Erdene Gold Inc.

Growing. Diversified. Experienced.

ANNUAL REPORT **2005**

Erdene is a rapidly ***growing*** company, strategically positioned to take advantage of China's record growth. Erdene provides shareholders with the potential for a significant appreciation of their investment through its ***diversified*** commodity portfolio of high quality projects in Mongolia. The company is also establishing a strong project base in North America with the potential for cash flow in the near-term and high growth over the long-term. With our exciting and diversified exploration interests, strong partnerships with industry leaders and an ***experienced*** management team, Erdene is well positioned to provide greater shareholder value in the near-term.

www.erdene.com

Corporate Profile

Diversified portfolio of high-growth commodities

- Focused on commodities forecast to be in high demand over the long-term including gold, copper, molybdenum, coal and uranium
- Strong portfolio of exploration properties in Mongolia
- Near-term opportunities for cash flow from proposed acquisition of North American assets

Strategic alliances with leading companies

- Demonstrated ability to partner with industry leaders at the appropriate point in a project's development
- Ensures necessary capital for the development of projects while retaining upside potential for Erdene shareholders
- Current partnerships with industry leaders are a testament to the significant potential of Erdene's properties

Mongolian properties are ideally located next to China

- China's modernization has made it the world's fastest-growing economy driven by infrastructure growth and a burgeoning middle class
- Mongolia has an abundance of resources ideally located to provide China with the raw materials it requires to fuel growth

Experienced management team

- Experienced in Mongolia with strong government and industry relationships
- Team members bring decades of experience in global exploration and mining as well as corporate finance and management


Erdene Properties
MONGOLIA
Erdene Properties
Copper-gold
Gold
Copper
Molybdenum
Coal
Uranium
Major road
Mine/major deposit
Gold
Copper
Coal
Capital city
Industrial centre
Airport; int'l, regional
Main railway
0 100 200 300 400 500
Kilometres
RUSSIA
KAZAKHSTAN
MONGOLIA
CHINA
ULAANBAATAR
BEIJING
Barnaul
Novokuznetsk
Abakan
Gorno-Altaisk
Semipalatinsk
Ust'-Kamenogorsk
Kyzyl
Irkutsk
Ust' Ordynskiy
Lake Baikal
Ulaan Ude
Chita
Aginskoye
Baley
Blagoveshchensk
Chatanga
Sukhbaatar
Darkhan
Hovsgol Nuur
Uvs Nuur
Ulaangom
Olgiy
Khovd
Moron
Yargait
Erdenet Ikh Tal
Erdenet
Bulgan
Boroo
Bayan Kharaat
Maikhan Khar
Wunugetushan
Qiqihar
Harbin
Choibalsan
Turquoise
Uliastai
Tsetserleg
Baganuur
Tsenkher Gol
Dzuunmod
Underkhaan
Bus Ovoo
Baruun Urt
Trans Mongolian Railway
Galshar Uul
Galshar Coal
Wild Mountain
Altai
Blue Springs
Bayankhongor
Arvaiheer
White Hills
Mandalgovi
Biger
Virgin
Sainshand
Yant
Ulan Ovoo
Zuun Mod
Tsagaan Savarga
Tavan Tolgoi
Dalandzadgad
Oyu Tolgoi
Nariin Sukhait
Bayan Obo
Changchun
Jilin
Shenyang
Fushun
Anshan
Jining
Huhot
Baotou
Datong
Copper Smelter
Tangshan
Dalian
Port of Tianjin (international exports)
Bohai Gulf (to Pacific Ocean)
Jiayuguan (Gansu Jiu Steel Complex)
Trans China Railway
Yinchuan
Taiyuan
Shijiazhuang
Jinan
Qingdao
YELLOW RIVER
EAST CHINA SEA
Xining
Lanzhou
Zhengzhou
Luoyang
Xi'an
RUSSIA
Lake Baikal
Ulaanbaatar
MONGOLIA
Frunze
Almaty
KYRGYZSTAN
Vladivostok
Beijing
Pyongyang
NORTH KOREA
Seoul
SOUTH KOREA
JAPAN
CHINA
Shanghai
East China Sea
NEPAL
Kathmandu
New Delhi
BHUTAN
Thimphu
BANGLADESH
Dhaka
INDIA
TAIWAN
Victoria
MYANMAR
Hanoi
LAOS
Vientiane
HONG KONG
South China Sea
PACIFIC OCEAN
Bay of Bengal
Rangoon
THAILAND
VIETNAM
PHILIPPINES

Report to Shareholders

Dear Shareholders,

I am very pleased to report on Erdene's progress during the past year, and excited to discuss the tremendous opportunities unfolding.

Review of 2005

During the past 14 months, the Erdene management team has worked hard to provide a strong base from which to pursue our objective of discovering high impact mineral resources with the goal of creating significant appreciation in shareholder value. In doing so, your management team has structured five arrangements that have brought the following benefits: high quality exploration assets; strategic alliances with leading mining companies; equity funds at a premium to market; and most recently a proposed acquisition, which balances the great upside yet higher risk of the Mongolian property portfolio through a number of North American assets with near-term cash flow potential.

Through established alliances, we are poised to provide our shareholders with energy opportunities next to two of the fastest growing energy markets in the world, the U.S. Eastern Seaboard and China, as well as stable industrial mineral projects in the U.S. We also continue to provide our shareholders with a 100% interest in all our precious and base metal opportunities. We believe our new strategic alliances with partners that are leaders in their respective fields will also enable us to enhance the development of our mineral rich Mongolian properties, as we can now leverage the considerable resources and experience of our partners. Although we plan to have some near-term producing North American assets our focus remains on developing our Mongolian properties to feed the large Chinese market.

This past year also saw Erdene graduate from the junior TSX Venture Exchange to a full senior TSX listing. Our senior listing makes us a stronger and more stable company. It also increases trading activity and improves the liquidity of our shares.

Strategic Alliances and Proposed Acquisitions

In early 2005, we completed the acquisition of a major asset base from Gallant Minerals for a total consideration valued at US$ 1.6 million. This was followed by a joint venture with International Uranium Corporation ("IUC") and an alliance with Erdenet Mining Corporation, Mongolia's largest mining company and operator of one of Asia's largest copper mines. At the beginning of 2006, we also announced a strategic alliance with global mining giant Xstrata Coal Canada Limited and the proposed acquisition of Kaoclay Resources Inc. Xstrata acquired a 9.8% equity stake in our company and will provide their resources and expertise to help develop our projects. A $3-million investment by Xstrata and $1-million investment by IUC as part of the uranium joint venture are both strong endorsements of our projects, people and direction, as well as the potential of Mongolia's mining industry. This alliance combines Erdene's strong portfolio of early stage mineral properties in Mongolia, strategically located to serve the lucrative Chinese market, with Xstrata's established Asian relationships, vast coal experience and ability to invest in and support world class projects. It also provides Xstrata and Erdene with the potential to mutually benefit from the development of non-coal opportunities.

Kaoclay Acquisition

On February 21, 2006, Erdene offered to acquire all of the shares of Kaoclay Resources Inc. in return for shares and warrants of Erdene. The approximate value of the proposed transaction is $15.6 million. Assuming our proposed acquisition of Kaoclay Resources is approved at a special meeting of the Kaoclay shareholders scheduled for May 25, 2006, it will provide your Company with near-term cash flow and significant upside potential. Kaoclay's portfolio includes two notable industrial mineral projects as well as a 20% interest in the Donkin coal project which provides Erdene with an opportunity to partner with Xstrata in North America. The industrial mineral opportunities include the Sparta Kaolin project in Georgia, U.S., which is operated by industry leader J.M. Huber Corporation, and the Maddox Granite Aggregate project, a royalty project in the southeast U.S. managed by another industry leader, Rinker Materials.

Mongolia Exploration

Late in the 2005, our exploration campaign in Mongolia delivered promising results. We revealed an expanded gold discovery at Tsenkher Gol and a very significant coal drill intersection at Galshar adjacent to the Trans-Mongolian Railway. In addition, we entered 2006 with exciting drill results at our Zuun Mod molybdenum project and generated new targets at the Erdenet copper project. We continue to believe Mongolia offers unparalleled opportunity in the exploration industry. Fuelling our optimism are the scale of deposits being discovered, the unexplored regions and the proximity to China's markets. Mongolia is a relatively young democratic country and it continues to mature, particularly in regard to mineral development, which has the potential to transform the country's economy. However, we are confident that over the long term Mongolia will maintain policies that provide for stability and give incentive to those willing to work in a developing country.

Management Team

Erdene has a strong senior management team experienced in all aspects of our business. This team has been active in Mongolia since 1996. We have positive relationships with the Mongolian government, industry professionals and the local population. In addition, we look forward to developing solid working relationships with our new partners. Following our strategic alliance with Xstrata, we welcomed Jeff Gerard to our board. Mr. Gerard is General Manager of Business Strategy at Xstrata Coal and brings 25 years of experience in mining and related industries to Erdene. We also welcome, conditional on approval of the Kaoclay acquisition, Kaoclay directors Stuart Rath and Philip Webster to our board. These three new directors bring a wealth of experience and knowledge to your board.

Outlook

Our industry is in the middle of one of the strongest commodity cycles of a generation. Your company is positioned in regions that provide some of the greatest potential for discovery and development, and is geographically well located to benefit from these high growth markets. We are very positive about the exploration programs in Mongolia and the continued development of the North American assets stemming from the proposed Kaoclay acquisition.

Our strategy is clear and consistent. Erdene remains focused on maximizing shareholder value through the discovery of mineral deposits in Mongolia. In the meantime, our plan is to balance the higher risk Mongolian exploration focus by generating cash flow from the near-term producing North American assets. In addition, we are always looking to enhance shareholder value, so we will consider further alliances and acquisitions if they benefit Erdene.

Acknowledgements

In closing, I would like to recognize and thank all the employees, geologists and partners of Erdene, who have worked extraordinarily hard to move us forward on time and on budget. To our board of directors, I extend my gratitude for their guidance, counsel and effort on behalf of all shareholders. And above all, I thank you, our shareholders. We appreciate your ongoing support, trust and commitment to Erdene. We look forward to continuing to serve you throughout 2006 and beyond.

Sincerely,

Peter C. Akerley
President & Chief Executive Officer

Operational Overview

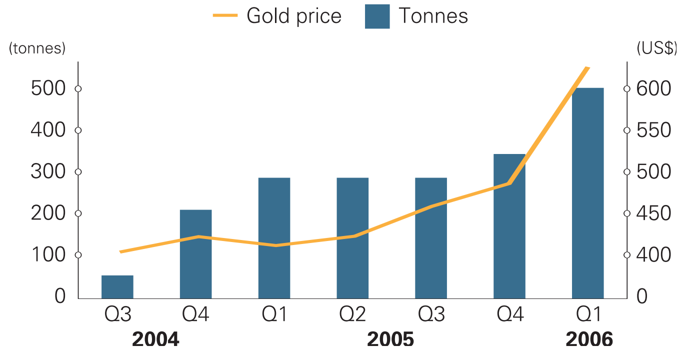
A strong gold price is being driven by a lack of new supply, a weakened U.S. currency and geopolitical issues.

Gold

Market Overview

Worldwide demand for gold has surged in the last few years, pushing prices past the US$600 mark in early 2006, up more than 40% from a year ago and 65% over five years. High demand is being fuelled by a strong investment market due to economic factors such as a weak U.S. dollar and high oil prices. There is also a strong fabrication demand, led by China and India seeking gold for jewellery and industrial use. The World Gold Council expects demand to remain strong over the long term. A lack of investment in exploration and production in the 1990s has resulted in a supply shortage and coupled with strong demand, gold prices are expected to remain high.

Global Demand for Gold



Property Highlights

Erdene has identified a number of properties with promising gold targets within excellent geologic environments including Tsenkher Gol, Blue Springs and Wild Mountain.

Tsenkher Gol is an early stage prospect with a geological setting and style of mineralization very similar to that found at Centerra Gold's Boroo Mine located in north-central Mongolia.

Gold mineralization is associated with disseminated sulfides in altered granite over target areas of kilometric scale. Erdene has outlined multiple high grade ore zones (5 to 7g/t gold over 1 to 2.5 metres) near lower grade alteration zones which range from 1.2g/t gold over 10 metres to 0.64g/t gold over 21 metres. The 2005 exploration program at Tsenkher Gol included soil and rock geochemistry, trenching, and supporting geophysical surveys. Operating placer gold mines are located within the Tsenkher Gol drainage basin, attesting to the mineralization potential of the area. The property is located 180 kilometres east of Ulaanbaatar and is readily accessible by a newly paved, all-weather highway.

Trenching and drilling programs at the Blue Springs property have confirmed that the high grade gold-copper-silver skarn mineralization found on surface extends to depth. Drilling results included a three-metre section averaging 25.2g/t gold in the North Zone and in the Central Zone, three metres averaging 6.29g/t gold which is an extension of a surface trench which returned 15.2g/t gold over 5 metres. Additional zones of mineralization have been identified that require further investigation.

At the Wild Mountain property, exploration work confirmed the extent of surface alteration and gold-copper mineralization east and west of the Jugants massive sulphide occurrence (24-metre trench with 1.85g/t gold, 11.92 g/t silver and 1.54% copper). Trenching identified weak to moderate pyrite alteration up to 100 metres wide that extends along strike over a distance of approximately one kilometre with significantly anomalous gold and copper values reported.

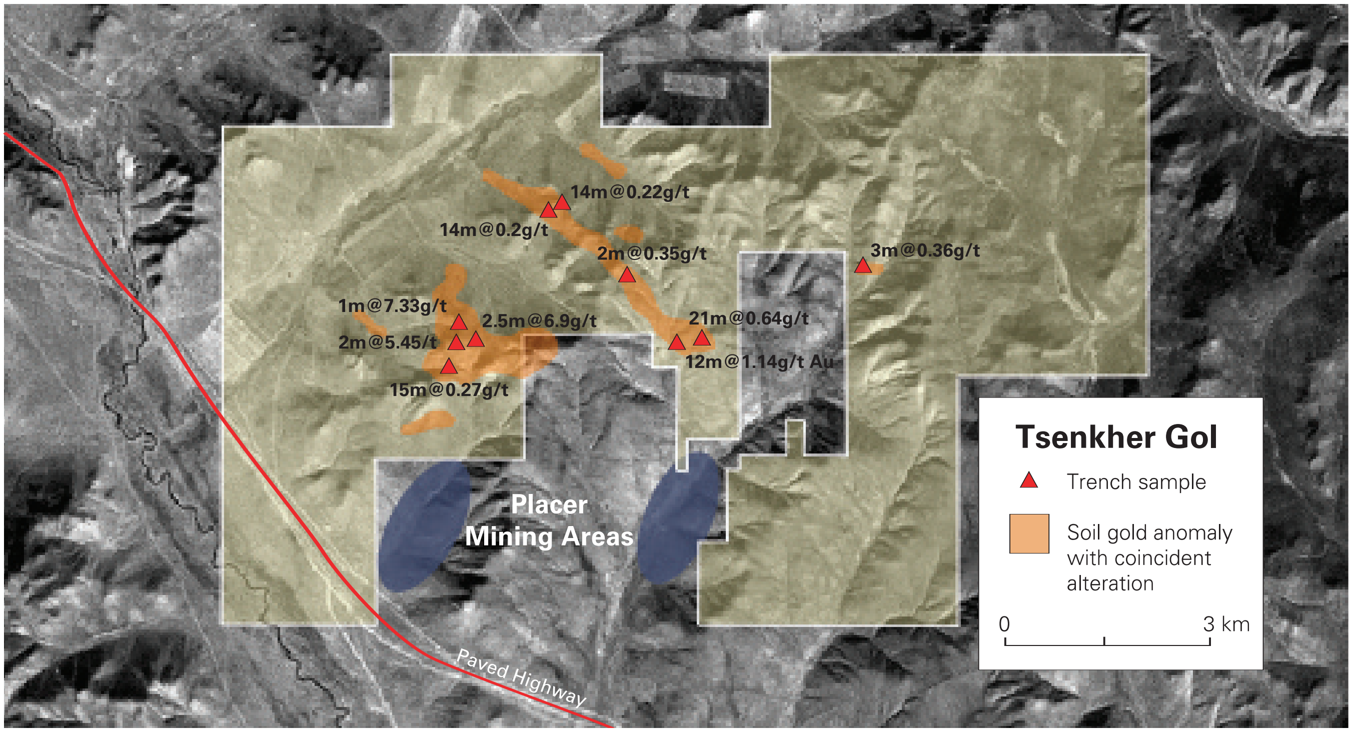
Exploration Plans

The presence of widespread, highly anomalous gold bearing zones at Tsenkher Gol makes this property a high priority project for the 2006 field season. Additional surface exploration work will be started in the spring followed by a drilling program designed to determine the extent and strength of the promising gold mineralization identified on the property to date.

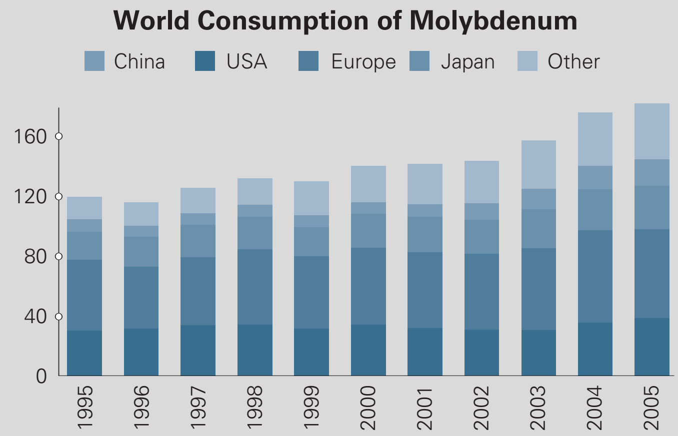
Additional surface evaluations are planned for Blue Springs and Wild Mountain to further define the existing targets.

In addition, Erdene will be carrying out an extensive program to identify and acquire highly prospective gold exploration projects through use of the company's proprietary mineral database, established industry contacts in Mongolia and an experienced exploration team. Management is committed to expanding Erdene's precious metal holdings as growth of this sector is projected to remain strong over the long term.

Kilometric-scale gold targets within altered granite identified at Tsenkher Gol



Molybdenum



Molybdenum is a key ingredient in stainless steel, a product in high demand by China's rapidly growing economy. The price is strong and expected to stay well above historic levels.

Market Overview

Molybdenum is a metal used principally as an alloying agent in steel making to enhance strength, hardness, weldability and corrosion resistance. The U.S., Japan, Germany and China are the largest molybdenum markets, together accounting for about 50% of world demand. With the construction boom underway in China and increased energy demands, steel alloys, primarily stainless steel are in strong demand for buildings and pipelines. As a result, consumption of molybdenum in China doubled between 2001 and 2005. Molybdenum prices are expected to remain well above historic levels, supported by limited roasting capacity and firm demand led by China.

Property Highlights

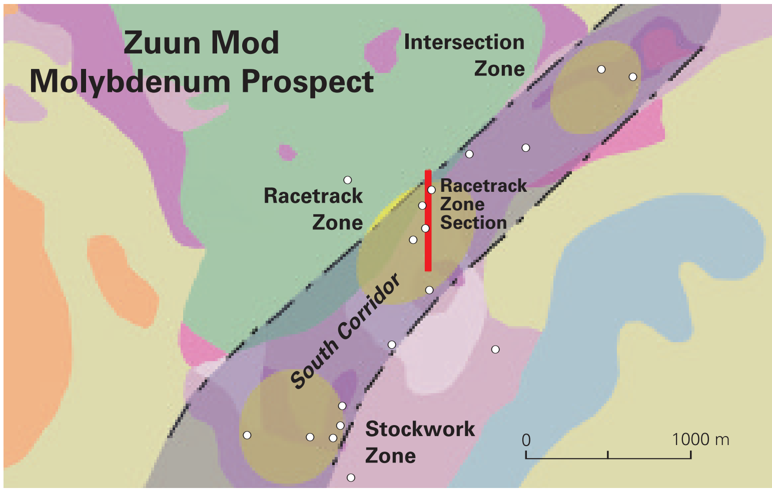
Erdene's Zuun Mod molybdenum porphyry prospect is strategically located less than 200 kilometres from China where rail and a power grid have recently been constructed to the border to serve the giant Gansu Jiu steel complex. Zuun Mod has the potential to host a large resource amenable to open pit mining. The current focus is on a three-kilometre long portion of the system, referred to as the South Corridor, where 12 of 15 holes have intersected thick intervals of significant mineralization. Recently intersected higher grades near surface, significant thickness of mineralized zones open at depth, and large untested areas remaining, all attest to the potential of the Zuun Mod project.

Exploration Plans

Erdene carried out extensive exploration in 2005 that has resulted in the delineation of multiple targets with highly significant molybdenum intersections. Erdene commissioned an independent technical review of the Zuun Mod Porphyry Molybdenum Project, which was completed in September of 2005, and recommends resource delineation drilling on the mineralized Racetrack and Stockwork zones.

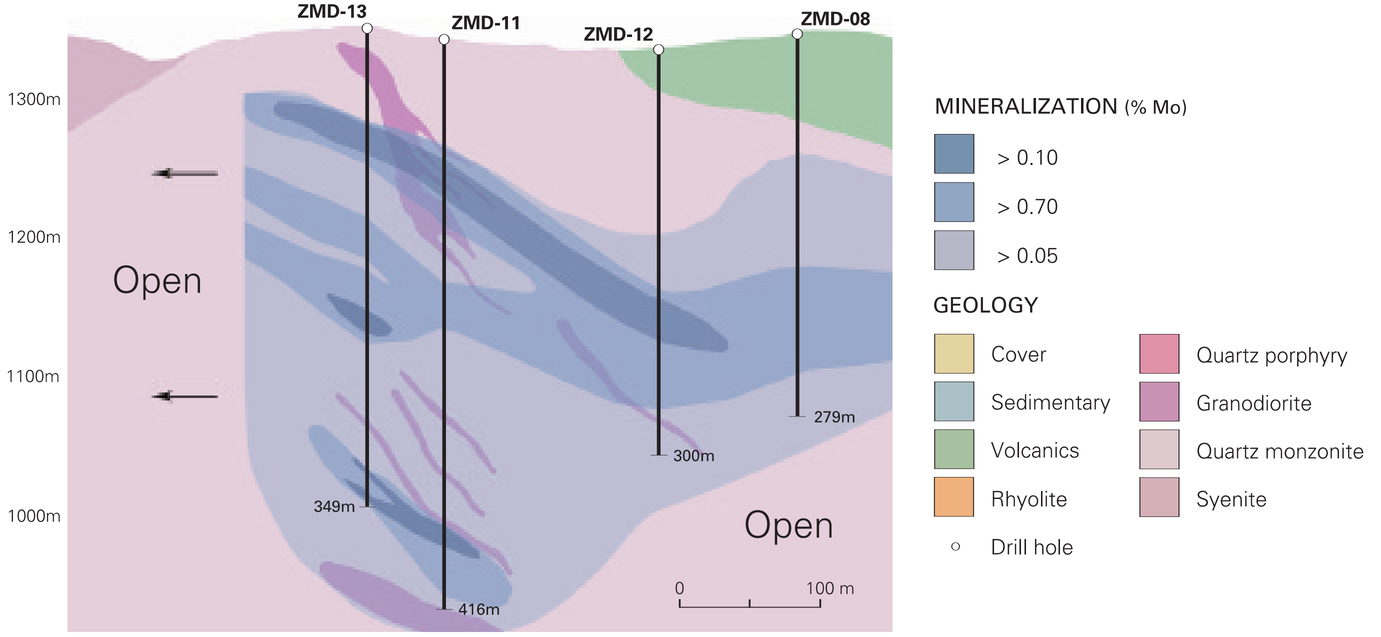
Internal scoping studies are underway in spring 2006 to provide an initial project evaluation prior to prefeasibility.

Significant mineralization identified in multiple holes at Zuun Mod close to China's steel industry



Zun Mod Racetrack Zone

Line 51700E (looking west)



Erdenet Mine production facility

Copper

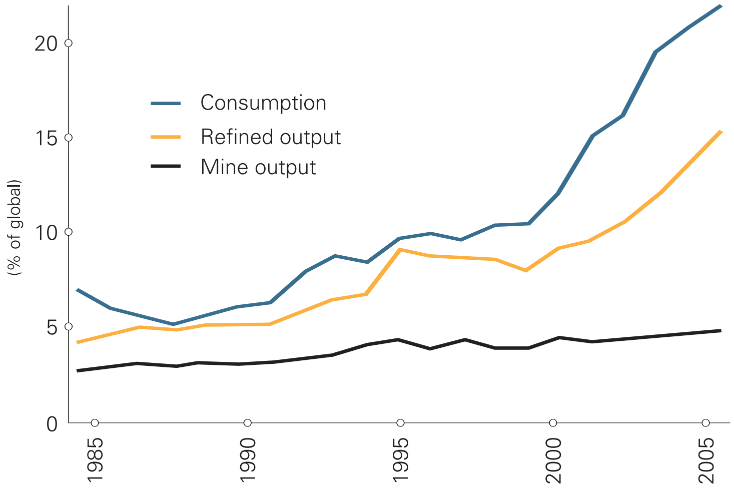
SX-EW production at Erdenet

Market Overview

Copper is widely used in construction, electronic products, transportation equipment, industrial machinery and a wide variety of consumer products. China's growing infrastructure, expanding exports and burgeoning middle class all contributed to a huge demand for copper that has helped push the metal to record high prices, which have doubled in the past year. Copper has very strong fundamentals, once again driven in particular by the increasing modernization and construction in China. Other Asian countries, such as Taiwan, Korea and Japan, also have high demands for copper and other metals as they increase manufacturing to supply China.

***China** – the world's biggest consumer of copper – is forecast to see its demand rise by 70% over the next decade.*

Copper in China



Property Highlights

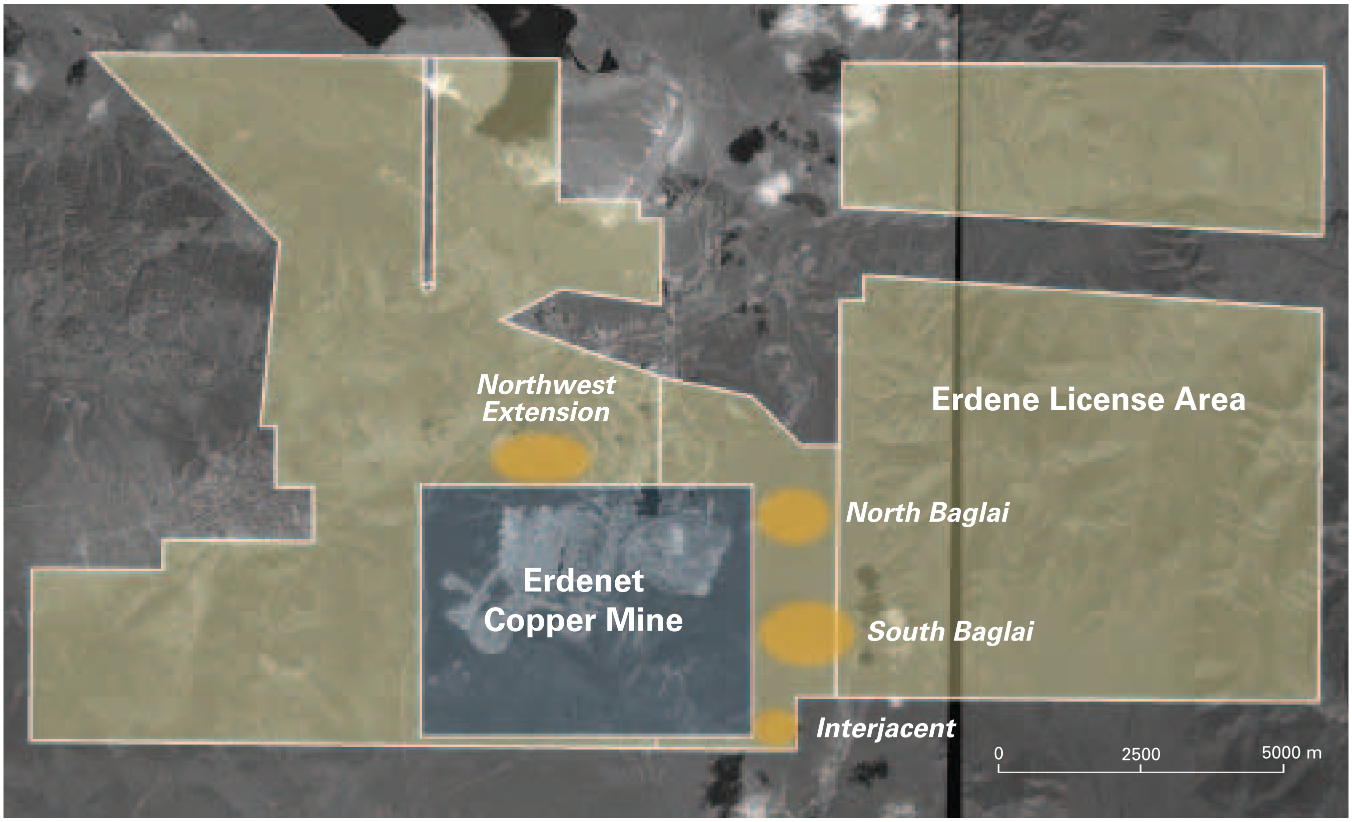
As part of the acquisition from Gallant Minerals Limited that closed early in 2005, Erdene acquired a very prospective land package within a major copper porphyry district. Erdene's 168-square-kilometre Erdenet property surrounds the Erdenet Copper Mine, one of the world's largest copper mines. The mine's annual production is approximately 27.6 million tonnes of ore producing approximately 280 million pounds of copper and 2.62 million pounds of molybdenum in concentrate. In the late 1970s copper head grades were 0.87% to 0.96%, while today they are approximately 0.60% as a result of the upper oxide portion being depleted. With declining head grades at depth, the discovery of a new high-grade, near-surface deposit to feed for the Erdenet mill complex would be highly attractive. The mine is located on rail with connections to China and Russia.

Erdene has a strong working relationship with the mine's management. It is expected that the development of any new discoveries would be expedited by the fact that all necessary infrastructure is close at hand.

Exploration Plans

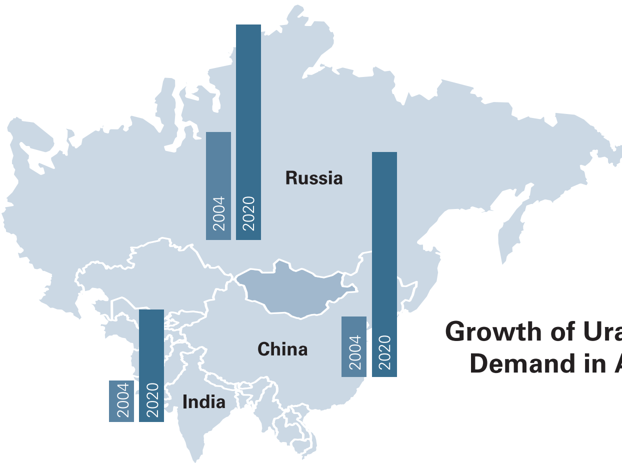
Erdene began exploring for extensions of the copper/molybdenum mineralization on its Erdenet properties in May of 2005 with reconnaissance mapping and sampling, magnetic and gradient IP surveys and diamond drilling. Recently completed IP surveys have identified two large, very intense geophysical anomalies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

Multiple drill targets identified on 168km^2 property surrounding world-class Erdenet copper mine



Location of Erdene's Licenses and Target Areas at Erdenet

Uranium



Growth of Uranium Demand in Asia

Market Overview

Global demand for uranium is outstripping supply and pushing prices upwards. On the demand side of the equation, China, India and other developing and developed countries are building nuclear reactors to meet their growing power needs. According to the World Nuclear Association, there are 440 uranium reactors operating in the world today, with another 27 under construction and 38 planned. On the supply side, uranium production in 2005 met approximately 63% of the requirements of power utilities with the balance coming from inventories stockpiled in the 1970s and 1980s that are being continually depleted. Uranium production will need to expand significantly to keep up with global demand.

China plans to invest US$40 billion on nuclear generating capacity by 2020 to provide electricity for its booming economy.

What is *in-situ* leach mining?

In-situ leaching ("ISL"), also known as solution mining, involves leaving the ore where it is in the ground, and using liquids which are pumped through it to recover the minerals out of the ore by leaching. Consequently there is little surface disturbance and no tailings or waste rock generated. In addition, the orebody needs to be permeable to the liquids used, and located so that they do not contaminate ground water away from the orebody.

– Uranium Information Centre

IUC can earn a 65% interest in any uranium mineral on Erdene's properties by spending $6 million over four years

Property Highlights

Erdene has multiple uranium licenses covering 1.2 million hectares in southeastern Mongolia. Erdene is targeting uranium deposits amenable to in-situ leach ("ISL") mining. ISL mining is an inexpensive and effective way to mine uranium. Erdene's properties have multiple uranium occurrences identified by Russian surveys, and its targets are in the same regional belt that hosts significant uranium deposits.

Exploration Plans

In June 2005, Erdene entered a joint venture agreement that gave International Uranium Corporation ("IUC") the option to earn a 65% interest in the uranium minerals on Erdene's properties. Under the terms of the agreement, Erdene was the operator for the IUC funded 2005 exploration program.

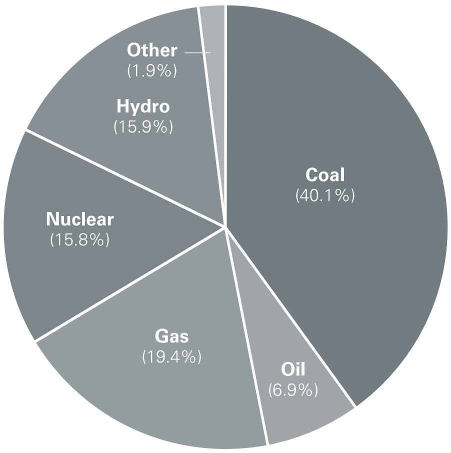
As a result of an extensive reconnaissance program carried out from September to November 2005, three properties were chosen for more detailed surface exploration. Target structures are believed to represent efficient conduits for oxygen-rich surface waters that can leach and mobilize metals to form roll-front type uranium deposits suitable for ISL mining. The 2006 exploration program is being managed by IUC and will include drill testing on several of Erdene's properties.

Coal mine adjacent to Galshar coal property

Coal

The strong demand for coal in China and the U.S. is being driven by continued economic expansion, increased electric power demand and high oil and natural gas prices

2003 World Electrical Generation



Market Overview

Coal use is expected to increase significantly over the next 20 years, led by China and the U.S. Fossil fuels currently provide 80% of China's energy and current coal output simply cannot keep up with demand. China's booming steel industry has also increased demand for metallurgical coal. As a result, coal prices have been strong over the last few years.

In the long term, coal prospects are very positive particularly in those regions adjacent to our projects. Mongolia has vast coal resources and is ideally positioned to feed its neighbour's demand. In the U.S., demand from coal-fired plants is expected to increase by 110 million tonnes over the next 10 years, primarily for use in power generation and steel manufacturing. At the same time, U.S. coal producers face declining production primarily of higher quality near-surface reserves.

Mongolia

Property Highlights

In February 2006, Erdene entered into a strategic alliance with Xstrata Coal that provides a strong base for the exploration and development of coal opportunities in Mongolia. Xstrata made a $3 million equity investment in Erdene and have the right to earn 75% of any coal projects in Mongolia by funding the project through to a production decision.

Erdene's coal opportunities in Mongolia include the Galshar property. Erdene's initial drilling of the Galshar coal project intersected a 49-metre coal seam in the central part of an area where previous drilling intersected coal seams over a three kilometre strike length that is open to the northeast. Erdene's property covers a large area surrounding an open pit coal mine that supplies coal to local towns. The property is 65 kilometres from direct access to the Trans-Mongolian railway.

Partnered with Xstrata Coal to explore and develop coal opportunities on China's doorstep

Exploration Plans

Erdene will be carrying out an Xstrata funded program to identify and acquire high quality coal exploration projects through use of the Erdene's proprietary coal database, established Mongolian contacts and our experienced exploration team. This program will be followed by an extensive 2006 exploration program.

In addition, quality analysis and evaluation are now underway to determine the thermal properties of the Galshar coal and the potential for the project to provide export quality coal.

Donkin tunnel No. 2

Aerial view of Donkin site

Donkin, Nova Scotia

Property Highlights

As part of the proposed Kaoclay acquisition, Erdene would acquire Kaoclay's 20% interest in the Donkin Coal Alliance with Xstrata Coal Canada (66%) and Atlantic Green Energy Development (14%). The alliance has been granted the rights to acquire the mineral license for the Donkin coal resource block, which is considered the last remaining undeveloped block of high quality coal off Cape Breton. 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 stage. The project is located near a shipping terminal making it ideally located to serve the large eastern U.S. market.

Development Plans and Economics

At Donkin, pre-feasibility studies are scheduled to commence in the summer of 2006. Approximately $100 million was spent on previous work that including the construction of two access tunnels. Assuming positive results from the pre-feasibility study, production could begin in late 2009 with a projected annual production of 5 million tonnes of coal by 2011.

Sparta kaolin being processed by Huber

Large tonnage, high-quality kaolin clay resource in commercial production in Georgia

Kaolin

Market Overview

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. Demand for kaolin products is strong in North America, Europe and Asia and this is expected to continue in the long term. The U.S. is the world's largest kaolin producer. Georgia is the kaolin centre of the U.S. and, according to the U.S. Geological Survey, produces eight million tonnes of the mineral a year with an estimated value of approximately US$1 billion.

Property Highlights

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

Development Plans and Economics

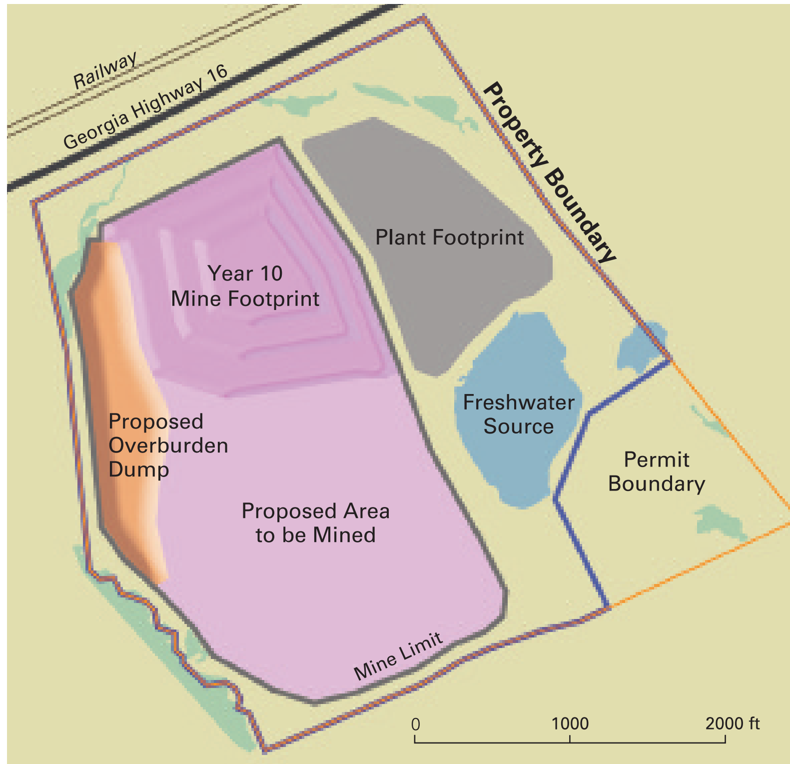
In October 2003, Kaoclay entered into an agreement with Huber for prepaid tonnage of crude kaolin. Huber conducted a due diligence evaluation program of the Sparta kaolin resource and performed an extensive product development program. This led to the successful commercialization of Huber Prime', a lightweight coater ("LWC") product, in late 2004. Following the proposed acquisition, Erdene management intends to negotiate a long-term agreement with Huber to maximize the value of the resource.

Granite Aggregate

Market Overview

Granite aggregate is mainly used for road and building construction. Demand is strong in the southeastern U.S. due to continued growth and infrastructure maintenance. As a result of the geology of Florida and coastal Georgia, the Maddox property owned by Kaoclay Resources is one of the closest sources of quality granite with rail access to southeast U.S. markets.

Royalty interest in large granite aggregate quarry with a rail link to lucrative southeast U.S. markets



Proposed Maddox Property

Property Highlights

Provided Erdene is successful in its bid to acquire Kaoclay Resources, the company would then own the Maddox granite aggregate project in Georgia, U.S. The Maddox project is being developed as a quarry primarily to serve the lucrative Florida market. It is adjacent to rail and is expected to begin production in early 2007.

Rinker Materials Corporation ("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 tonne mined or 7.5% of the selling price payable to Kaoclay. 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 the potential to reach four million tonnes. Based on current production projections, the Maddox quarry would have a lifespan of at least 20 years.

Development Plans and Economics

Permitting is currently underway at Maddox, with plans to commence production in 2007. Rinker has advised Kaoclay that it expects the pre-production development period to be 9 to 12 months from the date the quarry permit is issued. Rinker is designing a quarry and processing plant that will have a capacity of one million tons per annum. The plant, which is of modular design, can be expanded, subject to market conditions, up to four million tons per annum in one million ton increments.

Corporate Governance

The guiding principles of Erdene's Board of Directors are to ensure the long-term viability and profitability of the Corporation, as well as the well-being of its employees and of the communities in which it operates.

Mandate of Board and Committees

The Board of Directors is responsible for the stewardship of the Corporation through the appropriate supervision of the business and management of the Corporation.

The strategic planning and business objectives developed by Management are submitted to and reviewed by the full Board of Directors, both on a formal annual basis and on an on-going basis through regular interim reports from Management. The full Board also reviews and approves the annual financial statements, the annual report, 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.

The Board meets a minimum of four times a year and more frequently if required.

Independence of Management

Five of the Board's eight directors are unrelated. An unrelated director is defined to be a director who is independent of management and is free from any interest and any business or other relationship which could, or could be reasonably be perceived to, materially interfere with the director's ability to act with a view to the best interests of the corporation, other than interests and relationships arising from shareholding.

The Board is satisfied that it maintains adequate and appropriate independence from management. All directors, each of whom has considerable business experience, are expected and encouraged to exercise their independent judgment. To facilitate this, a majority of members of all committees, with the exception of the Pre-Clearance Committee, are unrelated directors.

Board Committees

Audit Committee Members
William Burton, John Byrne, David Carnell

Compensation Committee Members
William Burton, David Carnell, J.C. Cowan

Corporate Governance and Disclosure Policy Committee Members
William Burton, David Carnell, J.C. Cowan

Pre-Clearance Committee Members
Peter Akerley, J.C. Cowan, Kenneth MacDonald

Lotus Centre, Ulaanbaatar

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 earn the trust of the communities where we work by making a positive contribution to their sustainable economic development.

People & Community

Erdene is committed to supporting the communities that host us. We place a priority on hiring local workers where we can, and we are always eager to assist in supporting local community development projects. Our management team has developed strong relationships with local, provincial and state levels of government. Below is a list of some of the projects we have supported over the past few years.

- Provided material to upgrade facilities at the Lotus Centre, an Ulaanbaatar orphanage.
- Funded scholarships and provided financial support for students undertaking graduate and post-graduate thesis work at Ulaanbaatar universities.
- Provided hospital and school supplies to local villages proximal to exploration areas.
- Drilled new water hole and repaired water pump in village near exploration area. Transported water to village daily until pump was repaired.
- Funding the first year's expenditures of a new kindergarten in north-western Mongolia.

Environment

Mongolia has a well-preserved and unique ecology, and Erdene is committed to the highest standards of environmental stewardship. While we do not currently have mining operations, our objective is to minimize our environmental footprint. Erdene files an environmental protection and reclamation plan with the Governor of each district in which we operate, and we work to ensure those plans exceed requirements.

Management's Discussion & Analysis of Operating Results

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, 2005 and 2004 and its financial position as at December 31, 2005 and December 31, 2004. The following discussion and analysis provides a summary of selected consolidated financial information for the years ended December 31, 2005 and 2004 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. They also include the wholly-owned subsidiaries 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. The following information should be read in conjunction with the audited consolidated financial statements of the Company for the years ended December 31, 2005 and 2004, 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 17, 2006 and is subject to change after that date.

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

1.1 Date of Report

This report is prepared as of March 17, 2006

1.2 Nature of Business & Overall Performance

General

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

The Company is well-funded and is primarily engaged in exploration and development of mineral deposits. The Company is principally focused on the discovery and acquisition of large tonnage, low cost, gold, copper, molybdenum, uranium and coal deposits in Mongolia. In addition, the Company is involved in a program of seeking out and acquiring small to mid-size mineral projects in Mongolia and elsewhere with near-term cash flow potential. At December 31, 2005 the Company held 71 mineral licenses in Mongolia representing 20 projects covering approximately 4 million acres.

Agreement with Gallant Minerals Limited

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

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

a) US$275,000;
b) Direct or indirect expenditures aggregating $US1,000,000 on the properties acquired or under option to acquire; and,
c) 1,200,000 common shares of the Company.

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

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

Agreement with International Uranium Corporation

On June 14, 2005, pursuant to an April 4th Memorandum of Understanding with International Uranium Corporation ("IUC"), the Company granted International Uranium Mongolia Ltd. ("IUM") the exclusive right and option to acquire a 65 per cent interest in its uranium properties. IUM must spend $6,000,000 of eligible expenditures on the properties over a period of up to four years. The Company was the operator for the first year of the exploration program in 2005. The full cost of this program of $490,031 was fully funded by IUM. The Company and IUM have also formed a strategic alliance for the purpose of staking additional ground in Mongolia for the exploration of uranium over a three year period. In addition, IUC purchased 1.0 million common shares of Erdene at a price of $1.00 per share by way of a private placement. A finder's fee totaling $60,000 was paid in connection with this transaction.

2005 Exploration Program

The Company commenced its 2005 exploration field work activities in April, 2005. The objectives of the overall 2005 exploration program were:

- To conduct advanced level programs on each of its four core Mongolian projects, Zuun Mod, Virgin, Erdenet and the Uranium land package.
- To conduct programs on each of its four second tier projects, Wild Mountain, Shurtiin Khundii, Biger and Tsenkher Gol, to ascertain the potential to advance these properties to core projects.
- To perform more preliminary, reconnaissance exploration activities on a number of its remaining early-stage properties. The Company's exploration program is led by a senior management team with extensive exploration experience in Mongolia and globally.

The total budget for 2005 was $5.6 million and actual expenditures for the year amounted to $5.2 million. The Company will continue to fund operating losses and exploration expenditures out of existing working capital that amounted to $4.2 million at December 31, 2005.

The Company continued to expand the scope of its exploration activity in 2005. Total exploration expenses, before recovery of exploration partner contributions during 2005 from IUM, amounted to $4.3 million as compared to $3.4 million in 2004. The Company's loss increased to $5 million for fiscal 2005 from $4.4 million in 2004, primarily as a result of the expanded exploration program.

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

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

1.4 Results of Operations

The Company had a loss of $4,981,314 in the year ended December 31, 2005, as compared to a loss of $4,436,620 during the same period last year.

Exploration expenses in 2005 amounted to $3,841,959 compared to $3,435,009 in the previous year. The following schedule summarizes the resource property interests capitalized to the end of 2005 and 2004 and the exploration expenses charged to operations in fiscal 2005 and 2004, by project:

Year ended December 31, 2005

	Payments under Gallant Option Agreement	Properties under Gallant Option Agreement					Wholly Owned Properties				Total
		Zuun Mod	Tsenkher Gol	Erdenet, Ikh Tal	Biger	Other	Energy	Virgin	Wild Mountain	Other	
		$	$	$	$	$	$	$	$	$	$
Resource Properties											
Balance, Dec. 31, 2004	**44,690**	**–**	**–**	**–**	**–**	**–**	**16,208**	**107,893**	**63,369**	**416,137**	**648,297**
Resource property additions	1,166,469	–	–	–	–	–	76,611	148,069	2,817	17,536	1,411,502
Write off of resource properties	–	–	–	–	–	–	–	–	–	(26,729)	(26,729)
Exploration partner contributions	–	–	–	–	–	–	(31,362)	–	–	–	(31,362)
Resource Properties at Dec. 31, 2005	**1,211,159**	**–**	**–**	**–**	**–**	**–**	**61,457**	**255,962**	**66,186**	**406,944**	**2,001,708**
Exploration Expenses (cumulative)											
Expensed to Dec. 31, 2004	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**2,714,478**	**42,755**	**975,998**	**3,733,231**
Diamond Drilling	–	1,129,771	–	87,445	–	–	117,470	358,955	–	–	1,693,641
Assaying and Analytical	–	47,736	99,998	4,458	15,209	16,354	16,365	66,769	7,291	–	274,180
Geological Services	–	115,501	72,041	35,659	10,481	270,690	231,124	53,795	54,812	3,571	847,674
Geo-technical Surveys	–	55,154	63,131	70,189	–	17,82	–	98,207	8,062	5,704	318,275
Logistical and Field Support	–	268,295	88,273	55,151	4,088	37,729	289,081	122,374	53,561	13,034	931,586
Professional fees	–	–	–	–	–	67,811	24,020	–	–	–	91,831
Travel	–	8,544	–	6,015	–	105,453	7,537	14,407	6,246	9,219	157,421
Other	–	302	11,654	60	121	374	2,837	193	261	1,580	17,382
Exploration partner contributions	–	–	–	–	–	–	(490,031)	–	–	–	(490,031)
Total for the year ended Dec. 31, 2005	**–**	**1,625,303**	**335,097**	**258,977**	**29,899**	**516,239**	**198,403**	**714,700**	**130,233**	**33,108**	**3,841,959**
Cumulative Exploration to Dec. 31, 2005	**–**	**1,625,303**	**335,097**	**258,977**	**29,899**	**516,239**	**198,403**	**3,429,178**	**172,988**	**1,009,106**	**7,575,190**

Year ended December 31, 2004

	Payments under Gallant Option Agreement	Properties under Gallant Option Agreement					Wholly Owned Properties				Total
		Zuun Mod	Tsenkher Gol	Erdenet, Ikh Tal	Biger	Other	Energy	Virgin	Wild Mountain	Other	
		$	$	$	$	$	$	$	$	$	$
Resource Properties											
Balance, Dec. 31, 2003	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**77,380**	**60,320**	**400,883**	**538,583**
Resource property additions	44,690	–	–	–	–	–	16,208	30,513	3,049	21,732	116,192
Write off of resource properties	–	–	–	–	–	–	–	–	–	(6,478)	(6,478)
Resource Properties at Dec. 31, 2004	**44,690**	**–**	**–**	**–**	**–**	**–**	**16,208**	**107,893**	**63,369**	**416,137**	**648,297**
Exploration Expenses (cumulative)											
Expensed to Dec. 31, 2003	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**254,059**	**5,461**	**38,702**	**298,222**
Diamond Drilling	–	–	–	–	–	–	–	1,105,092	–	268,177	1,373,269
Assaying and Analytical	–	–	–	–	–	–	–	146,156	4,054	79,917	230,127
Geological Services	–	–	–	–	–	–	–	163,138	4,698	269,580	437,416
Geo-technical Surveys	–	–	–	–	–	–	–	383,737	5,599	8,456	397,792
Logistical and Field Support	–	–	–	–	–	–	–	529,966	22,943	311,166	864,075
Professional fees	–	–	–	–	–	–	–	14,936	–	–	14,936
Travel	–	–	–	–	–	–	–	116,720	–	–	116,720
Other	–	–	–	–	–	–	–	674	–	–	674
Total for the year ended Dec. 31, 2004	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**2,460,419**	**37,294**	**937,296**	**3,435,009**
Cumulative exploration to Dec. 31, 2004	**–**	**–**	**–**	**–**	**–**	**–**	**-**	**2,714,478**	**42,755**	**975,998**	**3,733,231**

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

All direct costs related to the acquisition of resource property interests have been capitalized as an asset which during 2005 amounted to $1,380,140 and the aggregate costs of resource properties that have or plan to be abandoned have been charged to operations which during 2005 amounted to $26,729 resulting in a net addition for the year of $1,353,411. Resource property interest additions in 2004 amounted to $116,193 and resource property write offs during the same year were $6,478 resulting in net additions for 2004 of $109,715.

General and administrative expenses increased in 2005 to $1,394,030 from $1,106,051 in 2004 as a result of costs associated with the Company making application and graduating from the TSX Venture Exchange to the TSX which became effective on December 14, 2005, increased administrative services costs as a result of greater administrative demands on the Company associated with supporting a more extensive exploration program in 2005 as well as increased regulatory compliance requirements, higher travel costs associated with increased corporate activity and increased travel associated with higher investor relations activity and conference attendance in 2005.

Other income amounted to $254,675 in 2005 compared with $104,440 in 2004. The primary reason for the $150,235 increase from 2004 was a result of the Company recognizing an $88,566 foreign exchange gain in 2005 compared with a $114,830 foreign exchange loss in 2004. This was partially offset by a $20,251 increase in the write down of resource properties in 2005, and a $28,249 decrease in interest revenue due to lower cash balances held in 2005 compared to 2004. The foreign exchange gain in 2005 of $88,566 was realized primarily in the first half of 2005 which accounted for approximately $68,000 of the gain when the Company was holding large US dollar denominated cash as the US dollar strengthened against the Canadian dollar.

During the second half of 2005 the Company changed its foreign exchange strategy to only purchasing US dollar requirements when needed on a spot basis, where it was able to recognize a further gain of approximately $20,000 during a period of a strengthening Canadian dollar versus the US dollar. The exchange loss of $114,830 in 2004 was a result of holding higher US dollar denominated liquid assets at a time when the US dollar weakened against the Canadian dollar. The loss for 2005 was $4,981,314 or $0.19 per common share as compared with a loss of $4,436,620 or $0.19 per common share in 2004.

As an exploration company that charges exploration costs to operations until an economically recoverable resource has been identified, reported losses vary directly with the extent of the exploration programs conducted. As the Company obtains exploration results from existing resource properties (and those it acquires) that justify and enable further equity financing and continued exploration programs, reported losses will continue and will vary with the extent of exploration activity until such time as economically recoverable resources are identified that warrant development to generate sustainable revenues from operations. Conversely, should exploration results not justify further equity financing or should further equity financing not be available or insufficient to conduct planned exploration programs, exploration activity would be reduced with exploration funds directed toward projects with highest potential, resulting in lower reported losses. During the calendar years ended December 31, 2005 and 2004, all of the Company's properties were in the exploration phase and accordingly, all exploration costs were charged to operations in the respective periods. There can be no assurance that the Company's properties will contain an economically recoverable resource.

A summary of exploration highlights during 2005 is presented later in this report in Section 1.16.

1.5 Summary of Quarterly Results

Expressed in thousands of Canadian dollars except per share amounts

	Fiscal 2005				Fiscal 2004			
	Q4 Dec-05	Q3 Sep-05	Q2 Jun-05	Q1 Mar-05	Q4 Dec-05	Q3 Sep-05	Q2 Jun-05	Q1 Mar-05
Revenue	**28**	**54**	**53**	**35**	43	67	63	25
Loss	**1,209**	**1,573**	**1,692**	**507**	1,110	2,417	703	207
Basic and diluted loss per share	**0.05**	**0.06**	**0.06**	**0.02**	0.04	0.11	0.03	0.01
Total Assets	**6,649**	**7,924**	**9,375**	**9,806**	9,426	11,022	12,578	13,319

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

1.6 Liquidity and Capital Resources

The Company had working capital at December 31, 2005 of $4.2 million representing a decrease of $4.3 million from the December 31, 2004 working capital position of $8.5 million. The decrease is primarily due to expenditures related to the Company's 2005 exploration program and general and administrative costs in support of this program offset by just over $1 million of equity proceeds during the year.

The year end working capital of $4.2 million, in addition to the $3 million raised from the Xstrata agreement of February 16, 2006 (referred to in section 1.11 below), will enable the Company to fund its 2006 exploration program and meet its property and contractual commitments for the next 24 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, 2005, $1,380,140 was expended on additions to resource property interests offset by a write-down of resource properties of $26,729, compared with additions of $116,193 and write-downs of $6,478 during 2004. Of the $1,380,140 expended in 2005, $796,831 was non cash payments made as part of the Gallant Agreement ($400,000 in common shares and the fair value of warrants at issue date, totalling $396,831(see section 1.2)). During the year ended December 31, 2005 the Company expended $38,599, predominantly on software and computer equipment. The 2004 expenditures of $117,604 were primarily for software and computer, office and field equipment to support the exploration program.

Although 2006 budgets were not finalized at the time of this report, the Company estimates it will spend approximately $5.0 million on its 2006 exploration program and general and administrative costs to support that program. In addition, the Company's partners have proposed to spend an additional $1.7 million in exploration on joint venture properties.

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

1.7 Contractual Obligations

As of December 31, 2005 the Company is committed to the following obligations:

- The Company has entered into an operating lease for office space until August 31, 2011 representing total payments of $288,778 to the end of the lease. The Company has the right to terminate the lease by giving notice prior to the anniversary date, after 2007.
- Pursuant to the Gallant Agreement (see section 1.2), the Company is committed to the following deliverables:
  - > On or before March 1, 2006, the Company shall deliver to Gallant 500,000 shares of Erdene and a payment of US$125,000. This obligation was met on March 1, 2006;
  - > On or before March 1, 2007, the Company shall deliver to Gallant 700,000 shares of Erdene and a payment of US$150,000.

1.8 Off-Balance Sheet Arrangements

As at December 31, 2005 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.

1.9 Transactions with Related Parties

Fisher Transport Limited, a company owned by the Vice-President of Finance and CFO of the Company (also a director), provided management and administrative services to the Company for the year ended December 31, 2005. The cost of these services, aggregating $114,922 and measured at fair market value, was charged to administrative expenses (2004 - $122,836).

J.C. Cowan, a director of the Company and a managing director of the Company's subsidiaries, provided management and technical services to the Company for the year ended December 31, 2005. The cost of the management and technical services, aggregating $102,000 and measured at fair market value, was charged to geological services (2004 - $66,000).

1.10 Fourth Quarter

There were no unusual events or items during the fourth quarter of 2005 that affected the Company's financial condition, cash flows or results of operations in a material nature.

1.11 Proposed Transactions

Xstrata Coal Agreement

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 Erdene at $1.00 per share, resulting in Xstrata owing a 9.8% equity interest in the Company.

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 was granted the right to name a nominee to the Board of Directors of the Company and on March 1, 2006 the Company announced that Jeffrey Gerard, General Manager Business Strategy for Xstrata Coal, Plc was named 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 Xstrata to hold up to 9.9% of the common shares of the Company.

Proposed Acquisition of Kaoclay Resources Inc

On February 21, 2006 the Company announced it reached an agreement with Kaoclay Resources Inc. ("Kaoclay") whereby the Company will acquire all of the outstanding shares of Kaoclay in exchange for shares and warrants of Erdene. Under the agreement, each Kaoclay share will be exchanged for 1.65 Erdene shares and a half warrant with each full warrant entitling the holder to purchase an Erdene share at $1.60 for a period of three years from closing. All of the directors of Kaoclay who own or control shares have agreed to vote their shares in support of the transaction. Kaoclay will be entitled to name two nominees to the Board of Directors of the Company. The transaction must be approved by the shareholders of Kaoclay and is subject to the receipt of all required regulatory and court approvals. If all required approvals are received, it is expected that closing will take place in late May or early June.

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

Erdene shares outstanding at date of offer	30,599,933
Kaoclay shares outstanding	8,979,950
Exchange ratio	1.65
Equivalent Erdene shares to be issued to Kaoclay shareholders	14,816,918
Erdene post acquisition shares outstanding	45,416,851

1.12 Critical Accounting Estimates

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

The acquisition cost of resource properties are recorded as an asset on the balance sheet under the caption resource property interests until such time as the related property(ies) commence commercial production at which time it will be depleted against related mine revenue from the property(ies) or when the Company determines the carrying value of a property cannot be recovered, in which case the carrying value will be written off or down to its recoverable value. Since the Company charges all exploration costs to operations when incurred, and ultimately to deficit, until potential for an economically recoverable resource has been identified, management feels confident that the recoverable value of its resource properties equals or exceeds its carrying value on the Company's balance sheet at December 31, 2005.

The $694,431 the Company determined in 2005 as 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 2005 (55% in 2004). 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.

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.

1.13 Changes in Accounting Policies

The accounting policies applied in the preparation of the December 31, 2005 audited consolidated financial statements did not differ from those applied in the preparation of the December 31, 2004 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, 2005 audited consolidated financial statements.

1.14 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.

1.15 Outstanding Share Data

See Note 6 to the December 31, 2005 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, 2005 and 2004.

Subsequent to December 31, 2005 the following changes occurred in the Company's outstanding share data:

	Number of Shares
Balance December 31, 2005	27,269,635
Issued to March 15, 2006	
On exercise of warrants	1,008,575
Pursuant to Gallant Minerals option agreement	500,000
On closing of the Xstrata agreement	3,000,000
	31,778,210

On February 16, 2006 the Company committed to issue, pursuant to the Xstrata Agreement described in Section 1.11 of this report, 3,000,000 common 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 1.2). The issuance of common shares subsequent to December 31, 2005, including the issuance of a total of 1,008,575 common shares on exercise of warrants, described below, brings the outstanding common shares at the date of this report to 31,778,210 shares.

Warrants

During the year ended December 31, 2005, the company issued 800,000 warrants to Gallant Minerals in conjunction with an agreement signed on March 1, 2005 (see Section 1.02); and 70,725 warrants were exercised at $0.85 per share for gross proceeds of $60,116. Subsequent to December 31, 2005, 1,008,575 warrants were exercised for total gross proceeds of $780,788. (828,575 warrants at $0.85 per share and 180,000 warrants at $0.425 per share) and 700 expired, bringing the outstanding warrants at the date of this report to 1,580,000.

Stock Options

During the year ended December 31, 2005, 25,000 options were exercised to purchase 25,000 common shares of the Company at $0.85 per share for proceeds of $21,250; and 560,000 options were granted to certain directors, employees and contractors, bringing the outstanding options at the date of this report to 2,330,000.

1.16 Exploration Results

Overview

During the year the Company carried out exploration on its 100% owned properties as well as properties the Company has acquired, or has the option to acquire, through an agreement dated March 1, 2005 with Gallant Minerals Ltd ("Erdene-Gallant Agreement"). Through the Erdene-Gallant Agreement, the Company has acquired nine uranium exploration licenses which are registered under the name of Erdene Energy, a wholly owned subsidiary of the Company. These nine exploration licenses are subject to a 1% NSR Royalty, which can be reduced to 0.5% in certain circumstances by making certain payments. Also through the Erdene-Gallant Agreement, the Company has the option to acquire a number of additional licenses. These licenses are registered in the name of Anian Resources XXK, a wholly owned subsidiary of Tamerlane International Limited. The Company may acquire 100% of the outstanding shares of Tamerlane International Limited by fulfilling certain obligations by February 28, 2007. Upon exercise of the option, the licenses are subject to a 1.5% NSR Royalty, which can be reduced to 0.5% in certain circumstances by making certain payments. The following is a brief summary of the highlights from each of the Company's 2005 exploration projects.

Zuun Mod Porphyry Molybdenum Project

The Zuun Mod property is a porphyry molybdenum prospect located in Bayankhongor Province approximately 950km southwest of Ulaanbaatar and 180km north of the Mongolia-China border. The property consists of two adjoining licenses totaling 90,344 hectares. The licenses are registered in the name of Anian Resources XXK and subject to the agreement with Gallant Minerals Limited (refer to section 1.2).

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

A program of detailed surface exploration over the Zuun Mod property was started in March 2005. This work included geological mapping and ground geophysics (gradient and dipole-dipole IP). The purpose of this work was to refine previous geological and geophysical survey work. Discrete zones of high chargeability and resistivity were identified coincident with zones of intense alteration and associated stockwork quartz veins. The surface mapping work also led to recognition of northeast and northwest-trending, fault-bounded, structural corridors that are the primary hosts to areas of anomalous molybdenum and copper-in-rock and soil geochemistry and significant copper-molybdenum intersections reported from the drill programs. The northeast-trending, 'South Corridor' extends over a distance of approximately 4km and contains three target areas identified by the Company, namely the Intersection, Racetrack and Stockwork Zones. The northwest-trending 'North Corridor' extends over a distance of 2.25km and contains an area of anomalous copper-molybdenum mineralization.

A nine hole, 2,672m drill program beginning in April 2005 (ZMD-01 to ZMD-09). The program was designed to extend areas of copper-molybdenum mineralization intersected in previous drilling and to test additional geological and geophysical targets. A review of this drilling resulted in a further two holes (ZMD-10, 11) totalling 932m being completed by the Company in July 2005. Of these first 11 holes, ZMD-11 intersected molybdenum mineralization of sufficient grade and width to be considered potentially economic; three holes (ZMD-01, 05, 10) intersected molybdenum mineralization of sufficient grade and width to be considered anomalous and perhaps indicative of more substantial mineralization nearby while of the remaining seven holes (ZMD-02, 03, 04, 06, 07, 08 and 09) did not intersect any significant copper or molybdenum mineralization.

Erdene commissioned an independent technical review of the Zuun Mod Porphyry Molybdenum - Copper Project in south-central Mongolia in accordance with National Instrument 43-101. The report was completed in September of 2005. In conjunction with recommendation from the independent consultant, the Company carried out a six hole, 1,793 metre drilling program to further delineate the molybdenum mineralization within the Racetrack and Stockwork Zones (ZMD-12, 13, 14) as well as testing targets near the Intersection Zone (ZMD-15, 16) and a regional exploration target two kilometres northwest of the Racetrack Zone (ZMD-17). Holes ZMD-12 and 13 intersected molybdenum mineralization of sufficient grade and width to be considered potentially economic; three holes (ZMD-14, 15, 16) intersected molybdenum mineralization of sufficient grade and width to be considered anomalous and perhaps indicative of more substantial mineralization nearby while of the remaining hole (ZMD-17) did not intersect any significant copper or molybdenum mineralization.

The most recent drill results further strengthen management's view that Zuun Mod hosts a potentially economic molybdenum resource. The increasing grades near surface in the southern portion of the Racetrack zone, significant thickness of mineralized zones and the large untested areas remaining, attest to the potential of the Zuun Mod project. Because of these factors and the project's close proximity to Chinese markets, processing capacity and infrastructure, the Company's management is very positive about the potential of the project. Scoping study components and drilling are expected to continue throughout 2006.

Erdenet Ikh-Tal Porphyry Copper Project

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

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

Erdene commenced exploration on the Erdenet properties in May of 2005 with reconnaissance mapping on the license immediately west of the Erdenet Mine open pit. Mapping of the sparse outcrop in this area identified weathered biotite granodiorite with some quartz-pyrite veining. Rock geochemical samples have returned multiple anomalous results from the area.

Magnetic and gradient IP surveys were carried out over an 80 line km grid on License 3963 adjacent to the western boundary of the Erdenet open pit. The survey outlined an E-W trending chargeability anomaly 2.2km long and 250m wide which is coincident with the anomalous rock chip samples and satellite imagery anomalies. A dipole-dipole IP survey was also completed on eight selected lines over the gradient anomalies. Results showed large (300m wide) low level (8mv) chargeability anomalies on several lines.

Three vertical diamond drill holes were collared in the area west of the Erdenet open pit using two drills from Erdenet mine to test gradient and co-incident high chargeability dipole anomalies. No significant mineralization was intersected in any of these holes and assays were routinely less than 0.1% copper and 0.003% molybdenum.

Reconnaissance mapping and sampling were carried out in July in the Tsagaan Chuluut area located northwest of the Erdenet Mine site. No significant mineralization or alteration was identified except in a construction pit where quartz-sericite-pyrite altered volcanic returned values up to 1% copper. A magnetic and subsequent gradient IP survey was carried out over this area and outlined a weak magnetic anomaly coincident with a discontinuous weak chargeability high with moderate resistivity over the southern part of area.

Reconnaissance mapping and sampling was also carried out in the Baglai area located just east of the Erdenet Mine open pit. Strong phyllic and argillic alteration with disseminated pyrite was identified in Erdenet complex microgranite and volcanics in the northeastern and south central part of the Baglai area. A magnetic survey and subsequent gradient IP survey was carried out over the Baglai area. These surveys outlined two areas of low magnetics co-incident with the alteration zones outlined in the mapping. These areas also exhibited strong high chargeability anomalies and co-incident resistivity highs. A dipole-dipole survey was completed in November on three lines at 200m spacing for a total of 9.6 line kilometers which covered part of the alteration zones and gradient anomalies previously outlined before the survey was interrupted by weather conditions. This survey outlined a strong 600m by 900m high chargeability and high resistivity anomaly in the northeastern Bagali area adjacent to the Erdenet open pit and several other 200m by 200m anomalies in the south central area. All these anomalies are open to the east and at depths of plus 300m.

Compilation of the results of the Company's exploration results to date and previous work completed by Erdenet Mine was in progress at year end in order to select and prioritize diamond drill targets for testing in 2006.

Energy Project – Uranium

Erdene holds 31 exploration licenses in south eastern Mongolia totaling 1,178,488 hectares. All of the licenses are registered in the name of Erdene Mongol or Erdene Energy, both of which are wholly owned by the Company. Nine of these licenses were acquired from Gallant Minerals Ltd and are subject to a 1% NSR Royalty, which can be reduced to 0.5% in certain circumstances by making certain payments (refer to section 1.2).

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.

As a result of the extensive reconnaissance program, three properties were chosen for more detailed surface exploration, Durvuljin Uul, Yant and Galshar Uul. Target structures are believed to represent efficient conduits for oxygen-rich surface waters that can leach and mobilize metals to form roll-front type uranium deposits suitable for in-situ leach ("ISL") mining.

Durvuljin Uul

This property is located approximately 50km northeast of the town on Sainshand and is situated within the defined uraniferous Sainshand Basin which is host to the Nars uranium deposit, located about 12km to the southwest. Three target areas have been identified on this property the largest of which extends over an area of 800m by 500m. The targets are characterized by highly anomalous radiometrics measuring from 500 to 9,800tcps (total counts per second), spectrometer values of 50 to 350ppm uranium and rock geochemical assays ranging from 100 to 1,300ppm uranium. Anomalous areas are typically underlain by mottled sandstone and siltstone.

Yant

This property is located approximately 60km west of Sainshand, where two anomalous target areas have been defined. Maximum scintillometer reading of 4,500tcps within unconsolidated carbonaceous siltstone have been identified. Two grab samples returned assays of 106ppm and 101ppm uranium while soil samples have returned assays of up to 984ppm uranium.

Galshar Uul

This property is located in the northeast part of the large Galshar Property block located 200 kilometres north of the Chinese border. Three target areas have been identified along a 2 kilometre long by 300 metre wide, northwest-trending zone of high radiometrics ranging from 500 to 2,700 tcps with spectrometer readings of 200 to 300 ppm uranium. This orientation conforms to regional structural trends and accordingly infers a structural and/or stratigraphic control for possible mineralization.

A reverse-circulation drilling program, including 8 holes totaling 546 metres was carried out from September to November to test the defined target areas at Durvuljin Uul, Yant and Galshar Uul. Of the seven targets drilled only one was tested satisfactorily with the remaining six untested at depth due to difficulty experienced with the reverse-circulation drill encountering thick near-surface clay horizons. The 2006 exploration program is being managed by International uranium Corporation who are planning to drill test the uranium potential on the Erdene controlled licences.

Energy Project – Coal

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

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

Hole CDD-01 intersected coal mixed with shale and clay beginning at 25 metres with continuous coal from 54 metres through 103 metres. The vertical hole was terminated at 107 metres in mixed coal and clay-rich sediments. Visual determinations suggest the quality of the coal varies from black, low to medium luster coal, to massive brown coal, over intervals ranging from 1 to 14 metres. Historical testing, as well as results from recent grab samples taken by the Company from the operating mine, indicate an average heating value of 5900 kcal/kg (10,600 BTU/lb). The coal seam is hosted in a northeast trending basin open to the northeast and bounded to the southwest by a fault which is interpreted to have shifted the coal seam to a depth greater than 100 metres. This interpretation is supported by a second hole (CDD-02), collared 550 metres southeast of CDD-01, drilled to 91.3 metres, that failed to intersect any significant coal. Previous drilling indicates that the coal beds in the Galshar coal project area are relatively flat lying with coal seam thicknesses of 5 to 30 metres over a strike length of three kilometres.

Quality analysis and evaluation is now underway to determine the thermal properties of the Galshar coal and the potential for the project to support domestic and export coal markets.

Tsenkher Gol Gold Project

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

The 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.

The 2005 exploration program completed at the Tsenkher Gol gold project identified the presence of widespread, highly anomalous gold bearing zones. The work program entailed soil sampling, rock-chip sampling, trenching, magnetic surveys and gradient and dipole-dipole induced polarization surveys on the main targets zones. The results have highlighted three main gold-bearing zones including Altan Suult, SE Khond Uul, and NW Khond Uul. These zones occupy an area of 10 square kilometres and are characterized by high-grade quartz veins (grab samples up to 179 g/t gold) and lower gold values associated with disseminated sulphides in the host altered granite. All three zones show evidence indicating strong structural control of gold mineralization. Structures of importance appear to be NW and EW trending as well as zones of intersection between these two structural trends.

Gold mineralization is typically contained within shear zones, sheeted and stockwork quartz veining, breccias, and as disseminations hosted within quartz-sericite-pyrite altered granitoids. Preliminary results of one-metre interval chip sampling from trenches indicate wide (10 metres -14 metres) intersections of low-grade (0.22g – 1.2g) gold mineralization in the SE Khond Uul Zone and individual quartz vein bearing samples which assay up to 7.33 g/t. Gradient induced polarization survey results indicate large, structurally oriented resistivity and chargeability anomalies that correlate with each of the three main gold bearing alteration zones. A dipole-dipole survey across the Altan Suult and SE Khond Uul alteration zones indicate that the anomalies extend to depth.

The encouraging results from the surface exploration program that confirmed previous work performed on the property, combined with supporting geophysical survey interpretation, place the Tsenkher Gol property as a high priority project for the 2006 field season.

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 12,522 hectare license. The licenses are registered in the name of Anian Resources XXK and subject to the agreement with Gallant Minerals Limited (refer to section 1.2).

The Biger project is an alkalic porphyry system with potential to host significant copper-gold-platinum mineralization, both in hypogene and supergene mineralization. Biger is an early stage exploration project, located within the Tien Shan terranes of the Gobi. Previous work documented over 30 copper occurrences in the area. Initial reconnaissance confirmed the presence of significant copper mineralization, with strongly elevated palladium, gold, and platinum. The mineralization and alteration zones are hosted within a large, magnetic dioritic to gabbroic intrusive. 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). Much of the prospective target area is covered beneath Quaternary and Cretaceous alluvium, suggesting the possibility for a preserved, supergene enriched deposit.

The project area was tested by the Company with three drill holes in 2005. The Altan Khad pediment outlier zone at the Biger property provided the best intersection with 24m of 0.5% copper (BGD-03, 94 to 118m). This is an isolated hole 6km from BGD-01 and located in a granodiorite exposure protruding through a relatively thin pediment. Previous surface sampling of this exposure returned highly anomalous platinum and palladium values. Three holes were drilled for a total of 610.10m. The drill targets include zones of highly anomalous copper-gold-platinum group elements rock geochemistry, coincident with circular magnetic anomalies, and zones of potassic alteration. The style of mineralization and alteration encountered in the drillholes are consistent with an alkaline copper-gold-platinum group elements porphyry system. BGD-03 intersected 24m of 0.5% copper, (94 to 118m), and 14m of 0.1% copper (174-188m). Copper mineralization occurs as trace to 2% concentrations of disseminated and fracture-fill chalcopyrite + copper-oxide, hosted within potassic altered diorite and gabbrodiorite intrusive. The upper intercept also contains elevated gold and palladium, 22m of 88ppb gold and 88ppb palladium (96 to 118m).

Temuujin Porphyry Copper Gold Project, Virgin Property

The large Virgin property consists of eight contiguous licenses covering 216,271 hectares. The property is located approximately 500km southeast of Ulaanbaatar in Sukhbaatar and Dorngovi provinces. All licenses are 100% owned by the Company and are registered in the name of Erdene Mongol XXK.

The Virgin property and its Temuujin prospect area are situated within the inferred northeast continuation of the island-arc environment which hosts significant copper-gold porphyry mineral deposits, including the world-class Hugo deposit at Oyu Tolgoi. The Company's exploration to date has focused on the 20 by 8km Temuujin district in the northeast part of the 95km long Virgin claim block where a copper-gold discovery was made in 2003. Drilling has confirmed a porphyry-related deposit environment within the Temuujin area. Extensive porphyry-type propylitic and phyllic alteration within andesitic volcanic rocks and sulphide-rich, tourmalinized and quartz stockworked monzonite intrusive intersected in the Temuujin II area are typical of the distal part of a zoned porphyry system. Drill results also suggest the presence of porphyry-related alteration and potential mineralized environments at the Togrug Uul, Temuujin I and Temuujin IV prospect areas.

2005 Exploration Program

A complete review of all exploration results to the end of 2004 indicated that the mineralization and alteration observed within the Temuujin district was typical of the distal portion of a zoned porphyry system. Geological, geochemical and geophysical evidence indicated that the center of the porphyry system may be at depth. As a result, a 'TITAN-24 Deep Earth Imaging System' survey was completed over the Temuujin II porphyry copper-gold prospect in early June. Titan is a state-of-the-art geophysical system developed and operated by Quantec Geosciences Inc. of Canada. This system offers the potential to identify mineral anomalies at depths ranging from near surface to greater than 1000 metres below the earth's surface. The survey was successful in identifying an Induced Polarization (IP) anomaly that distinctly intensifies below the two holes drilled at Temuujin II. This has been interpreted as indicating the potential of an increase in the intensity of mineralization with depth.

Three diamond drill holes (TDD-2A, TDD-20, TDD-21) totaling 1,743 metres were completed in September 2005. Holes TDD-2A and 20 were collared to investigate a broad

Titan IP high chargeability anomaly centered over the Temuujin II prospect. Hole TDD-21 was drilled in the Temuujin II West grid area to test the western extension of a high chargeability IP anomaly defined in 2004 coincident with the tourmaline monzogranite dyke.

The two holes testing the Titan anomaly intersected generally intense propylitic andesite with an overprint of intense phyllic alteration over widths varying from 1 metre to 10 metres. The propylitic alteration zones include some minor gold (up to 0.3g/t), copper (up to 0.08%) and zinc (up to 0.5%) enrichment over two-metre wide intervals. Phyllic altered zones also have significant gold enrichment (up to 1.2g/t) over isolated two-metre intervals.

Hole TDD-21 was collared 1.3 kilometres west of previous scout drilling to test a sulphide-bearing tourmaline breccia zone exposed on surface in the Temuujin II west grid area. The hole intersected an approximate 60 metre wide zone (21 to 81 metres) of an argillic (clay)-altered, tourmaline-bearing intrusive monzonite to intrusive breccia Assay results are consistent with previous assays of the monzonite, characterized by enriched arsenic (up to 0.13% arsenic) and low concentrations of gold and copper.

Previous 2004 scout drilling and the results of the recent three drill holes identify the Temuujin II prospect as an area of porphyry-related alteration and mineralization. Alteration occurs over a four kilometre distance from Temuujin II to the Temuujin II west grid areas coincident with the strike of a tourmaline monzonite dyke. While the program has been successful in confirming a well-mineralized and altered porphyry system, it has not been successful in identifying potentially economic concentrations of copper or gold.

Wild Mountain Copper Gold Project

The Wild Mountain property consists of two contiguous licenses totalling 3,385 hectares located in western Mongolia, approximately 650km southwest of Ulaanbaatar, and about 5km southwest of the village of Altai in Govi-Altai Province. Both licenses are 100% owned by the Company and are registered in the name of Erdene Mongol XXK.

A program of surface mapping and rock sampling, and trenching were completed at Khets Uul in early September. This work confirmed the extent of surface alteration and secondary copper-bearing zones from 2004 exploration. Trenching east and west of the Jugants massive sulphide zone (24 metre trench result of 1.85g/t gold, 11.92 g/t silver and 1.54% copper) in the Khets Uul property identified weak to moderate pyrite alteration up to 100 metres wide that extends along strike over a distance of approximately 1 kilometre. The possibility remains that the Jugant massive sulphide zone represents the near surface exposure of more substantial mineralization occurring down-dip. Channel samples from the westernmost trench (Trench 2) intersected narrow zones (1-2 metres) of silicification and rare quartz veining with maximum assays of 0.18% copper and 5g/t gold. These results effectively confirm the results from 2004 surface sampling which returned a grab sample of 4.9g/t gold. The easternmost trench (Trench 1) intersected a zone of pyrite alteration zone with maximum assays of 0.1% copper and 0.25g/t gold. Several dipole-dipole IP survey lines were also completed across the alteration zone along strike. Several narrow moderate high chargeability anomalies were defined and remain unexplained. The effectiveness of IP surveys is greatly limited by the rugged topography.

1.17 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, 2005, 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.

1.18 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 2006 exploration program on any of its properties will result in an expanded program on the relevant property or properties relative to the significance of the results. Conversely, if anticipated results are not forthcoming on a particular property, a disciplined review and evaluation program will be in place to ensure expenditures are scaled back where management feels they may not be warranted.

1.19 Qualified Persons

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

1.20 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'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.

The board of directors is responsible for ensuring that management fulfills its financial reporting and internal control responsibilities, 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. The external auditors have established their independence from, and have full and free access to, management and the audit committee.

Peter C. Akerley

President & Chief Executive Officer
March 3, 2006

Ken W. MacDonald

Vice President & Chief Financial Officer

Auditors' Report

We have audited the consolidated balance sheets of Erdene Gold Inc. as at December 31, 2005 and 2004 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, 2005 and 2004 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 3, 2006, except as to note 6 which is as of March 17, 2006

Consolidated Balance Sheets

Expressed in Canadian dollars

Years ended December 31	**2005** $	2004 $
## Assets		
Current assets		
Cash and cash equivalents	**4,269,991**	8,579,289
Marketable securities (market value, 2005 - $123,000; 2004 - $38,333)	**50,666**	28,167
Accounts receivable (note 2)	**189,599**	41,369
Prepaid expenses	**12,862**	8,375
	4,523,118	8,657,200
Resource property interests (note 3)	**2,001,708**	648,297
Capital assets, net (note 4)	**123,780**	120,975
	6,648,606	9,426,472
## Liabilities and Shareholders' Equity		
Liabilities		
Accounts payable and accrued liabilities	**253,474**	147,982
Due to related parties (note 5)	**24,902**	21,494
	278,376	169,476
Shareholders' equity		
Share capital (note 6)	**17,372,074**	15,906,210
Contributed surplus (note 7)	**1,201,779**	513,095
Deficit	**(12,203,623)**	(7,162,309)
	6,370,230	9,256,996
Commitments (note 14)		
Subsequent events (note 15)		
	6,648,606	9,426,472

See accompanying notes to consolidated financial statements

Approved on behalf of the Board

David S.B. Carnell, Director

Ken W. MacDonald, Director

Consolidated Statements of Operations and Deficit

Expressed in Canadian dollars

Years ended December 31	2005 $	2004 $
Expenses		
Exploration expenses		
Diamond drilling	**1,693,641**	1,373,269
Analytical and assaying	**274,180**	230,127
Geological services	**847,674**	437,416
Geo-technical surveys	**318,275**	397,792
Logistical and field support	**931,586**	864,075
Professional services	**91,831**	14,936
Travel	**157,421**	116,720
Other	**17,382**	674
Exploration partner contributions	**(490,031)**	–
	3,841,959	3,435,009
General and administrative expenses:		
Depreciation	**30,658**	13,942
Insurance	**40,003**	38,183
Investor relations and communications	**184,708**	193,611
Office	**83,928**	86,016
Professional services	**178,755**	144,522
Regulatory compliance	**139,096**	74,789
Administrative services	**384,688**	253,187
Stock-based compensation	**208,470**	215,105
Travel and accommodations	**112,794**	70,610
Other	**30,930**	16,086
	1,394,030	1,106,051
Other income (expenses)		
Interest revenue	**155,855**	184,104
Gain on sale of resource property	**22,499**	28,167
Foreign exchange	**88,566**	(114,830)
Write down of resource properties	**(26,729)**	(6,478)
Other	**14,484**	13,477
	254,675	104,440
Loss for the year	**4,981,314**	4,436,620
Deficit, beginning of year	**7,162,309**	1,147,571
Share issue costs	**60,000**	1,578,118
Deficit, end of year	**12,203,623**	7,162,309
Basic and diluted loss per share (note 8)	**0.19**	0.19
Weighted average number of common shares outstanding	**26,907,848**	23,114,417

See accompanying notes to consolidated financial statements

Consolidated Statements of Cash Flows

Expressed in Canadian dollars

Years ended December 31	2005 $	2004 $
Cash provided by (used in)		
Operations		
Loss for the year	**(4,981,314)**	(4,436,620)
Items not involving cash		
Depreciation	**35,794**	13,942
Stock-based compensation	**297,601**	287,619
Write down of resource properties	**26,729**	6,478
Gain on sale of resource property	**(22,499)**	(28,167)
Change in non-cash operating working capital	**(43,816)**	86,813
	(4,687,505)	(4,069,935)
Financing		
Issue of common shares for cash	**1,000,000**	10,727,000
Share issue costs	**(60,000)**	(1,354,276)
Issue of common shares on exercise of options and warrants	**60,116**	–
	1,000,116	9,372,724
Investing		
Resource property interests	**(583,310)**	(116,192)
Purchase of capital assets	**(38,599)**	(117,604)
	(621,909)	(233,796)
Increase (decrease) in cash and equivalents	**(4,309,298)**	5,068,993
Cash and equivalents, beginning of year	**8,579,289**	3,510,296
Cash and equivalents, end of year	**4,269,991**	8,579,289

Supplemental cash flow information (note 10)

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended December 31, 2005 and 2004

Nature of business

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

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

1. Summary of Significant Accounting Policies

a) Principles of consolidation

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

b) Use of estimates

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

c) Cash and cash equivalents

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

d) Marketable securities

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

e) Resource property interests

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

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

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

f) Capital assets

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

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

g) Foreign currency translation

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

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

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

h) Income taxes

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

i) Stock-based compensation:

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

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

2. Accounts Receivable

	2005	2004
	$	$
Exploration partner recovery	**114,338**	–
Other	**75,261**	41,369
	189,599	41,369

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

3. Resource Property Interests

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

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

Year ended December 31, 2005

	Payments under Gallant Option Agreement	**Properties under Gallant Option Agreement**					**Wholly Owned Properties**				
		Zuun Mod	Tsenkher Gol	Erdenet, Ikh Tal	Biger	Other	Energy	Virgin	Wild Mountain	Other	Total
		$	$	$	$	$	$	$	$	$	$
Resource Properties											
Balance, Dec. 31, 2004	**44,690**	**–**	**–**	**–**	**–**	**–**	**16,208**	**107,893**	**63,369**	**416,137**	**648,297**
Resource property additions	1,166,469	–	–	–	–	–	76,611	148,069	2,817	17,536	1,411,502
Write off of resource properties	–	–	–	–	–	–	–	–	–	(26,729)	(26,729)
Exploration partner contributions	–	–	–	–	–	–	(31,362)	–	–	–	(31,362)
Resource Properties at Dec. 31, 2005	**1,211,159**	**–**	**–**	**–**	**–**	**–**	**61,457**	**255,962**	**66,186**	**406,944**	**2,001,708**
Exploration Expenses (cumulative)											
Expensed to Dec. 31, 2004	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**2,714,478**	**42,755**	**975,998**	**3,733,231**
Diamond Drilling	–	1,129,771	–	87,445	–	–	117,470	358,955	–	–	1,693,641
Assaying and Analytical	–	47,736	99,998	4,458	15,209	16,354	16,365	66,769	7,291	–	274,180
Geological Services	–	115,501	72,041	35,659	10,481	270,690	231,124	53,795	54,812	3,571	847,674
Geo-technical Surveys	–	55,154	63,131	70,189	–	17,82	–	98,207	8,062	5,704	318,275
Logistical and Field Support	–	268,295	88,273	55,151	4,088	37,729	289,081	122,374	53,561	13,034	931,586
Professional fees	–	–	–	–	–	67,811	24,020	–	–	–	91,831
Travel	–	8,544	–	6,015	–	105,453	7,537	14,407	6,246	9,219	157,421
Other	–	302	11,654	60	121	374	2,837	193	261	1,580	17,382
Exploration partner contributions	–	–	–	–	–	–	(490,031)	–	–	–	(490,031)
Total for the year ended Dec. 31, 2005	**–**	**1,625,303**	**335,097**	**258,977**	**29,899**	**516,239**	**198,403**	**714,700**	**130,233**	**33,108**	**3,841,959**
Cumulative Exploration to Dec. 31, 2005	**–**	**1,625,303**	**335,097**	**258,977**	**29,899**	**516,239**	**198,403**	**3,429,178**	**172,988**	**1,009,106**	**7,575,190**

Year ended December 31, 2004

	Payments under Gallant Option Agreement	**Properties under Gallant Option Agreement**					**Wholly Owned Properties**				
		Zuun Mod	Tsenkher Gol	Erdenet, Ikh Tal	Biger	Other	Energy	Virgin	Wild Mountain	Other	Total
		$	$	$	$	$	$	$	$	$	$
Resource Properties											
Balance, Dec. 31, 2003	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**77,380**	**60,320**	**400,883**	**538,583**
Resource property additions	44,690	–	–	–	–	–	16,208	30,513	3,049	21,732	116,192
Write off of resource properties	–	–	–	–	–	–	–	–	–	(6,478)	(6,478)
Resource Properties at Dec. 31, 2004	**44,690**	**–**	**–**	**–**	**–**	**–**	**16,208**	**107,893**	**63,369**	**416,137**	**648,297**
Exploration Expenses (cumulative)											
Expensed to Dec. 31, 2003	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**254,059**	**5,461**	**38,702**	**298,222**
Diamond Drilling	–	–	–	–	–	–	–	1,105,092	–	268,177	1,373,269
Assaying and Analytical	–	–	–	–	–	–	–	146,156	4,054	79,917	230,127
Geological Services	–	–	–	–	–	–	–	163,138	4,698	269,580	437,416
Geo-technical Surveys	–	–	–	–	–	–	–	383,737	5,599	8,456	397,792
Logistical and Field Support	–	–	–	–	–	–	–	529,966	22,943	311,166	864,075
Professional fees	–	–	–	–	–	–	–	14,936	–	–	14,936
Travel	–	–	–	–	–	–	–	116,720	–	–	116,720
Other	–	–	–	–	–	–	–	674	–	–	674
Total for the year ended Dec. 31, 2004	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**2,460,419**	**37,294**	**937,296**	**3,435,009**
Cumulative exploration to Dec. 31, 2004	**–**	**–**	**–**	**–**	**–**	**–**	**-**	**2,714,478**	**42,755**	**975,998**	**3,733,231**

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. The consideration provided to Gallant has been recorded by the Company as resource property interests and to December 31, 2005, has an ascribed value of $984,440. This includes the estimated fair value of the warrants issued on the date granted of $396,830. The Company also advanced $226,719 to Anian Resources XXK in order to maintain certain mineral licenses which form part of the agreement mentioned above. The Company has recorded these advances as resource property interests. At December 31, 2005, the option consideration and advances to Anian Resources XXK paid have not yet been allocated to specific properties.

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

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

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

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

Properties under Gallant option agreement

Zuun Mod
The Zuun Mod property is a molybdenum/copper occurrence and consists of two adjoining licenses totaling 90,344 hectares. It is located in Bagarkhongor Province approximately 950km southwest of Ulaanbaatar. The licenses renewal dates are May and November 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 five 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. The licenses renewal dates are December 2006.

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 75,279 hectares.

Wholly Owned Properties

Energy
Properties Subject to the Erdene-IUC Joint Venture Agreement (Energy Properties)

Pursuant to an agreement between Erdene and International Uranium Corporation ("IUC") 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 other obligations. The properties have been categorized geographically as follows:

Galshar Properties
The Galshar properties are a series of 15 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 15 licenses are all contiguous and total 359,067 hectares. All of these licenses are 100% owned by the company. Nine of the licenses are in their second year of issue with the remaining six licenses in their first year of issue. The licenses renewal dates are between December 2007 and May 2008.

Southeast Uranium Properties
The Southeast Uranium Properties consist of a series 17 licenses, most of which are not contiguous, that total 845,368 hectares. While some of these properties are contiguous to the Galshar Properties, others are scattered across an area 300km 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 3) 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 17 licenses totaling 239,910 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 eight contiguous licenses and covers 216,371 hectares. The property is located approximately 500km southeast of Ulaanbaatar in Sukhbaatar and Dorngovi provinces. The licenses renewal dates are between May 2006 and December 2007.

Wild Mountain
This copper/gold property consists of two contiguous licenses totaling 3,385 hectares located in western Mongolia, approximately 650km southwest of Ulaanbaatar, and about 5km southwest of the village of Altai in Govi-Altai Province. Licenses renewal dates are June and September 2006.

Wholly Owned Other
An additional seven licenses covering 20,154 hectares are wholly owned by Erdene Mongol XXK.

4. Capital assets

	$	$	**2005** $	2004 $
	Cost	Accumulated depreciation	Net book value	Net book value
Equipment, furniture and fixtures	77,854	18,706	**59,148**	59,658
Software and computer				
	96,026	31,394	**64,632**	61,317
	173,880	50,100	**123,780**	120,975

5. Related parties and due to related parties

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

	2005 $	2004 $
Fisher Transport Limited	**16,013**	14,988
J.C. Cowan	**8,889**	6,506
	24,902	21,494

a) Fisher Transport Limited, a company owned by the Vice-President of Finance of the Company (also a director), provided management and administrative services to the Company for the year ended December 31, 2005. The cost of these services, aggregating $114,922 and measured at fair market value, was charged to administrative expenses (2004 - $122,836).

b) J.C. Cowan, a director of the Company and co-managing director of the Company's subsidiary, provided management and technical services to the Company for the year ended December 31, 2005. The cost of the technical services, aggregating $102,000 and measured at fair market value, was charged to geological services (2004 - $66,000).

6. Share Capital

Authorized and issued	**2005** Number of shares	**2005** $	2004 Number of shares	2004 $
Authorized				
Unlimited number of common shares without par value				
Issued				
Balance, beginning of period	**25,798,910**	**15,906,210**	13,058,910	5,171,722
Issued for cash	**1,000,000**	**1,000,000**	12,500,000	10,625,000
Issued pursuant to option agreement	**400,000**	**400,000**	-	-
Issued on exercise of options and warrants	**70,725**	**65,864**	240,000	109,488
Total	**27,269,635**	**17,372,074**	25,798,910	15,906,210

Warrants

The following table summarizes the continuity of the warrants for 2005 and 2004:

	2005 Number of Warrants	**2005** Weighted average exercise price	2004 Number of Warrants	2004 Weighted average exercise price
Opening balance	**1,835,000**	**0.63**	1,200,000	0.425
Issued	**800,000**	**0.87**	875,000	0.850
Exercised	**(45,725)**	**0.85**	(240,000)	0.425
Closing balance	**2,589,275**	**0.70**	1,835,000	0.630

The following is a summary of the warrants outstanding as of December 31, 2005:

Exercise Price $	Expiry Date	Number of Warrants
0.850	March 16, 2006	829,275
0.870	March 1, 2007	800,000
0.425	January 23, 2008	960,000
0.700		2,589,275

During the year ended December 31, 2005, 800,000 warrants were granted to Gallant Minerals Limited in conjunction with an agreement signed on March 1, 2005 (see note 3). Subsequent to year-end, 1,008,575 warrants were exercised for total proceeds of $780,789 and 700 warrants expired on March 16, 2006.

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:

	2005	2004
Dividend yield	**0%**	0%
Risk-free interest rate	**3.7%**	3.5%
Expected volatility	**80%**	55%
Expected life	**1 year**	2.5 years

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 2005 and 2004.

	2005	**2005**	2004	2004
		$		$
	Number of options	Weighted average exercise price	Number of	Weighted average exercise options price
Opening balance	**1,795,000**	**0.670**	770,000	0.425
Granted	**560,000**	**0.779**	1,025,000	0.850
Exercised	**(25,000)**	**0.850**	–	–
Closing balance	**2,330,000**	**0.690**	1,795,000	0.670

The following is a summary of the options outstanding and exercisable as of December 31, 2005, all of which are exercisable:

Exercise price $	Expiry date	Number of options
0.85	July 19, 2006	40,000
0.425	May 8, 2008	400,000
0.425	November 18, 2008	370,000
0.85	March 31, 2009	100,000
0.85	April 6, 2009	760,000
0.85	August 26, 2009	100,000
0.70	February 4, 2010	200,000
0.70	March 30, 2010	10,000
0.77	May 1, 2010	90,000
0.74	July 1, 2010	10,000
0.85	August 5, 2010	250,000
0.69		**2,330,000**

Stock Based Compensation

As of December 31, 2005 there were 2,330,000 share purchase options outstanding. During the year ended December 31, 2005, 560,000 options (2004 - 1,025,000) were granted to certain directors, officers, employees and consultants of the Company. The fair value of the options on the date granted of $297,601 (2004 - $287,619) 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:

	2005	2004
Dividend yield	**0%**	0%
Risk-free interest rate	**4.0%**	3.5%
Expected volatility	**80%**	55%
Expected life	**5 years**	2.5 years

7. Contributed surplus

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

	2005 $	2004 $
Opening balance	**513,095**	61,464
Warrants/options relating to issue costs	**–**	171,500
Warrants relating to resource property option agreement	**396,831**	–
Warrants exercised	**(5,748)**	(7,488)
Options expensed	**297,601**	287,619
	1,201,779	513,095

8. Basic and diluted loss per share

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

9. Income taxes

The tax effects of temporary differences that give rise to significant portions of the future tax assets at December 31, 2005 and 2004 are presented below:

	2005 $	2004 $
Future tax assets		
Non-capital loss carry forwards - Canada	**1,548,370**	808,800
Deferred expenses - Mongolia	**1,545,210**	805,900
Deferred exploration and development expenditures	**7,519**	7,519
Incorporation costs	**1,224**	1,224
Share issue costs	**368,455**	475,310
Capital assets - Canada	**10,650**	3,598
	3,481,428	2,102,351
Less valuation allowance	**(3,481,428)**	(2,102,351)
Net future tax asset	–	–

Included in the determination of total gross tax assets are Canadian non-capital loss carry-forwards of approximately $4,061,800 which expire substantially between 2010 and 2013. Deferred expenses for tax purposes of $5,150,695 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% (2004 - 38.12%) to loss before taxes as follows:

	2005 $	2004 $
Loss before taxes	**4,981,314**	4,436,620
Computed expected tax recovery	**(1,898,877)**	(1,691,240)
Effects of foreign exchange translation	**117,320**	32,455
Increase in valuation allowance	**1,379,077**	1,297,015
Expenses not deductible for tax purposes	**173,295**	133,380
Effect of different foreign tax rates	**255,041**	212,858
Tax deductible expenses charged to retained earnings	**(22,872)**	–
Other	**(2,984)**	15,532
Net income tax recovery	**–**	–

10. Supplemental cash flow information

	2005 $	2004 $
Non-cash investing and financing activities:		
Issue of warrants as a share issue cost	**–**	171,500
Sale of resource properties in exchange for marketable securities	**22,499**	28,167
Issue of common shares and warrants for investment in resource property interests	**796,83**	–
Cash and cash equivalents consist of:		
Cash on hand, held in trust by third parties and in banks	**81,191**	95,958
Temporary money market instruments	**4,188,800**	8,483,331
	4,269,991	8,579,289

11. Financial instruments

a) Fair values

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

b) Credit risks

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

12. Foreign currency risks

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

13. Segmented information

a) General information

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

b) Geographic information

The Company's head office is located in Nova Scotia, Canada with resource properties and exploration activities predominantly in Mongolia. The following table presents the geographic origin of the Company's assets and liabilities:

	2005 Canada	**2005** Mongolia	**2005** Total	2004 Canada	2004 Mongolia	2004 Total
Working capital	**4,254,791**	**(10,049)**	**4,244,742**	8,437,573	50,151	8,487,724
Capital assets	**62,821**	**60,959**	**123,780**	59,878	61,097	120,975
Resource properties	**–**	**2,001,708**	**2,001,708**	–	648,297	648,297
Net assets	**4,317,612**	**2,052,618**	**6,370,230**	8,497,451	759,545	9,256,996

14. Commitments

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

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

15. Subsequent events

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

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

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

b) On February 21, 2006 the Company announced it has reached an agreement with Kaoclay Resources Inc. ("Kaoclay") whereby the Company will acquire all of the outstanding shares of Kaoclay in exchange for shares and warrants of the Company. Each Kaoclay share will be exchanged for 1.65 Erdene shares and a half warrant with each full warrant entitling the holder to purchase an Erdene share at $1.60 for a period of three years from closing giving an approximate purchase price consideration of $15.6 million for the transaction. All of the directors of Kaoclay who own or control shares have agreed to vote these shares in support of the transaction. Kaoclay will be entitled to name two nominees to the Board of Directors of the Company. The transaction must be approved by the shareholders of Kaoclay and is subject to the receipt of all required regulatory and court approvals. If all required approvals are received, it is expected that closing will take place in May.

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

Erdene shares outstanding at date of offer	30,599,933
Kaoclay shares	8,979,950
Exchange ratio	1.65
Equivalent Erdene shares to be issued to Kaoclay shareholders	14,816,918
Erdene post acquisition shares outstanding	45,416,851

16. Comparative figures

Certain comparative financial data for 2004 has been reclassified to conform to the presentation adopted in the 2005 financial statements.

Corporate Information

Directors, Officers & Senior Management

Peter C. Akerley
President & CEO; Director

Ken W. MacDonald
Vice President & CFO; Director

Wayne G. Beach
Director; Partner, Beach Hepburn

William B. Burton
Director; President & CEO, MagIndustries Inc.

John Byrne
Director; President, Petroleum Corporation of Canada Exploration Ltd.

David S. B. Carnell
Director; President, Bedford Capital Group Inc.

J.C. (Chris) Cowan
Director; Managing Director, Erdene Mongol XXK

Jeffrey Gerard
Director; General Manager of Business Strategy, Xstrata Coal

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

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 June 14th, 2006 commencing at 5:30pm.

www.erdene.com

Financial Highlights

As at December 31, 2005 Erdene had working capital of ***$4.2 million***, with ***27.2 million*** shares issued and outstanding and ***32.2 million*** shares fully diluted.

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, many 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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