource exploration company listed on the Toronto Stock Exchange with no operating cash flow. Effective June 12, 2006, the Company completed a plan of arrangement pursuant to the Canada Business Corporations Act and, consequently, acquired Kaoclay Resources Inc. ("Kaoclay") and two other companies, 6531954 Canada Limited and Sparta Kaolin Corporation. As a result, the Company now owns three advanced-stage projects including coal assets in Nova Scotia and aggregate and kaolin clay assets in Georgia, U.S.A. The Georgia kaolin project began commercial production in January 2005. Cash flow is expected to increase over the next five years conditional on the Georgia aggregate project commencing production, anticipated in 2008, and culminating with the potential production from the Donkin coal exploration and development project in Cape Breton, Nova Scotia. Until a decision is made to proceed with commercial development of the aggregate and coal projects, to expand the scope of the kaolin operations and until resultant cash flows increase substantially over current, the annual level of exploration expenditures of the Company is dependent primarily on the sale of share capital to finance its exploration programs. Prior to the acquisition of Kaoclay, the Company had no sources of revenue other than interest earned on cash and short-term money market instruments derived from issuances of share capital. Post acquisition, the Company also generates royalty income from its kaolin and aggregate properties which are early stage. It is therefore difficult to identify any meaningful trends or develop an analysis from the Company's cash flows.

The Company is well-funded with its focus on the discovery of large tonnage, low cost, gold, copper, molybdenum, uranium and coal deposits primarily in Mongolia; and the development of its coal and industrial mineral interests in North America with near term cash flow potential. At December 31, 2006 the Company held 48 mineral licenses in Mongolia representing 14 projects covering approximately 1.0 million hectares.

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

Acquisition of Kaoclay Resources Inc.

Effective June 12, 2006 the Company concluded by way of plan of arrangement, pursuant to the Canada Business Corporations Act, the acquisition of Kaoclay (incorporated under the laws of Canada) and its wholly owned subsidiaries, Sparta Kaolin Corporation ("Sparta")(incorporated under the laws of Delaware) and 6531954 Canada Limited (incorporated under the laws of Canada). Based in Halifax, Nova Scotia, Kaoclay, through its subsidiaries, controlled three advanced-stage projects including an interest in coal assets in Nova Scotia and kaolin clay and aggregate assets in Georgia, USA. Each project has an experienced partner that is responsible for all operations. Under the plan of arrangement the Company issued 1.65 common shares and a half warrant for each Kaoclay share (14,816,917 shares and 4,489,975 warrants of the Company for the 8,979,950 Kaoclay shares outstanding). Each warrant entitles the holder to purchase one common share of the Company for $1.60 per share until June 15, 2009. The purchase price has been determined to be $18,346,143, including acquisition costs of $125,000.

The purchase has been accounted for using the purchase method, whereby the purchase consideration was allocated to the fair values of the assets acquired and liabilities assumed at the effective date of the purchase.

Net Assets Acquired	$
Cash and cash equivalents	107,629
Non-cash working capital, net	(115,152)
Resource property interests	11,999,500
Capital assets	1,438,070
Intangible assets	1,217,000
Goodwill	5,800,079
Future income taxes	(2,100,983)
	18,346,143

Purchase Price	$
Common shares issued	16,476,412
Warrants issued	1,744,731
Acquisition costs	125,000
	18,346,143

The Donkin Coal Alliance was formed by or on behalf of Xstrata Coal Pty Limited (66%), Kaoclay Resources Inc. ("Kaoclay") (20%), American Transbridge Technologies LLC (9.33%) and PDC Resources Corporation (4.67%) to submit a proposal to the

Province of Nova Scotia to secure the exclusive right to the Donkin Coal Project; namely, the project to explore, assess, study and, if feasible, develop the Donkin Coal Resource Block into an operating coal mine. On December 14, 2005, the Province of Nova Scotia announced that the Donkin Coal Alliance was the successful proponent. Effective June 12, 2006, Kaoclay amalgamated with Erdene Resources Inc., a wholly-owned subsidiary of the Company, under a court approved Plan of Arrangement and Kaoclay is now a wholly-owned subsidiary of the Company operating under the name of Erdene Resources Inc. On October 26, 2006 the Company entered into agreements with minority partners to increase its ownership in the Donkin Coal Alliance from 20% to 25% in exchange for cash consideration of US$9,400 and 360,000 common shares of the Company. Closing of the transaction is anticipated to take place on of before April 16, 2007. Under the agreements, Xstrata Coal Donkin Limited ("XCDL"), a related party to Xstrata Coal Pty Limited, has also increased its interest in the Donkin Coal Alliance from 66% to 75% in exchange for cash.

The members of the Donkin Coal Alliance signed an agreement ("Alliance Agreement") effective March 11, 2005, and amending agreements dated April 23, 2006, October 26, 2006 and October 27, 2006. Pursuant to the April 23, 2006 amending agreement, the Company's interest in the Donkin Coal Alliance is held by 6531954 Canada Limited, a wholly owned subsidiary of Erdene Resources Inc., and Xstrata Coal Pty Limited's interest is held by XCDL. The Company and XCDL are presently negotiating the terms of a definitive joint venture agreement and a sales agency agreement. Xstrata Coal Donkin Management Limited, a related party to XCDL, is acting as manager for the Donkin Coal Project. If the Donkin Coal Project is approved to proceed to development, the manager will be responsible for mine development, including infrastructure, coal mining and processing, and coal distribution and sales programs.

In June 2006, Xstrata Coal Donkin Management Limited acquired the surface lands relating to the Donkin Coal Resource Block from the Cape Breton Development Corporation ("CBDC"). The Donkin Alliance began its exploration program and evaluation and scoping study ("Exploration Program") in June 2006.

Pursuant to the Alliance Agreement, the Company is committed to fund up to $10,000,000 ("Initial Funding") of the expenditures incurred during the Exploration Program of the Donkin Coal Project provided such expenses qualify as Canadian Exploration Expenses ("CEE"). XCDL agreed to pay any other costs up to a maximum of $5,000,000 but if the Company only pays a portion of the Initial Funding, XCDL is only obliged to pay a corresponding portion of the $5,000,000. The Company is responsible to fund 25% of any additional expenditures incurred in the Exploration Program if it is to maintain its 25% interest in the Donkin Coal Project. A preliminary estimate of the total budget for the Exploration Program is approximately $17,200,000 and the Exploration Program is expected to be complete in the first quarter of 2008. In July 2006, the Company completed a $6,000,000 flow-through financing to partially fund its obligation.

Strategic Alliance with Xstrata Coal Canada Limited

On February 14, 2006 the Company announced that it had concluded an alliance agreement with Xstrata Coal Canada Limited ("Xstrata") a subsidiary of Xstrata plc (London Stock Exchange: XTA.L; Zurich Stock Exchange: XTA.S), pursuant to which Xstrata subscribed for 3,000,000 common shares of the Company at $1.00/share, resulting in Xstrata owing a 9.8% equity interest in the Company, at the date of the transaction. Xstrata's equity interest in the Company as at December 31, 2006 was 5.66%.

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

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

Joint Venture Agreement with International Uranium Corporation (now Denison Mines Corporation)

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

Agreement with Gallant Minerals Limited

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

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

a) US$275,000;
b) direct or indirect expenditures aggregating US $1,000,000 on the properties acquired or under option to acquire; and,
c) 1,200,000 common shares of the Company.

The Company has met its obligation to incur US $1,000,000 of expenditures on the optioned properties and on March 1, 2006 paid US $125,000 and issued 500,000 shares, consistent with the option terms. Subsequent to year-end on February 28, 2007, the Company made its final payment of US $150,000 and issued 700,000 shares to Gallant, meeting all conditions of the option agreement entitling it to 100% ownership of Tamerlane.

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

2006 Exploration and Development Program

The Company had a transformational year in 2006. With the acquisition of Kaoclay, the Company acquired three advanced stage projects. The objectives of the overall 2006 exploration and development program were:

i) To conduct advanced level programs on four core Mongolian projects, Galshar (Coal), Tsenkher Gol (Gold), Erdenet (Copper), and the Uranium land package optioned to IUC;
ii) to begin evaluation of the Donkin coal project in Cape Breton, Nova Scotia with operating partner Xstrata Coal Donkin Limited. To this end, the Company raised $6,000,000 in flow-through dollars to partially fund its obligation under the joint venture;
iii) to continue to advance its newly acquired clay and aggregate projects in Georgia, USA; and,
iv) to perform more preliminary, reconnaissance exploration activities on a number of its remaining early-stage properties in Mongolia. The Company's exploration program is led by a senior management team with extensive exploration experience in Mongolia and globally.

The Company will continue to fund operating losses and exploration expenditures out of existing working capital of $3.3 million and flow-through funds of $4.6 million at December 31, 2006.

1.03 SELECTED ANNUAL INFORMATION

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

Expressed in thousands of Canadian dollars except per share amounts.

Fiscal Year Ended December 31	2006 $	2005 $	2004 $	2003 $
Revenues	**250**	-	-	-
Loss for the year	**4,565**	4,981	4,437	629
Basic and diluted loss per share	**0.11**	0.19	0.19	0.14
Total assets	**34,177**	6,649	9,426	4,161
Total long-term liabilities	**2,899**	-	-	-
Cash dividends declared	**Nil**	Nil	Nil	Nil

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

1.04 RESULTS OF OPERATIONS

The Company had a loss of $4,565,028 in the year ended December 31, 2006, as compared to a loss of $4,981,314 during the same period last year.

With the acquisition of Sparta, via the acquisition of Kaoclay, Erdene began to earn revenue from a number of sources. Sparta's industrial lab in Eatonton, Georgia generated $165,916 in revenue since acquisition in June, 2006. During the same period, approximately 82% of the revenue earned from the lab came from a single customer.

The Company also recognized $84,260 in royalty revenue since the Sparta/Kaoclay acquisition in June 2006. The royalties were received as part of a long-term lease of the Company's Maddox property in Sparta, Georgia to Rinker Materials Corporation ("Rinker").

Exploration and operating expenses in 2006 amounted to $2,854,951 compared to $3,868,688 in the previous year. The following schedule summarizes the resource property interests capitalized to the end of 2006 and 2005 and the exploration expenses charged to operations in fiscal 2006 and 2005, by project:

			Properties under Gallant Option Agreement					100% Owned Mongolian Properties			
Year ended December 31, 2006	Sparta $	Donkin $	Zuun Mod $	Tsenkher Gol $	Erdenet Ikh Tal $	Biger $	Other $	Energy $	Virgin $	Other $	Total $
RESOURCE PROPERTIES											
Balance, December 31, 2005	**–**	**–**	**499,250**	**354,433**	**152,380**	**44,027**	**161,069**	**61,457**	**255,962**	**473,130**	**2,001,708**
Acquired via plan of arrangement	6,488,000	5,511,500	–	–	–	–	–	–	–	–	11,999,500
Resource property additions	34,558	1,412,102	656,496	466,066	200,375	57,893	211,800	113,199	70,937	30,057	3,253,483
Write off of resource properties	–	–	–	–	–	–	–	(62,901)	(67,134)	(330,143)	(460,178)
Exploration partner contributions	–	–	–	–	–	–	–	(39,782)	–	–	(39,782)
Resource Properties at Dec. 31, 2006	**6,522,558**	**6,923,602**	**1,155,746**	**820,499**	**352,755**	**101,920**	**372,869**	**71,973**	**259,765**	**173,044**	**16,754,731**
EXPLORATION AND OPERATING EXPENSES (cumulative)											
Expensed to December 31, 2005	**–**	**–**	**1,625,303**	**335,097**	**258,977**	**29,899**	**516,239**	**198,403**	**3,429,178**	**1,208,823**	**7,601,919**
Diamond Drilling	–	–	–	400,004	173,778	–	–	211,762	–	–	785,544
Assaying and Analytical	–	–	6,865	115,705	3,121	–	19,384	14,902	84	135	160,196
Geological Services	–	–	32,405	181,695	37,486	32,985	16,834	434,451	42,560	213,283	991,699
Geo–technical Surveys	–	–	–	22,429	13,182	45,239	–	10,014	–	–	90,864
Logistical and Field Support	–	–	64,717	176,400	38,128	19,768	9,120	86,059	1,246	17,913	413,351
Professional fees	–	–	–	–	–	–	–	45,589	–	–	45,589
Travel	–	–	11,518	4,186	6,376	25,624	–	90,674	–	3,630	142,008
Write off of resource properties	–	–	–	–	–	–	–	62,901	67,134	330,143	460,178
Other	–	–	–	337	279	–	46	2,055	–	–	2,717
Exploration partner contributions	–	–	–	–	–	–	–	(562,729)	–	–	(562,729)
Net exploration expenses	–	–	115,505	900,756	272,350	123,616	45,384	395,678	111,024	565,104	2,529,417
Lab operating expenses	231,967	–	–	–	–	–	–	–	–	–	231,967
Amortization of intangibles	93,567	–	–	–	–	–	–	–	–	–	93,567
Net operating and other expenses	325,534	–	–	–	–	–	–	–	–	–	325,534
Total expenses for the year ended December 31, 2006	325,534	–	115,505	900,756	272,350	123,616	45,384	395,678	111,024	565,104	2,854,951
Cumulative expenses to December 31, 2006	**325,534**	**–**	**1,740,808**	**1,235,853**	**531,327**	**153,515**	**561,623**	**594,081**	**3,540,202**	**1,773,927**	**10,456,870**

All financial data has been prepared in accordance with Canadian generally accepted accounting principles and are stated in Canadian dollars.

Year ended December 31, 2005	Sparta	Donkin	Properties under Gallant Option Agreement					Wholly Owned Properties			Total
			Zuun Mod	Tsenkher Gol	Erdenet Ikh Tal	Biger	Other	Energy	Virgin	Other	
	$	$	$	$	$	$	$	$	$	$	$
RESOURCE PROPERTIES											
Balance, Dec. 31, 2004	–	–	**18,422**	**13,078**	**5,623**	**1,625**	**5,943**	**16,208**	**107,893**	**479,506**	**648,297**
Resource property additions	–	–	480,828	341,355	146,758	42,402	155,126	76,611	148,069	20,353	1,411,502
Write off of resource properties	–	–	–	–	–	–	–	–	–	(26,729)	(26,729)
Exploration partner contributions	–	–	–	–	–	–	–	(31,362)	–	–	(31,362)
Resource Properties at December 31, 2005	–	–	**499,250**	**354,433**	**152,380**	**44,027**	**161,069**	**61,457**	**255,962**	**473,130**	**2,001,708**
EXPLORATION AND OPERATING EXPENSES (cumulative)											
Expensed to December 31, 2004	–	–	–	–	–	–	–	–	**2,714,478**	**1,018,753**	**3,733,231**
Diamond Drilling	–	–	1,127,242	–	87,445	–	–	117,470	374,574	–	1,706,731
Assaying and Analytical	–	–	47,736	99,998	4,458	15,209	19,742	16,365	66,769	7,291	277,568
Geological Services	–	–	126,574	72,041	35,659	10,481	258,717	230,578	38,176	58,384	830,610
Geo-technical Surveys	–	–	55,154	63,131	70,189	–	22,182	–	98,207	13,767	322,630
Logistical and Field Support	–	–	268,295	88,273	55,151	4,088	40,782	289,081	122,374	66,595	934,639
Professional fees	–	–	–	–	–	–	68,989	24,020	–	–	93,009
Travel	–	–	–	–	6,015	–	105,453	7,537	14,407	15,464	148,876
Write off of resource properties	–	–	–	–	–	–	–	–	–	26,729	26,729
Other	–	–	302	11,654	60	121	374	3,383	193	1,840	17,927
Exploration partner contributions	–	–	–	–	–	–	–	(490,031)	–	–	(490,031)
Total for the year ended December 31, 2005	–	–	1,625,303	335,097	258,977	29,899	516,239	198,403	714,700	190,070	3,868,688
Cumulative Exploration to December 31, 2005	–	–	**1,625,303**	**335,097**	**258,977**	**29,899**	**516,239**	**198,403**	**3,429,178**	**1,208,823**	**7,601,919**

All financial data has been prepared in accordance with Canadian generally accepted accounting principles and are stated in Canadian dollars.

The Company charges all exploration costs to operations in the period incurred until such time as it has been determined that a property has potential to contain an economically recoverable resource, in which case subsequent exploration costs and the costs incurred to develop a property will be capitalized. All direct costs related to the acquisition of resource property interests have been capitalized as an asset, which during 2006 amounted to $15,213,201. The aggregate costs of resource properties that have, or plan to be abandoned have been charged to operations which during 2006 amounted to $460,178 resulting in a net addition for the year of $14,753,023. Resource property interest additions in 2005 amounted to $1,380,140 and resource property write offs during the same year were $26,729 resulting in net additions for 2005 of $1,353,411.

Since the Company charges exploration costs to operations until a property displays potential for an economically recoverable resource, reported losses vary directly with the extent of the exploration programs conducted. As the Company obtains exploration results from existing resource properties (and those it acquires) that justify and enable further equity financing and continued exploration programs, reported losses will continue and will vary with the extent of exploration activity until such time as economically recoverable resources are identified that warrant development to generate sustainable revenues from operations. Conversely, should exploration results not justify further equity financing or should further equity financing not be available or be insufficient to conduct planned exploration programs, exploration activity would be reduced with exploration funds directed toward projects with highest potential, resulting in lower reported losses. During the calendar years ended December 31, 2006 and 2005, all of the Company's Mongolian properties were in the exploration phase, and accordingly, all exploration costs were charged to operations in the respective periods. The funds expended on the Donkin coal project have been capitalized because in the opinion of management the project has potential to contain an economically recoverable resource. Further development costs will continue to be capitalized unless it is determined, at a future date, the resource will not be economically recoverable.

A summary of exploration highlights during 2006 is presented later in this MD&A in Section 1.14.

General and administrative expenses increased in 2006 to $2,373,844 from $1,394,030 in 2005. The following is a commentary on the changes over the prior year:

- Depreciation increased due to the acquisition of depreciable capital assets from Kaoclay.
- Insurance costs have increased due to an increase in corporate D&O coverage and the additional insurance on acquisition of the Company's subsidiaries, Kaoclay and Sparta.
- Investor relations and communications are higher for a couple of reasons: The acquisition of Kaoclay, as well as other corporate developments, necessitated greater investor relations activity during the year. The Company also attended more investor and commodity shows in 2006.
- Office costs are higher for a number of reasons. The Company assumed the lease for Kaoclay's head office. The lease was bought out and office transferred to the Company's corporate head office in November. The costs to operate the Company's Mongolian regional office increased in 2006. The remainder of the variance is due to higher office costs in the Company's corporate head office. Office costs are expected to decrease in 2007, as many of the Kaoclay costs have been eliminated.
- The increase in professional fees is due to the increase in corporate activity in 2006 including the acquisition of Kaoclay, warrant and option issue/exercise, flow–through financing, tax guidance and compliance work.
- Regulatory compliance increased mainly because of increased transfer agent costs associated with the exchange of Kaoclay shares and the listing of warrants issued in connection with the Kaoclay acquisition.
- Administrative services increased mainly due to changes in remuneration for certain employees and contractors in 2006. There was also some additional contract work supplied in 2006 which was not incurred in 2005.
- Stock based compensation increased for a number of reasons. The Company's board of directors increased by three new members during the year. Xstrata appointed one new member and two former Kaoclay directors joined the board of the Company. The new board was issued 750,000 options during the year. Another 525,000 options were issued to certain employees and contractors during the year. This compares to 275,000 options issued in 2005.
- Administrative travel costs increased significantly in 2006 for a number of reasons. With all the activity associated with the Company's various joint ventures agreements, there were greater travel and accommodation costs. As mentioned above the Company attended more conferences in 2006 compared to 2005. There was more general travel associated with investor relations and corporate matters. Approximately a third of the variance is directly related to Kaoclay travel costs.
- Other income amounted to $413,591 in 2006 compared with $281,404 in 2005. The increase from 2005 was a result of higher interest income in 2006 and an increase in gain of the sale of resource properties. This was partially offset by a foreign exchange loss of $19,946 during the year compared to a gain of $88,566 in 2005.

1.05 SUMMARY OF QUARTERLY RESULTS

Expressed in thousands of Canadian dollars except per share amounts

	Fiscal 2006				Fiscal 2005			
	Q4 Dec-06 $	Q3 Sep-06 $	Q2 Jun-06 $	Q1 Mar-06 $	Q4 Dec-05 $	Q3 Sep-05 $	Q2 Jun-05 $	Q1 Mar-05 $
Revenue	**(205)**	**301**	**110**	**44**	28	54	53	35
Loss	**1,199**	**1,504**	**1,185**	**677**	1,209	1,573	1,692	507
Basic and diluted loss per share	**0.03**	**0.03**	**0.03**	**0.02**	0.05	0.06	0.06	0.02
Total Assets	**34,177**	**39,170**	**34,944**	**10,345**	6,649	7,924	9,375	9,806

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

1.06 LIQUIDITY AND CAPITAL RESOURCES

The Company had working capital at December 31, 2006 of $3,265,414 representing a decrease of $979,328 from the December 31, 2005 working capital position of $4,244,742. This working capital does not include the $4,598,523 in flow through cash the Company had at year end. The flow-through funds are restricted to qualifying Canadian Exploration Expenditures ("CEE") and are therefore excluded from working capital. The decrease in working capital is primarily due to expenditures related to the Company's 2006 exploration program and general and administrative costs in support of this program offset by just under $4 million of non flow-through equity proceeds during the year.

The year end working capital of $3.3 million will enable the Company to fund its 2006 exploration program and meet its property and contractual commitments for the next 18 months. The timing for additional financing will be determined largely by market conditions and the results of the Company's ongoing exploration program.

During the year ended December 31, 2006, $15,213,201 was expended on additions to resource property interests offset by a write-down of resource properties of $460,178, compared with additions of $1,380,140 and write-downs of $26,729 during 2005. Of the $15,213,201 expended in 2006, $11,999,500 was acquired via the plan of arrangement and the issue of shares and warrants on acquisition of Kaoclay. The Company advanced $1,412,102 of resource property additions to the Donkin project manager Xstrata Coal Donkin Management Limited to fund qualifying CEE. The remaining $1,801,599 includes $1,333,307 in non cash additions including $535,000 in non cash payments made as part of the Gallant Agreement (500,000 common shares issued on March 1, 2006 (see section 1.02)).

During the year ended December 31, 2006, the Company expended $2,212,308 on capital assets. $1,438,070 was acquired via plan of arrangement. Of the remaining $774,238 in capital asset additions, $746,636 was for land in Georgia, USA, $15,267 was for the purchase of a vehicle to support the exploration work in Mongolia, and the remaining $12,335 was for office and field equipment. The 2005 expenditures of $38,599 were primarily for software and computer equipment.

As mentioned in note 17d) to the December 31, 2006 financial statements, on March 23, 2007 the Company signed an engagement letter with National Bank Financial who will purchase, on a private placement bought deal basis subject to certain conditions, 10,000,000 shares of the Company at $1.00 per share resulting in gross proceeds to Erdene of $10,000,000 ("Offering"). The agreement and Offering are subject to receipt of all necessary approvals, including regulatory and stock exchange approvals. The closing is expected to occur on or about April 12, 2007.

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

1.07 CONTRACTUAL OBLIGATIONS

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

- The Company has entered into an operating lease for office space until August 31, 2011 representing total payments of $263,920 to the end of the lease. The Company has the right to terminate the lease by giving notice prior to the anniversary date, after 2007.
- The Company, through its subsidiary Sparta Kaolin Corporation, has entered into lease agreements and exploration agreements with options to lease kaolin properties in the United States. The aggregate commitment associated with the cancelable agreements over the next twelve months is US $46,000.
- Pursuant to the Gallant Agreement (see section 1.02), the Company is committed to the following deliverables:
- On or before February 28, 2007, the Company shall deliver to Gallant 700,000 shares of Erdene and a payment of US$ 150,000. This obligation was met on February 28, 2007.
- As mentioned in section 1.02, on October 26, 2006 the Company entered into an agreement with the Donkin project minority partners to increase its ownership from 20% to 25%. To exercise its right, the Company paid US$9,200 and agreed to issue 360,000 shares of the Company. Closing is expected to take place on or before April 16, 2007.
- Pursuant to the Alliance Agreement (see section 1.02) the Company is committed to fund up to $10,000,000 of the expenditures incurred during the Exploration Program of the Donkin Coal Project provided such expenses qualify as CEE.

1.08 OFF-BALANCE SHEET ARRANGEMENTS

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

1.09 FOURTH QUARTER

In the fourth quarter the Company finalized the purchase price equation and accounting related to the purchase of Kaoclay. The resulting adjustments to operations are not considered material to prior quarters and were recorded in the fourth quarter.

During the fourth quarter, the most significant addition to resource properties relates to $1,401,477 in flow through funds advanced to Xstrata Coal Donkin Management Limited, the manager of the Donkin Coal Project, leaving a balance of flow through funds at December 31, 2006 of $4,598,523.

During the fourth quarter, the Company made the final payment of $251,566 to acquire approximately 39 acres of land in McDuffie County, GA, USA. This represents the majority of additions to capital assets during the quarter.

Other than those mentioned above, there were no unusual events or items during the fourth quarter of 2006 that affected the Company's financial condition, cash flows or results of operations in a material nature.

1.10 CRITICAL ACCOUNTING ESTIMATES

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

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

Stock-based compensation was calculated using the Black-Scholes model, a recognized option/warrant valuation formula, which is highly dependent on the expected volatility of the market price of the Company's common shares. The Company used an expected volatility rate of 80% in 2006 (80% in 2005). This is an estimate only based on using past share trading data to predict future volatility and actual volatility may be different from the estimate used in the valuation formula. Although the actual cost of stock-based compensation can vary materially from the estimated cost recorded in the Company's financial statements, it represents a non-cash expense and, as such, has no impact on the Company's financial position or liquidity. The $2,780,006 the Company determined in 2006 as stock-based compensation was charged as follows: $766,320 to general and administrative expenses, $127,593 to Geological Services, $141,362 to issue costs, and $1,744,731 in purchase consideration associated with the Kaoclay acquisition.

Future income tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and on unclaimed losses carried forward and are measured using the substantively enacted tax rates expected to apply to taxable income in the years in which those differences are expected to reverse or when unclaimed losses are expected to be utilized. A valuation allowance is provided when it is more likely than not a future tax asset will not be recognized.

1.11 CHANGES IN ACCOUNTING POLICIES

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

As of January 1, 2007, the Company will be required to adopt the following sections of the CICA Handbook: Section 1530 – Comprehensive Income and Section 3251 - Equity. A statement of comprehensive income would be included in a full set of financial statements for both interim and annual periods under this new standard. Comprehensive income is defined as the change in equity of an enterprise during a period from transactions and other events and circumstances from non-owner sources. The new statements would present net income and each component to be recognized in other comprehensive income. Section 3251 of the CICA Handbook requires the separate presentation of the components of equity (retained earnings, accumulated other comprehensive income, the total of retained earnings and accumulated other comprehensive income, contributed surplus, share capital and reserves) and the changes in equity arising from each of these components.

1.12 FINANCIAL INSTRUMENTS AND OTHER RISKS

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

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

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

1.13 OUTSTANDING SHARE DATA

See Note 8 to the December 31, 2006 audited consolidated financial statements for detail as to the change in the issued and outstanding common shares, warrants and options of the Company during the years ended and as at December 31, 2006 and 2005.

Issued and Outstanding Share Capital

During the year ended December 31, 2006 the Company issued a total of 25,781,492 shares as follows:

- On February 16, 2006, pursuant to the Xstrata Agreement described in section 1.02 of this MD&A, the Company issued 3,000,000 shares at $1.00/share.
- On February 24, 2006 the company issued 500,000 shares to Gallant Minerals Limited as part of the agreement signed on March 1, 2005 (see section 1.02).
- Throughout the year, the Company issued 1,464,575 shares on the exercise of warrants and options, described below.
- On June 12, 2006 the Company concluded by way of Plan of Arrangement, the acquisition of Kaoclay as described in section 1.02. Consideration for the transaction included exchanging each Kaoclay share for 1.65 shares of the Company, which resulted in the issuance of 14,816,917 shares of the Company.
- On July 14, 2006 the Company issued 6,000,000 flow-through shares at $1.00/share to funds its obligation under the Donkin Alliance as described in section 1.02.

This brings the total shares outstanding at December 31, 2006 to 53,051,127.

Warrants

During the year ended December 31, 2006, the Company issued 4,885,725 warrants (4,489,975 as consideration for the Kaoclay acquisition and 395,750 in agent warrants associated with the $6,000,000 flow through financing). During the year 1,008,575 warrants were exercised at an average price of just over $0.77 per share for gross proceeds of $780,789, and 700 warrants expired. This brings the outstanding warrants at December 31, 2006 to 6,465,725.

Stock Options

During the year ended December 31, 2006, 1,470,000 options were granted to certain directors, employees and contractors; 456,000 options were exercised to purchase 456,000 common shares of the Company at an average price of just under $0.48 per share for proceeds of $218,800; and 85,000 options expired, bringing the outstanding options at December 31, 2006 to 3,259,000.

1.14 EXPLORATION RESULTS

During the year the Company carried out an extensive exploration program on a number of its Mongolian mineral projects. Drill programs were completed on the Erdenet Ikh Tal copper project, the Tsenkher Gol gold project, the Galshar coal project and the Southeast uranium project. At Erdenet drilling results indicate the extension of both near surface oxide and deeper sulfide copper mineralization onto the Company's adjoining property to the southeast as well as the northwest of Erdenet mine. At Tsenkher Gol the drilling program confirmed that gold mineralization extends to depth in multiple low-grade gold mineralized zones over broad thicknesses that locally envelop higher grade zones. At Galshar drilling results show that the coal bearing lithologies extend at least 3.6 kilometres. The Uranium exploration program was carried out by joint venture partners IUC and drilling returned anomalous results on the Galshar licenses. Geotechnical surveys were carried out on the Biger copper-gold-PGE and the Bayan Kharaat copper-gold porphyry projects and resulting in the identification of drill targets slated for testing in 2007. The Zuun Mod project underwent an internal review and in February 2007 the Company announced Minarco Asia Pacific Pty Limited had been appointed to evaluate strategic options and advise on project planning and design. In North America, the initial phases of a prefeasibility study were initiated by project manager Xstrata Coal Donkin Management Limited on the Donkin Coal Project, pre-development and permitting activities were being completed by Rinker for the Maddox Aggregate Project in Georgia, USA while Huber Engineered Materials continued mining operations on the Company's Lucky property and pursued permitting of new areas owned by the Company in McDuffie County Georgia. The following is an overview of the programs carried out on the Company's properties in 2006.

Mongolia

ERDENET IKH-TAL PORPHYRY COPPER PROJECT

The Erdenet Project is located in Orkhon and Bulgan aimags in northern Mongolia, approximately 250km northwest of Ulaanbaatar, the capital of Mongolia. The properties are connected to Ulaanbaatar by paved road and a rail line which is a spur of the Trans Mongolian railroad which runs through Mongolia between Russia and China. The Erdenet Ikh-Tal properties consist of three contiguous exploration licenses (Ikh Tal 1 to 3) covering 8,540 hectares which surround the Erdenet Mining Corporation ("EMC") open pit copper-molybdenum mining operation. The licenses are registered in the name of Anian Resources XXK and are subject to the agreement with Gallant Minerals Limited (refer to section 1.02).

The project goal is to identify extensions of porphyry-style copper/molybdenum mineralization on the Company's exploration licenses that surround the Erdenet open pit copper/molybdenum mining operation. Erdenet is the second largest porphyry copper deposit in Central Asia and one of the largest in the world, with published mining reserves in 2002 of 766.7 million tonnes grading 0.61% copper and 0.015% molybdenum.

During the year the Company's exploration team carried out an extensive exploration-drilling program to test a number of targets identified by geophysical surveys (IP and magnetics) in association with geological and alteration mapping on the Company property adjacent to the EMC open pit. Nine diamond drill holes (ITDD 4 to ITDD 12) were completed for a total of 1,773.8 metres. Drill hole, ITDD 4 in the South-Central Baglai area, located 200 metres from the EMC property boundary intersected a mineralized zone starting at 36 metres that returned 0.2% copper over 32 metres, including an 8 metre section of 0.3% copper and up to 0.65% copper over 2 metres. Occasionally samples exceeding 0.2% copper over 2 metres were returned deeper in the hole. A second hole ITDD-08, located 200 metres southeast of ITDD-04, intersected 32 metres of 0.27% copper including 0.33% copper over 12 metres, starting at 34 metres from surface. In addition, sulfide zones were intersected deeper in the hole including 8 metres of 0.3% copper at 125 metres and 25 metres of 0.23% copper from 215 metres to the bottom of the hole. A broad high chargeability anomaly has been traced for 400 metres southeast of ITDD-08 along with surface porphyry style alteration. In the Northwest Extension area, hole ITDD-09, located 1200 metres northwest of EMC's open pit, returned a 35 metre interval with copper oxide mineralization that averaged 0.21% copper from 24 to 59 metres. This includes a five metre section of 0.71% copper at 54 metres. Hole ITDD-10, located 550 metres to the northeast of hole ITDD-09, intersected five metres of 0.25% copper at 40 metres from the surface. These results indicate the extension of both near surface oxide and deeper sulfide porphyry copper mineralization onto the Company's adjoining property to the southeast as well as the northwest of EMC's mine

Tsagaan Chuluut Area

Additional geological mapping and sampling in the Tsagaan Chuluut area in the north central part of the Ikh Tal 1 license, 4 kilometres northwest of the Erdenet open pit has outlined an area of silicification and alunite alteration coincident with a large magnetic low, high chargeability and low resistivity.

TSENKHER GOL GOLD PROJECT

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

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

Four target areas, 1 to 4 kilometres apart, all returned anomalous gold intersections (0.2 g/t gold and higher) commonly over significant thicknesses (up to 68 metres) including 10 metres of 1.2g/t gold and 2 metres of 6.6g/t gold at Altan Suult. This Phase I drilling program confirmed that gold mineralization is hosted in all granitic, volcanic and metasedimentary rock types and extends to depth in multiple gold mineralized zones over broad thicknesses. These broad zones of low grade gold mineralization typically envelop higher grade zones.

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

A Phase II drilling program, consisting of six holes totaling 1,215 metres, was carried out in late 2006. All holes were drilled across the Altan Suult zone mineralized zone and have confirmed widespread gold mineralization across the Altan Suult zone at Tsenkher Gol. The Phase II holes were step-out holes ranging from 120 to 280 metres from the previous Phase I drilling and tested coincident surface gold geochemical and dipole-dipole geophysical anomalies. Broad zones of anomalous gold values including 62 metres (52 to 114m) of 0.10g/t gold in drill hole TGD-10 and narrow higher grade zones, including 2 metres (223 to 225m) of 1.6g/t gold in drill hole TGD-9, were intersected. The extensive northwest trending Khond Uul gold zone was not tested in Phase II drill program.

ENERGY PROJECT – COAL

The Company is involved in a comprehensive coal target generation program in cooperation with Xstrata evaluating numerous prospective metallurgical and high quality thermal coal deposits. The Company's technical staff has compiled an extensive database on coal deposits, occurrences and prospective sedimentary basins allowing for a prioritization of targets. Data on approximately 350 coal deposits and occurrences have been entered into the database. All the Company's coal exploration in Mongolia is being fully funded by Xstrata (refer to section 1.02 for further information about the Xstrata agreement) and is being carried out in consultation with Xstrata personnel.

Compilation of geological information and field evaluations of coal opportunities in Mongolia continued during the quarter with the objective of identifying deposits with the greatest potential as targets for possible joint venture or acquisition.

Exploration was carried out on the Galshar Coal property, held 100% by the Company. The property is located 300km southeast of Ulaanbaatar on the border of Dornogovi and Khentii provinces. Galshar lies 63km from the nearest rail link and 250km from the Mongolia-China border. Three exploration licenses totalling 97,082 hectares are considered to be part of the Galshar coal property. The licenses are 100% owned by the Company and are registered in the name of the Erdene Mongol XXK.

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

In 2006, the Company carried out a widely spaced nine-hole drill program totaling 895 metres north and southeast of hole CDD-1 to test the extent of the Galshar coal seams. Results of this program show that the coal lithologies extend at least 3.6 kilometres northeast of hole CDD-01 where holes GHR-03 and GHR-11 intersected multiple seams, including a 4 to 17.5 m thick seam averaging >7000BTU/lb coal. Drilling results from 2006 and historic exploration reports suggest additional seams may also occur east and south of the area currently being explored.

ENERGY PROJECT - URANIUM

The company holds 25 exploration licenses in south eastern Mongolia totaling 818,205 hectares. All of the licenses are registered in the name of Erdene Mongol or Erdene Energy, both of which are wholly owned by the Company. Nine of these licenses were acquired from Gallant Minerals Ltd and are subject to a 1% NSR Royalty, which can be reduced to 0.5% in certain circumstances by making certain payments (refer to section 1.02).

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

IUC's focus is on sandstone-hosted deposits that can be mined using the "In Situ Leach" ("ISL") method. Successful ISL pilot plant testing was completed previously by IUC.

The 2006 exploration program was managed by IUC which initiated an extensive drill program in June to evaluate the uranium potential on a number of Company controlled licenses including Galshar, Yant and Tsagaan Del.

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

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

A total of 49 rotary holes were drilled on the Tsagaan Del License to depths of 30 to 100 metres totaling 3431.6 metres to test 6 target areas (profiles) outlined by ground radiometric surveys in 2005 in the northern part of the Undershill basin. All holes intersected arkosic and pink colored sandy – clayey sediments of Upper Cretaceous age with no uranium anomalies of interest.

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

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

ZUUN MOD PORPHYRY MOLYBDENUM PROJECT

The Zuun Mod property is a porphyry molybdenum prospect located in Bayankhongor Province approximately 950 kilometres southwest of Ulaanbaatar and 180 kilometres north of the Mongolia-China border. The property consists of a single license totaling 49,538 hectares. The licenses are registered in the name of Anian Resources XXK and subject to the agreement with Gallant Minerals Limited (refer to section 1.02).

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

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

These drill results further strengthened management's view that Zuun Mod potentially hosts a molybdenum resource. The increasing grades near surface in the southern portion of the Racetrack zone, significant thickness of mineralized zones and the large untested areas remaining, attest to the potential of the Zuun Mod project.

During 2006, the Zuun Mod project underwent an internal review and in February 2007 the Company announced Minarco Asia Pacific Pty Limited ("Minarco") had been appointed to evaluate strategic options and advise on project planning and design. Minarco is a leading mining and energy consulting company providing expert advice and technical services to clients in the Asia Pacific region.

BIGER COPPER-GOLD-PGE PROJECT

The Biger project is located approximately 780km southwest of Ulaanbaatar and 100km southeast of the provincial centre of Altai in Govi-Altai Province. The property consists of a single license totaling 12,522 hectares. The licenses are registered in the name of Anian Resources XXK and subject to the agreement with Gallant Minerals Limited (refer to section 1.02).

Biger is an early stage exploration project located in a highly prospective area for copper and gold in southwestern Mongolia. Initial property examination and rock sampling identified copper values up to 2.8%, accompanied by elevated palladium (1.37 g/t), gold (0.5 g/t), and platinum (0.29 g/t). The strongest mineralized zones are coincident with composite ground magnetic high and low circular and annular anomalies, up to 1500 metres in diameter. Three scout diamond holes drilled in 2005 to test coincident geochemical and geophysical anomalies, intersected several copper mineralized intercepts hosted within potassic altered diorite and gabbrodiorite in the eastern part of the property and in an outlier of altered granosyenite and diorite in the center of the large Biger pediment called Altan Khad. The one hole in the mineralized Altan Khad outlier intersected a 24 metre section that assayed 0.5% copper with elevated gold (86 ppb) and palladium (89 ppb) values. An area of younger rocks and recent sediments with a radius of at least 6 kilometres from this drill intersection remains untested.

In October 2006, a 115 line-kilometre gradient induced polarization survey was completed over the main 5 by 9 kilometre Biger area including the central Altan Khad mineralized outlier in the buried pediment area and an adjacent mineralized gabbro/diorite located 7 kilometres to the east. This was followed by 5 by 2 kilometre long north-south oriented dipole–dipole lines designed to identify buried base metal and precious metal mineralization. Results of the geophysical survey include several anomalous targets. In addition, a two line mobile metal ion (MMI) geochemical orientation survey was also completed over the central Altan Khad mineralized outlier and the mineralized zone intersected in the 2005 drill hole in an attempt to identify buried mineralized bodies. Analyses of the MMI results indicate that subtle gold and copper anomalies occur over zones of high magnetics.

BAYAN KHARAAT COPPER PORPHYRY PROJECT

The Bayan Kharaat project is located in Selenge Province in northern Mongolia approximately 200 km north-northwest of Ulaanbaatar and is adjacent to the paved highway leading from Ulaanbaatar to the Russian border. The property consists of a single license totaling 3,523 hectares. The licenses are registered in the name of Anian Resources XXK and subject to the agreement with Gallant Minerals Limited (refer to section 1.02).

The Bayan Kharaat property was obtained by GMML in 2001 after a reconnaissance follow up of copper porphyry districts in Mongolia. Strong pyrite and sericite altered granite porphyry intrusive occurs on a SW-NE elongated low ridge in the middle of the property. On the west side of the area, local weak prophyllitic alteration of the intrusive rocks was observed. In addition, strong copper oxide, minor copper sulfide and iron sulfide mineralization was found at one location in the felsic porphyry intrusive. Two other copper oxide bearing fractures in fine grained diorite were also discovered.

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

In June 2006, a systematic soil survey was carried out on a 200 metre grid over the south western and south central portions of the property. A total of 473 soil samples on 50 metre centers and 24 scattered rock samples were collected and analyzed for copper and gold. Two target areas of co-incident silicification, sericite/pyrite alteration and elevated copper in soil, with associated resistivity and chargeability highs have been outlined on the NE-SW trending structure in granite porphyry in the southwest central area and in felsic volcanics in the west central area. Grab samples in the southwest central area have returned values up to 0.2% copper.

North American Projects

The Company's North American project portfolio includes two notable industrial mineral projects as well as a 25% interest in the Donkin coal project (see section 1.02). The industrial mineral opportunities include the Sparta Kaolin project in Georgia, U.S., which is operated by J.M. Huber Corporation, and the Maddox Granite Aggregate project, a royalty project in the southeast USA managed by Rinker.

DONKIN COAL PROJECT

A 200 million tonne portion of the Donkin coal resource, considered to have very good thermal and metallurgical qualities, is targeted in the initial development planned. The project is well located to serve domestic and Eastern U.S. markets. Approximately $100 million was spent on previous work that included the construction of two 3.5 kilometre access tunnels.

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

Since the project commencement in June 2006, considerable work was carried out on the site in preparation for the dewatering and tunnel access program. The old tunnel entrances have been reopened, refurbished and secured. Excavation work has been carried out on the property to provide a settling pond for the water that will be pumped from the tunnels. Water samples have been taken to test the quality of the tunnel water with no significant concerns identified. Pumps and piping equipment was put in place in readiness for the dewatering process. A 'code of conduct' was submitted to provincial and federal regulatory departments for approval before the dewatering process could commence. Final approval was received and the dewatering process commenced on November 13, 2006.

As of early March 2007, there were 14 full-time equivalent employees and local contractors on site involved in the tunnel dewatering process which is at the 1,800 metre mark or approximately half of the 3.5 kilometre length of two parallel tunnels. Since the pumping started 150 million litres has been safely discharged into the adjoining settling ponds. Additional pumping capacity has been added to accelerate the dewatering process. Clearing and refurbishment of the tunnels is well underway with debris from the main access tunnel being removed as dewatering progresses. The second access tunnel is relatively free of debris. Access to the targeted Harbour Seam coal face is anticipated during the second quarter of 2007 which will be followed by an extensive in-seam exploratory drilling and bulk sampling program. To date, the activities are on schedule and on budget for the project and conditions in the tunnels are good, as expected.

SPARTA KAOLIN PROJECT

The Company controls through land purchases and leases a large primary kaolin resource in Georgia, USA. Due to an aggressive exploration and acquisition program by Kaoclay (acquired in 2006 by the Company) in the late 1990s, the Company now controls a large high brightness primary clay resource through its subsidiary, Sparta Kaolin Corporation. The Company's in-ground, "premium" quality, primary kaolin resource in Georgia amounts to 27.4 million tons. For the project's development stage, Kaoclay partnered with industry leader Huber Engineered Materials (Huber), a subsidiary of J.M. Huber Corporation, a diversified multi-national company and one of the world's largest kaolin producers.

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

During the year, Huber mined 209,904 tons from two open pits on the Company's Lucky Area holdings in Hancock County, Georgia bringing the total tons of kaolin mined since start-up in 2004 to 469,210 tons. In addition, during the year Huber has cleared approximately 120 additional acres at Lucky Main and is carrying out in-fill drilling at 100 ft centers, prior to the start of mining in this area. The permitting preparation process for several properties located in McDuffie County was started during the year and was ongoing at year end however strong concerns have been expressed by residents within close proximity of the proposed pit development area.

The Company continues to work with Huber on the permitting of new areas and other third parties to identify products and markets to increase utilization of the raw material and therefore increase revenues and volumes mined and produced.

MADDOX AGGREGATE PROJECT

As a result of the acquisition of Kaoclay, the Company now owns the Maddox granite aggregate project in Georgia, USA. Rinker has been granted an exclusive right by the Company to mine, process, and sell aggregate from the Maddox property subject to an industry competitive royalty. The Maddox project is being developed as a granite quarry, primarily to serve the southeastern USA markets by rail. Rinker has submitted permitting applications to Hancock County and to the State of Georgia. The county special use permit was approved in November 2006. The Georgia State permitting process is ongoing. Rinker has planned for the construction of a rail spur under Georgia State Highway 16, construction of the crushing plant, all equipment and all site preparation for a modular design with capacity of up to 4 million tons per annum with a first phase production capacity of 1 million tons per annum. In late 2006 Rinker purchased an adjoining property to secure rail access onto the Maddox property. Rinker has advised the Company that it expects the pre-production development period to be nine to twelve months from the date development commences. The project has an estimated lifespan of at least 20 years.

1.15 DISCLOSURE CONTROLS AND PROCEDURES

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

1.16 OUTLOOK

The Company continues to be optimistic about the potential demonstrated by its principal and early stage resource properties. Success from the efforts of the Company's 2007 exploration program on any of its properties will result in an expanded program on the relevant property or properties relative to the significance of the results. Conversely, if anticipated results are not forthcoming on a particular property, a disciplined review and evaluation program will be in place to ensure expenditures are scaled back where management feels they may not be warranted.

1.17 QUALIFIED PERSONS

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

1.18 OTHER INFORMATION

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

MANAGEMENT & AUDITORS' REPORTS

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Where appropriate, these financial statements reflect management's best estimates and judgments based on currently available information.

Internal systems of financial and operating controls, which include effective controls to provide reasonable assurance that relevant and reliable financial information is produced, are the responsibility of management. Management believes it maintains an appropriate system of internal controls to provide reasonable assurance that transactions are authorized, assets safeguarded and proper records are maintained.

The board of directors is responsible for ensuring that management fulfills its financial reporting and internal control responsibilities, which it does primarily through the audit committee. The audit committee meets periodically with management and the Company's external auditors to discuss internal controls over the financial reporting process, the consolidated financial statements, management's discussion and analysis, the results of the annual audit and the auditors' report to shareholders. The audit committee reports its findings to the board of directors before submitting the audited consolidated financial statements to the Board for approval.

The Company's external auditors, KPMG LLP, are appointed by the shareholders to conduct an independent audit in accordance with Canadian generally accepted auditing standards. The external auditors have established their independence from, and have full and free access to, management and the audit committee.

Peter Akerley

President & Chief Executive Officer
March 15, 2007

Vice President North America & Chief Financial Officer

AUDITORS' REPORT

We have audited the consolidated balance sheets of Erdene Gold Inc. as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Halifax, Canada
March 15, 2007, except as to note 17 (d) which is as of March 23, 2007

CONSOLIDATED BALANCE SHEETS

Expressed in Canadian dollars

December 31	2006 $	2005 $
ASSETS		
Current Assets		
Cash and cash equivalents	3,047,970	4,269,991
Marketable securities (market value, 2006 - $522,667; 2005 - $123,000)	164,333	50,666
Accounts receivable (note 4)	363,147	189,599
Prepaid expenses	43,719	12,862
	3,619,169	4,523,118
Cash - flow-through funds (note 3)	4,598,523	–
Resource property interests (note 5)	16,754,731	2,001,708
Capital assets, net (note 6)	2,281,140	123,780
Intangible assets, net (notes 2 and 7)	1,123,433	–
Goodwill (note 2)	5,800,079	–
	$ 34,177,075	$ 6,648,606
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	353,755	278,376
Future income taxes (notes 2 and 11)	2,899,290	–
Shareholders' Equity		
Share capital (note 8)	44,611,619	17,372,074
Contributed surplus (note 9)	3,753,241	1,201,779
Deficit	(17,440,830)	(12,203,623)
	30,924,030	6,370,230
Commitments (note 16)		
Subsequent events (note 17)		
	$ 34,177,075	$ 6,648,606

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board

David S.B. Carnell, Director

Ken W. MacDonald, Director

CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT

Years ended December 31	2006 $	2005 $
Revenue		
Lab services	165,916	–
Royalties	84,260	–
	250,176	–
Expenses		
Exploration and operating expenses		
Diamond drilling	785,544	1,706,731
Analytical and assaying	160,196	277,568
Geological services	991,699	830,610
Geo-technical surveys	90,864	322,630
Logistical and field support	413,351	934,639
Professional services	45,589	93,009
Travel	142,008	148,876
Lab and property maintenance	231,967	–
Write down of resource properties	460,178	26,729
Amortization of intangible assets	93,567	–
Other	2,717	17,927
Exploration partner contributions	(562,729)	(490,031)
	2,854,951	3,868,688
General and administrative expenses		
Depreciation	41,509	30,658
Insurance	68,606	40,003
Investor relations and communications	246,226	184,708
Office	125,780	83,928
Professional services	216,366	178,755
Regulatory compliance	204,418	139,096
Administrative services	472,140	384,688
Stock-based compensation	766,320	208,470
Travel and accommodations	196,008	112,794
Other	36,471	30,930
	2,373,844	1,394,030
Other income (expenses)		
Interest revenue	303,462	155,855
Gain on sale of resource property	113,667	22,499
Foreign exchange	(19,946)	88,566
Other	16,408	14,484
	413,591	281,404
Loss for the year	4,565,028	4,981,314
Deficit, beginning of year	12,203,623	7,162,309
Share issue costs	672,179	60,000
Deficit, end of year	$ 17,440,830	$ 12,203,623
Basic and diluted loss per share (note 10)	$ 0.11	$ 0.19
Weighted average number of common shares outstanding	42,374,640	26,914,503

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31	2006 $	2005 $
Cash provided by (used in)		
Operations		
Loss for the year	(4,565,028)	(4,981,314)
Items not involving cash		
Depreciation	54,948	35,794
Amortization of intangible assets	93,567	–
Stock-based compensation	893,913	297,601
Write down of resource properties	460,178	26,729
Gain on sale of resource property	(113,667)	(22,499)
Change in non-cash operating working capital	(357,846)	(43,816)
	(3,533,935)	(4,687,505)
Financing		
Issue of common shares for cash	9,000,000	1,000,000
Share issue costs	(530,817)	(60,000)
Issue of common shares on exercise of options and warrants	999,588	60,116
	9,468,771	1,000,116
Investing		
Resource property interests	(1,766,725)	(583,310)
Purchase of capital assets	(774,238)	(38,599)
Cash acquired on acquisition (net of cash acquired $107,629)	(17,371)	–
	(2,558,334)	(621,909)
Increase (decrease) in cash and equivalents	3,376,502	(4,309,298)
Cash, beginning of year	4,269,991	8,579,289
Cash, end of year	$ 7,646,493	$ 4,269,991
Cash is defined as		
Cash and cash equivalents	3,047,970	4,269,991
Cash – flow-through funds	4,598,523	–
	$ 7,646,493	$ 4,269,991

Supplemental cash flow information (note 12)

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2006 and 2005

NATURE OF BUSINESS

Erdene Gold Inc. (the "Company") was incorporated by Articles of Incorporation dated June 27, 2000, pursuant to the provisions of the Canada Business Corporations Act. The principal business of the Company is the exploration and development of mineral deposits. The Company is principally focused on the discovery of large tonnage, low cost, gold, copper, molybdenum, uranium and coal deposits primarily in Mongolia; and the development of its coal and industrial mineral interests in North America with near-term cash flow potential. To date the Company has not yet earned any significant operating revenues and is considered to be in the development stage.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Principles of consolidation

These consolidated financial statements are presented in Canadian dollars and include the accounts of the Company and its wholly-owned subsidiaries Erdene Gold International Inc., Erdene International Exploration Inc. (Barbados), Erdene Mongol XXK and Erdene Energy XXK (Mongolia), Erdene Resources Inc. (formerly Kaoclay Resources Inc ("Kaoclay")) and 6531954 Canada Limited (Canada), and Sparta Kaolin Corporation (Delaware). Inter-company accounts and transactions have been eliminated.

b) Use of estimates

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

c) Cash and cash equivalents

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

d) Marketable securities

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

e) Resource property interests

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

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

Contributions from exploration partners to fund explorations expenses are recorded on the accrual basis as a reduction of exploration and operating expenses.

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

f) Capital assets

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

Asset	Basis	Rate
Building	Declining balance	10%
Equipment, furniture and fixtures	Declining balance	20%
Software and computers	Declining balance	33%
Vehicles	Declining balance	30%

g) Foreign currency translation

Integrated subsidiaries are financially or operationally dependent on the parent company. The accounts of Erdene Gold International Inc., Erdene International Exploration Inc., Erdene Mongol XXK, Erdene Energy XXK, Erdene Resources Inc. (formerly Kaoclay Resources Inc.), 6531954 Canada Limited, and Sparta Kaolin Corporation which are considered to be integrated operations use the temporal method to translate their financial statements. Under this method monetary items are translated at exchange rates in effect at the balance sheet date, non-monetary assets and liabilities are translated at historical exchange rates, and revenues and expenses are translated at average exchange rates for the period.

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

h) Income taxes

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

i) Stock-based compensation

The Company has a stock-based compensation plan, which is described in note 8. The Company accounts for all stock-based payments to non-employees and employee awards that are direct awards of stock using the fair value based method. Consideration paid by employees on the exercise of stock options is recorded as share capital.

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

j) Flow-through shares

The Company has financed a portion of its exploration activities through the issue of flow-through shares. As permitted under the Income Tax Act (Canada), the tax attributes of eligible expenditures incurred with the proceeds of flow-through share issuances are renounced to subscribers. On the date that the Company files the renouncement documents with the tax authorities, a future income tax liability is recognized and shareholders' equity is reduced, for the tax effect of expenditures renounced to subscribers.

k) Intangible assets

Intangible assets represent the value of certain customer relationships and contracts, as well as the brand value of an acquired subsidiary, and are amortized on a straight-line basis over their estimated useful lives of 15 years.

l) Goodwill

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on their fair values. Goodwill is allocated, as of the date of the business combination, to the Company's reporting units that are expected to benefit from the synergies of the business combination.

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

2. ACQUISITION

On June 12, 2006 the Company concluded by way of Plan of Arrangement pursuant to the Canada Business Corporations Act, the acquisition of Kaoclay Resources Inc. (incorporated under the laws of Canada) now Erdene Resources Inc., and its wholly owned subsidiaries, Sparta Kaolin Corporation ("Sparta", incorporated under the laws of Delaware) and 6531954 Canada Limited (incorporated under the laws of Canada). Based in Halifax, Nova Scotia, Kaoclay, through its subsidiaries, controlled three advanced-stage projects including an interest in coal assets in Nova Scotia and kaolin clay and aggregate assets in Georgia and South Carolina, USA. Each project has an experienced partner that is responsible for all operations. Under the Plan of Arrangement the Company issued 1.65 common shares and a half warrant for each Kaoclay share (14,816,917 shares and 4,489,975 warrants of the Company for the 8,979,950 Kaoclay shares outstanding). Each warrant entitles the holder to purchase one common share of the Company for $1.60 per share until June 15, 2009. The purchase price has been determined to be $18,346,143, including acquisition costs of $125,000.

The purchase has been accounted for using the purchase method, whereby the purchase consideration was allocated to the fair values of the assets acquired and liabilities assumed at the effective date of the purchase.

Net assets acquired	$
Cash and cash equivalents	107,629
Non-cash working capital, net	(115,152)
Resource property interests	11,999,500
Capital assets	1,438,070
Intangible assets	1,217,000
Goodwill	5,800,079
Future income taxes	(2,100,983)
	18,346,143

Purchase Price	$
Common shares issued	16,476,412
Warrants issued	1,744,731
Acquisition costs	125,000
	18,346,143

3. CASH – FLOW-THROUGH FUNDS

On July 14, 2006 The Company completed a $6,000,000 flow-through financing to fund its commitment under the Donkin Coal Alliance (see note 5) regarding the exploration and evaluation of the Donkin Coal Resource Block located in Cape Breton, Nova Scotia. The use of these funds is restricted to qualifying Canadian Exploration Expenditures ("CEE") under the Income Tax Act (Canada) and is therefore shown separately. To December 31, 2006 $1,401,477 was advanced to the project manager Xstrata Coal Donkin Management Limited, of which $1,339,211 has been expended on CEE, leaving a balance of $4,598,523 at December 31, 2006 and a balance to be spent of $4,660,789. It is the Company's intention to advance these funds to the project manager who anticipates expending these funds on CEE in the 2007 fiscal year.

4. ACCOUNTS RECEIVABLE

	2006 $	2005 $
Trade receivables	47,392	–
Exploration partner recovery	251,149	114,338
Other	64,606	75,261
	363,147	189,599

Other receivables includes an amount receivable of $44,700 (2005 - $45,000) from a director and officer, which is non-interest bearing and repayable on demand.

5. RESOURCE PROPERTY INTERESTS

The Company's mineral exploration licenses in Mongolia are held by its subsidiaries, Erdene Mongol XXK and Erdene Energy XXK. Mineral exploration licenses are valid for a period of three years and, through renewals, can be extended to a maximum of nine years, subject to minimum work requirements. These rights are held in good standing through the payment of an annual license fee. The Company's mineral exploration licenses in Georgia are held by its subsidiary, Sparta Kaolin Corporation and in Nova Scotia the Company's interest in the Donkin coal project is held through Erdene Resources Inc.'s wholly owned subsidiary 6531954 Canada Limited. Resource property interests are recorded at the cost of acquisition.

The cost of resource property interests as at December 31 2006 and 2005 and cumulative exploration expenses for the years then ended are as follows:

			Properties under Gallant Option Agreement					100% Owned Mongolian Properties			
Year ended December 31, 2006	Sparta $	Donkin $	Zuun Mod $	Tsenkher Gol $	Erdenet Ikh Tal $	Biger $	Other $	Energy $	Virgin $	Other $	Total $
RESOURCE PROPERTIES											
Balance, December 31, 2005	**–**	**–**	**499,250**	**354,433**	**152,380**	**44,027**	**161,069**	**61,457**	**255,962**	**473,130**	**2,001,708**
Acquired via plan of arrangement	6,488,000	5,511,500	–	–	–	–	–	–	–	–	11,999,500
Resource property additions	34,558	1,412,102	656,496	466,066	200,375	57,893	211,800	113,199	70,937	30,057	3,253,483
Write off of resource properties	–	–	–	–	–	–	–	(62,901)	(67,134)	(330,143)	(460,178)
Exploration partner contributions	–	–	–	–	–	–	–	(39,782)	–	–	(39,782)
Resource Properties at Dec. 31, 2006	**6,522,558**	**6,923,602**	**1,155,746**	**820,499**	**352,755**	**101,920**	**372,869**	**71,973**	**259,765**	**173,044**	**16,754,731**
EXPLORATION AND OPERATING EXPENSES (cumulative)											
Expensed to December 31, 2005	**–**	**–**	**1,625,303**	**335,097**	**258,977**	**29,899**	**516,239**	**198,403**	**3,429,178**	**1,208,823**	**7,601,919**
Diamond Drilling	–	–	–	400,004	173,778	–	–	211,762	–	–	785,544
Assaying and Analytical	–	–	6,865	115,705	3,121	–	19,384	14,902	84	135	160,196
Geological Services	–	–	32,405	181,695	37,486	32,985	16,834	434,451	42,560	213,283	991,699
Geo–technical Surveys	–	–	–	22,429	13,182	45,239	–	10,014	–	–	90,864
Logistical and Field Support	–	–	64,717	176,400	38,128	19,768	9,120	86,059	1,246	17,913	413,351
Professional fees	–	–	–	–	–	–	–	45,589	–	–	45,589
Travel	–	–	11,518	4,186	6,376	25,624	–	90,674	–	3,630	142,008
Write off of resource properties	–	–	–	–	–	–	–	62,901	67,134	330,143	460,178
Other	–	–	–	337	279	–	46	2,055	–	–	2,717
Exploration partner contributions	–	–	–	–	–	–	–	(562,729)	–	–	(562,729)
Net exploration expenses	–	–	115,505	900,756	272,350	123,616	45,384	395,678	111,024	565,104	2,529,417
Lab operating expenses	231,967	–	–	–	–	–	–	–	–	–	231,967
Amortization of intangibles	93,567	–	–	–	–	–	–	–	–	–	93,567
Net operating and other expenses	325,534	–	–	–	–	–	–	–	–	–	325,534
Total expenses for the year ended December 31, 2006	325,534	–	115,505	900,756	272,350	123,616	45,384	395,678	111,024	565,104	2,854,951
Cumulative expenses to December 31, 2006	**325,534**	**–**	**1,740,808**	**1,235,853**	**531,327**	**153,515**	**561,623**	**594,081**	**3,540,202**	**1,773,927**	**10,456,870**

All financial data has been prepared in accordance with Canadian generally accepted accounting principles and are stated in Canadian dollars.

Year ended December 31, 2005	Sparta	Donkin	Properties under Gallant Option Agreement					Wholly Owned Properties			Total
			Zuun Mod	Tsenkher Gol	Erdenet Ikh Tal	Biger	Other	Energy	Virgin	Other	
	$	$	$	$	$	$	$	$	$	$	$
RESOURCE PROPERTIES Balance, Dec. 31, 2004	–	–	**18,422**	**13,078**	**5,623**	**1,625**	**5,943**	**16,208**	**107,893**	**479,506**	**648,297**
Resource property additions	–	–	480,828	341,355	146,758	42,402	155,126	76,611	148,069	20,353	1,411,502
Write off of resource properties	–	–	–	–	–	–	–	–	–	(26,729)	(26,729)
Exploration partner contributions	–	–	–	–	–	–	–	(31,362)	–	–	(31,362)
Resource Properties at December 31, 2005	–	–	**499,250**	**354,433**	**152,380**	**44,027**	**161,069**	**61,457**	**255,962**	**473,130**	**2,001,708**
EXPLORATION AND OPERATING EXPENSES (cumulative) Expensed to December 31, 2004	–	–	–	–	–	–	–	–	**2,714,478**	**1,018,753**	**3,733,231**
Diamond Drilling	–	–	1,127,242	–	87,445	–	–	117,470	374,574	–	1,706,731
Assaying and Analytical	–	–	47,736	99,998	4,458	15,209	19,742	16,365	66,769	7,291	277,568
Geological Services	–	–	126,574	72,041	35,659	10,481	258,717	230,578	38,176	58,384	830,610
Geo-technical Surveys	–	–	55,154	63,131	70,189	–	22,182	–	98,207	13,767	322,630
Logistical and Field Support	–	–	268,295	88,273	55,151	4,088	40,782	289,081	122,374	66,595	934,639
Professional fees	–	–	–	–	–	–	68,989	24,020	–	–	93,009
Travel	–	–	–	–	6,015	–	105,453	7,537	14,407	15,464	148,876
Write off of resource properties	–	–	–	–	–	–	–	–	–	26,729	26,729
Other	–	–	302	11,654	60	121	374	3,383	193	1,840	17,927
Exploration partner contributions	–	–	–	–	–	–	–	(490,031)	–	–	(490,031)
Total for the year ended December 31, 2005	–	–	1,625,303	335,097	258,977	29,899	516,239	198,403	714,700	190,070	3,868,688
Cumulative Exploration to December 31, 2005	–	–	**1,625,303**	**335,097**	**258,977**	**29,899**	**516,239**	**198,403**	**3,429,178**	**1,208,823**	**7,601,919**

All financial data has been prepared in accordance with Canadian generally accepted accounting principles and are stated in Canadian dollars.

a) Sparta

The Company, through its subsidiary Sparta Kaolin Corporation, has entered into lease agreements and exploration agreements with options to lease and/or purchase kaolin properties in the United States. The aggregate commitment associated with the cancelable agreements over the next twelve months is US $46,000. These agreements also provide that the Company will pay a royalty based on either the production of finished product or crude tons extracted from the related properties. The majority of the payments to land-owners pursuant to these agreements are creditable against future royalty payments or, where applicable, the purchase price of the property.

The Maddox property, which is owned by Sparta Kaolin Corporation, is under long term lease to Rinker Materials Corporation and is in the process of permit approval for a commercial aggregate quarry with production anticipated in 2008.

b) Donkin

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

The Donkin Coal Alliance was formed by or on behalf of Xstrata Coal Pty Limited (66%), Kaoclay Resources Inc. ("Kaoclay") (20%), American Transbridge Technologies LLC (9.3%) and PDC Resources Corporation (4.67%) to submit a proposal to the Province of Nova Scotia to secure the exclusive right to the Donkin Coal Project; namely, the project to explore, assess, study and, if feasible, develop the Donkin Coal Resource Block into an operating coal mine. On December 14, 2005 the Province of Nova Scotia announced that the Donkin Coal Alliance was the successful proponent. Effective June 12, 2006, Kaoclay amalgamated with Erdene Resources Inc., a wholly-owned subsidiary of the Company, under a court approved Plan of Arrangement and Kaoclay is now a wholly-owned subsidiary of the Company operating under the name of Erdene Resources Inc (see note 2). On October 26, 2006 the Company entered into agreements with minority partners to increase its ownership in the Donkin Coal Alliance from 20% to 25% in exchange for cash consideration of US$9,400 and 360,000 common shares of the Company. Closing of the transaction is anticipated to take place on April 16, 2007. Under the agreements, Xstrata Coal Donkin Limited ("XCDL"), a related party to Xstrata Coal Pty Limited has also increased its interest in the Donkin Coal Alliance from 66% to 75% in exchange for cash.

The members of the Donkin Coal Alliance signed an agreement ("Alliance Agreement") effective March 11, 2005, and amending agreements dated April 23, 2006, October 26, 2006 and October 27, 2006. The Company and XCDL are presently negotiating the terms of a definitive joint venture agreement and sales agency agreement. Pursuant to the April 23, 2006 amending agreement, the Company's interest in the Donkin Alliance is held by 6531954 Canada Limited, a wholly owned subsidiary of Erdene Resources Inc., and Xstrata Coal Pty Limited's interest is held by XCDL, Xstrata Coal Donkin Management Limited, a related party to XCDL is acting as manager for the Donkin Coal Project. If the Donkin Coal Project is approved to proceed to development, the manager will be responsible for mine development, including infrastructure, coal mining and processing, and coal distribution and sales programs.

In June 2006, Xstrata Coal Donkin Management Limited acquired the surface lands relating to the Donkin Coal Resource Block from the Cape Breton Development Corporation ("CBDC"). The Donkin Coal Alliance began its exploration program and evaluation and scoping study ("Exploration Program") in June 2006.

Pursuant to the Alliance Agreement, the Company is committed to fund up to $10,000,000 ("Initial Funding") of the expenditures incurred during the exploration program of the Donkin Coal Project provided such expenses qualify as CEE. Xstrata Coal Donkin Limited agreed to pay any other costs up to a maximum of $5,000,000 but if the Company only pays a portion of the Initial Funding, XCDL is only obliged to pay a corresponding portion of the $5,000,000. The Company is responsible to fund 25% of any additional expenditures incurred in the exploration program if it is to maintain its 25% interest in the Donkin Coal Project. A preliminary estimate of the total budget for the Exploration Program is approximately $17,200,000 and the exploration program is expected to be complete in the first quarter of 2008. In July 2006, the Company completed a $6,000,000 flow-through financing to partially fund its obligation.

c) Payments under Gallant option agreement

On March 1, 2005 the Company entered into an agreement with Gallant Minerals Limited ("Gallant") to acquire certain uranium property licenses and license applications in Mongolia, obtain possession and control of certain assets and geological data pertaining to Mongolia and an exclusive and irrevocable option to acquire all of the issued and outstanding shares of Gallant's wholly-owned subsidiary, Tamerlane International Limited ("Tamerlane") which controls 100% ownership of mineral properties in Mongolia through it's wholly owned subsidiary Anian Resources XXK. On signing, the Company released to Gallant US $75,000, 400,000 common shares of the Company and 800,000 warrants with each warrant entitling Gallant to purchase one common share of the Company for prices ranging from $0.60 to $1.00 for a period of 24 months from the date of issue. Under the option terms, the Company also committed to the following payments, expenditures and deliverables on or before February 28, 2007 in exchange for 100% ownership of Tamerlane:

- i US $275,000;
- ii Direct or indirect expenditures on properties aggregating US $1,000,000; and
- iii 1,200,000 common shares of the Company.

The Company has met its obligation to incur US $1,000,000 of expenditures on the optioned properties and on March 1, 2006 paid US $125,000 and issued 500,000 shares, consistent with the option terms. Subsequent to year-end, on February 28, 2007, the Company made its final payment of US $150,000 and issued 700,000 shares to Gallant, meeting all conditions of the option agreement and entitling it to 100% ownership of Tamerlane (see Subsequent Events note 17a).

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

The consideration provided to Gallant has been recorded by the Company as resource property interests and to December 31, 2006, has an ascribed value of $1,655,390. This includes the estimated fair value of the warrants issued on the date granted of $396,830. The Company also advanced $350,092 to Anian Resources XXK in order to maintain certain mineral licenses which form part of the agreement mentioned above. The Company has recorded these advances as resource property interests.

d) Properties under Gallant option agreement

ZUUN MOD
The Zuun Mod property is a molybdenum/copper occurrence and consists of one license totaling 49,538 hectares. It is located in Bagarkhongor Province approximately 950km southwest of Ulaanbaatar. The licenses renewal date is May 2007.

TSENKHER GOL
The Tsenkher Gol gold exploration property is located in Khentii Province, 180km east of Ulaanbaatar. The property consists of two contiguous licenses totaling 7,982 hectares. The licenses renewal dates are May 2007.

IKH TAL (ERDENET)
The Erdenet-Ikh Tal property consists of three contiguous exploration licenses virtually surrounding the Erdenet copper/molybdenum mine property in northern Mongolia. The property is approximately 250km northwest of Ulaanbaatar and adjacent to the town of Erdenet and covers 8,540 hectares. The licenses renewal dates are December 2009.

BIGER
The Biger property consists of a single 12,522 hectare license. The property is being explored for its copper and platinum group metals potential and is located approximately 780km southwest of Ulaanbaatar and 100km southeast from the provincial centre of Altai in govi-Altai Province. The license renewal date is July 2007.

GALLANT OTHER
An additional nine properties consisting of 13 licenses are included in the Gallant agreement. These properties are a mixture of precious and base metal properties located throughout the country and cover approximately 30,980 hectares.

e) Wholly Owned Properties

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

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

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

Pursuant to an agreement between Erdene and International Uranium Corporation ("IUC") now Denison Mines Corporation dated June 14, 2005, IUC has the option to earn a 65% interest in the uranium minerals on a group of properties by spending a minimum of CDN$6 million over a four year period and by meeting certain other obligations. The properties have been categorized geographically as follows:

Galshar Properties

The Galshar properties are a series of nine exploration licenses located in east-central Mongolia approximately 330km southeast of Ulaanbaatar. These licenses are located mainly in Khentii and Dornogobi Provinces with some of the property located in Sukhbaatar Province as well. The nine licenses are all contiguous and total 185,261 hectares. All of these licenses are 100% owned by the company. The licenses renewal dates are between December 2007 and May 2008.

Southeast Uranium Properties

The Southeast Uranium Properties consist of a series 16 licenses, most of which are not contiguous, that total 632,944 hectares. While some of these properties are contiguous to the Galshar Properties, others are scattered across an area 300 km wide on either side of the trans-Mongolian railway near the town of Saynshand, approximately 420 km south of Ulaanbaatar. The properties are principally located in Dornogobi Province with some of the properties, in part or in whole, located in neighboring provinces of Dundgobi, Sukhbaatar and Khentii. Nine of the licenses were acquired from Gallant Minerals (see note 5c) and are subject to a 1% NSR royalty, which can be reduced to 0.5% in certain circumstances by making certain payments. The licenses renewal dates are between February and September 2008.

The Company has a 100% interest in 11 licenses totaling 97,158 hectares which are not subject to option or joint venture agreements. All of the licenses are held in the name of Erdene Mongol XXK and include the following:

VIRGIN (ONGON)

The large Virgin property is a copper/gold porphyry prospect and consists of six contiguous licenses and covers 62,606 hectares. The property is located approximately 500km southeast of Ulaanbaatar in Sukhbaatar and Dorngovi provinces. The licenses renewal dates are between October 2007 and May 2008.

WHOLLY OWNED OTHER

An additional five licenses covering 34,552 hectares are wholly owned by Erdene Mongol XXK. The licenses renewal dates are between March and September 2007.

6. CAPITAL ASSETS

	Cost $	Accumulated depreciation $	2006 Net book value $	2005 Net book value $
Land	1,874,766	–	**1,874,766**	–
Building	386,830	202,305	**184,525**	–
Equipment, furniture and fixtures	631,661	483,480	**148,181**	59,148
Software and computer	117,096	59,354	**57,742**	64,632
Vehicles	27,267	11,341	**15,926**	–
	3,037,620	756,480	**2,281,140**	123,780

7. INTANGIBLE ASSETS

	Cost $	Accumulated amortization $	2006 Net book value $	2005 Net book value $
Customer relationships and contracts	984,500	85,817	**898,683**	–
Brand	232,500	7,750	**224,750**	–
	1,217,000	93,567	**1,123,433**	–

8. SHARE CAPITAL

Authorized and issued

	2006 Number of shares	2006 $	2005 Number of shares	2005 $
Authorized				
Unlimited number of common shares without par value				
Issued				
Balance, beginning of period	**27,269,635**	**17,372,074**	25,798,910	15,906,210
Issued for cash	**3,000,000**	**3,000,000**	1,000,000	1,000,000
Flow through shares issued	**6,000,000**	**6,000,000**	–	–
Issued pursuant to option agreement	**500,000**	**535,000**	400,000	400,000
Issued on purchase of subsidiary	**14,816,917**	**16,476,412**	–	–
Issued on exercise of options and warrants	**1,464,575**	**1,228,133**	70,725	65,864
Total	**53,051,127**	**44,611,619**	27,269,635	17,372,074

Warrants

The following table summarizes the continuity of the warrants for 2006 and 2005

	2006 Number of warrants	2006 Weighted average exercise price $	2005 Number of warrants	2005 Weighted average exercise price $
Opening balance	2,589,275	0.70	1,835,000	0.63
Issued	4,885,725	1.55	800,000	0.87
Exercised	(1,008,575)	0.77	(45,725)	0.85
Expired	(700)	0.85	–	–
Closing balance	6,465,725	1.33	2,589,275	0.70

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

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

During the year ended December 31, 2006, 4,489,975 warrants were granted to former shareholders of Kaoclay Resources Inc. in conjunction with the plan of arrangement concluded June 12, 2006 (see note 2). Also during the year, 395,750 warrants were issued to the Company's agents as part of the flow-through share financing (see notes 3 and 5 b)).

The Company estimates the fair value of warrants at the date of grant using the Black-Scholes model, recognized over the vesting period with the following assumptions:

	2006	2005
Dividend yield	0%	0%
Risk-free interest rate	5.0%	3.7%
Expected volatility	80%	80%
Expected life	2 year	1 year

Stock Options

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

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

	2006 Number of options	2006 Weighted average exercise price $	2005 Number of options	2005 Weighted average exercise price $
Opening balance	2,330,000	0.69	1,795,000	$0.67
Granted	1,470,000	0.87	560,000	0.77
Exercised	(456,000)	0.48	(25,000)	0.85
Expired	(85,000)	0.81	–	–
Closing balance	3,259,000	0.80	2,330,000	0.69

The following is a summary of the options outstanding and exercisable as of December 31, 2006, all of which are exercisable:

Exercise Price ($)	Expiry Date	Number of Warrants
$0.43	May 8, 2008	104,000
$0.43	November 18, 2008	290,000
$0.85	March 31, 2009	100,000
$0.85	April 6, 2009	720,000
$0.85	August 26, 2009	100,000
$0.70	February 4, 2010	125,000
$0.77	May 1, 2010	90,000
$0.74	July 1, 2010	10,000
$0.85	August 5, 2010	250,000
$1.05	March 31, 2011	180,000
$0.85	August 23, 2011	1,290,000
$0.80		3,259,000

Stock Based Compensation

As of December 31, 2006 there were 3,259,000 share purchase options outstanding. During the year ended December 31, 2006, 1,470,000 options (2005 – 560,000) were granted to certain directors, officers, employees and consultants of the Company. The fair value of the options on the date granted of $893,913 (2005 - $297,601) was expensed as stock-based compensation and geological services and recorded as contributed surplus. The company estimates the fair value of stock based incentives at the date of grant using the Black-Scholes model, recognized over the vesting period with the following assumptions:

	2006	2005
Dividend yield	0%	0%
Risk-free interest rate	5.0%	3.5%
Expected volatility	80%	55%
Expected life	5 years	2.5 years

9. CONTRIBUTED SURPLUS

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

	2006 $	2005 $
Opening balance	1,201,779	513,095
Warrants/options relating to issue costs	141,362	–
Warrants relating to purchase of subsidiary	1,744,731	–
Warrants relating to resource property option agreement	–	396,831
Warrants/options exercised	(228,545)	(5,748)
Options expensed	893,914	297,601
	3,753,241	1,201,779

10. BASIC AND DILUTED LOSS PER SHARE

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

11. INCOME TAXES

The tax effects of temporary differences that give rise to significant portions of the future tax assets and liabilities at December 31, 2006 and 2005 are presented below:

	2006 $	2005 $
Future tax assets		
Non-capital loss carry forwards	2,375,968	1,548,370
Deferred expenses - Mongolia	2,096,041	1,545,210
Share issue costs	422,231	368,455
Other	443,675	19,393
	5,309,885	3,481,428
Less valuation allowance	(5,309,885)	(3,481,428)
Net future tax asset	–	–

Included in the determination of total gross tax assets are Canadian non-capital loss carry-forwards of approximately $6,057,977 which expire substantially between 2007 and 2015, and US loss carry-forwards of approximately $96,592 which expire in 2026. Deferred expenses for tax purposes of $6,986,803 can be used to reduce future taxable income in Mongolia.

Income taxes vary from the amount that would be computed by applying the basic Federal and Provincial tax rate of 38.12% (2005 - 38.12%) to loss before taxes as follows:

	2006 $	2005 $
Loss before taxes	4,565,028	4,981,314
Computed expected tax recovery	(1,740,189)	(1,898,877)
Effects of foreign exchange translation	(119,406)	117,320
Increase in valuation allowance	1,828,457	1,379,077
Expenses not deductible for tax purposes	443,454	173,295
Effect of different foreign tax rates	124,971	255,041
Tax deductible expenses charged to retained earnings	(202,347)	(22,872)
Opening adjustment related to acquisition	(331,486)	–
Other	(3,454)	(2,984)
Net income tax recovery	–	–

12. SUPPLEMENTAL CASH FLOW INFORMATION

	2006 $	2005 $
Non-cash investing and financing activities		
Issue of shares on purchase of subsidiary	16,476,412	–
Issue of warrants as a share issue cost	141,362	–
Sale of resource properties in exchange for marketable securities	113,667	22,499
Issue of common shares and warrants for investment in resource property interests	535,000	796,831
Cash consists of:		
Cash on hand, held in trust by third parties and in banks	192,728	81,191
Temporary money market instruments	2,855,242	4,188,800
Temporary money market instruments (flow-through funds)	4,598,523	–
	7,646,493	4,269,991

13. FINANCIAL INSTRUMENTS

a) Fair values

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

b) Credit risks

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

14. FOREIGN CURRENCY RISKS

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

15. SEGMENTED INFORMATION

The Company's executive office is located in Nova Scotia, Canada with resource properties and exploration and development activities in Canada, United States and Mongolia. The following table presents selected financial information by geographic origin (in thousands of dollars):

				2006				2005
	Canada	USA	Mongolia	Total	Canada	USA	Mongolia	Total
Working capital	3,122	118	25	3,265	4,254	–	(10)	4,244
Capital assets	68	2,145	68	2,281	62	–	60	123
Resource properties	6,924	6,523	3,308	16,755	–	–	2,001	2,001
Total assets	17,207	13,413	3,557	34,177	4,500	–	2,149	6,649

16. COMMITMENTS

The Company has an operating lease for office premises until August 31, 2011. The Company has the right to terminate the lease by giving notice prior to the anniversary date, after 2007. Annual payments are as follows:

	$
2007	56,601
2008	57,733
2009	58,888
2010	60,065
2011	30,633
	263,920

17. SUBSEQUENT EVENTS

On February 28, 2007 the Company made its final payment of US $150,000 and issued 700,000 shares to Gallant, meeting all conditions of the option agreement and entitling it to 100% ownership of Tamerlane (see note 5c).

On March 1, 2007 600,000 Gallant warrants expired unexercised. The value assigned to these expired warrants, at the date of issue, was $278,030 and was charged to resources properties. In the first quarter of 2007, the assigned value of these expired warrants was removed from resource properties and the applied against contributed surplus.

Subsequent to year end the Company sold marketable securities for net proceeds of $636,571 and recognized a gain of $472,238.

On March 23, 2007, the Company signed an engagement letter with National Bank Financial who will purchase, on a private placement bought deal basis subject to certain conditions, 10,000,000 shares of the Company at $1.00 per share resulting in gross proceeds to Erdene of $10,000,000 ("Offering"). The agreement and Offering are subject to receipt of all necessary approvals, including regulatory and stock exchange approvals. The closing is expected to occur on or about April 12, 2007 ("Closing"). Erdene has agreed to pay the underwriters a commission of 6% of the aggregate gross proceeds and to issue 600,000 broker warrants, representing 6% of the number of shares issued under the Offering. One broker warrant will entitle the holder to acquire one share for $1.00 at any time until the date that is 12 months from Closing.

18. COMPARATIVE FIGURES

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

CORPORATE INFORMATION

Directors, Officers and Senior Management

Peter C. Akerley
President and CEO; Director

J.C. (Chris) Cowan
Vice-President Asia; Director

Ken W. MacDonald
Vice-President North America and CFO; Director

Wayne G. Beach
Director
Partner – Beach, Hepburn

William B. Burton
Director
President and CEO – MagIndustries Inc.

John P. Byrne
Director
President – Petroleum Corporation of Canada Exploration Ltd.

David S. B. Carnell
Director
President – Bedford Capital Group Inc.

Jeffrey J. Gerard
Director
COO of the Americas for Xstrata Coal

Stuart P. Rath
Director
President – Stuco Holdings Limited

Philip L. Webster
Director
President – Imperial Windsor Group Inc.

Michael X. Gillis
Director of Business Operations

Michael O'Keefe
Director of Finance

D. Suzan Frazer
Corporate Secretary
Partner – McInnes Cooper

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Shareholder Information

Auditor
KPMG LLP
Chartered Accountants
Halifax, Nova Scotia

Transfer Agent
Computershare Trust Company of Canada
Halifax, Nova Scotia;
Toronto, Ontario

Legal Counsel
McInnes Cooper, Halifax
Lynch and Mahoney, Mongolia

Stock Exchange Listing
TSX : ERD

Website
www.erdene.com

Annual Meeting
The Annual Meeting of Erdene Gold Inc. will be held at the Halifax Marriott Harbourfront, 1919 Upper Water Street, Halifax, Nova Scotia on May 10, 2007 commencing at 5:30pm

Financial Highlights

As at December 31, 2006	
Working Capital and Flow-through	$7.9 million
Shares Issued and Outstanding	53.1 million
Shares Fully Diluted	62.8 million

www.erdene.com

Forward Looking Statement
Certain information regarding Erdene Gold inc. ("Erdene") contained herein may constitute forward-looking statements within the meaning of applicable securities laws. Forward-looking statements may include estimates, plans, expectations, opinions, forecasts, projections, guidance or other statements that are not statements of fact. Although Erdene believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Erdene cautions that actual performance will be affected by a number of factors, most of which are beyond Erdene's control, and that future events and results may vary substantially from what Erdene currently foresees. Factors that could cause actual results to differ materially from those in forward-looking statements include market prices, exploitation and exploration results, continued availability of capital and financing and general economic, market or business conditions. Erdene's forward-looking statements are expressly qualified in their entirety by this cautionary statement. The information contained herein is stated as of the current date and subject to change after that date.

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