

**AVNEL GOLD MINING LIMITED  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED DECEMBER 31, 2006**

The following discussion and analysis (the "MD&A") for Avnel Gold Mining Limited ("Avnel" or "the Company") describes the operating and financial results of the Company for the period from January 1, 2006 to December 31, 2006. Avnel was incorporated under The Companies (Guernsey) Laws 1994 on February 18, 2005 with the purpose of becoming the holding company for, and to carry on the business of, Avnel Gold, Limited, a Cayman Islands company ("Avnel Cayman"), pursuant to a reorganization which was completed on February 22, 2005 (the "Reorganization"). Accordingly, the information contained in this MD&A is presented on a pro forma basis as if the Reorganization was completed as of January 1, 2005. The results for the year ended December 31, 2004 are the amounts reported by Avnel Gold, Limited in its consolidated financial statements for the year ended December 31, 2004.

This MD&A should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2006 and related notes thereto. The selected financial information and the discussion of results of operations were prepared in accordance with U.S. GAAP. Reference should be made to Note 15 of the consolidated financial statements of the Company for a reconciliation of Canadian and U.S. GAAP. All amounts in this discussion are expressed in U.S. dollars, unless identified otherwise.

This MD&A contains forward-looking statements that involve numerous risks and uncertainties and which are based on the Company's expectations, estimates and projections regarding its business and the gold market and economic environment in which it operates. These statements are not guarantees of future performance and involve risks and uncertainties that are difficult to control or predict. Therefore, actual results of the Company could differ materially from those discussed in such forward-looking statements as a result of these risks and uncertainties and readers should not place undue reliance on such statements.

**Overall Performance**

Avnel's principal asset is an 80% interest in Societe des Mines d'Or De Kalana ("SOMIKA"). The state of Mali holds the remaining 20% interest in SOMIKA. SOMIKA is the owner and operator of the Kalana Gold Mine located in the southwest of Mali and is the holder of an exploration permit in respect of 387.4 kilometers squared in south western Mali. Avnel's strategic objective, through SOMIKA, is to commercially exploit the reserves at the Kalana Gold Mine, and enhance the economics of the Kalana Gold Mine through underground exploration to increase mineral reserves and through surface exploration.

The mine was acquired by Avnel in late 2002 following which the existing plant and infrastructure were upgraded and mining operations were resumed by SOMIKA in January 2004 with commercial production commencing in March 2004. During the years 2004, 2005 and 2006 Avnel has been engaged on increasing gold production from 7,396 ounces in 2004, to 14,823 ounces in 2005 and to 22,638 ounces in 2006. At the same time, Avnel has invested significantly in capital expenditures and underground development required to expand production to a planned annual rate of 60,000 tonnes. The mine development was behind schedule in 2005 and 2006 and it is now planned that underground production will increase from 23,000 tonnes in 2006 to 32,000 tonnes in 2007 with the objective of developing the mine to attain its design throughput rate of 60,000 tonnes per annum on a sustainable basis.

## Selected Annual Information

(in thousands of U.S. dollars except per share amounts)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total Revenue.....	11,872	5,699	2,621
Total Expenses.....	13,735	11,637	6,759
Net Loss.....	(2,675)	(7,106)	(5,411)
Loss per share	\$(0.05)	\$(0.29)	\$(58.00)
Weighted average shares outstanding	55,920,189	24,671,988	93,288

### Balance Sheet

Working Capital (Deficiency) .....	623	5,065	(2,959)
Total Assets .....	25,821	26,308	18,514
Long Term Debt .....	11,821	11,821	19,255
Shareholders' Equity (Deficit).....	10,024	11,517	(5,538)

Revenue has increased to \$11,872,000 in 2006 from \$5,699,000 in 2005. This is as a result of an increase in gold ounces sold from 13,356 ounces in 2005 to 23,062 ounces in 2006 and an increase in average sales price from \$425 per ounce in 2005 to \$513 per ounce in 2006.

Avnel recorded a net loss of \$2,675,000 (\$0.05 per share) for the year ended December 31, 2006 compared to a net loss of \$7,106,000 (\$0.29 per share) in 2005. The losses have occurred because Avnel's only income earning asset, the Kalana Gold Mine, is building up its gold production to reach the design production rate of 60,000 tonnes per annum. Avnel continued to invest in the development of the Kalana Mine and exploration on the Kalana Permit.

As compared to the balance sheet as at December 31, 2005, Avnel's cash and cash equivalents as at December 31, 2006 decreased by \$4,200,000. Operating activities generated a positive cash flow of \$201,000 but this was offset by capital expenditure of \$4,402,000.

Working capital decreased to \$623,000 at December 31, 2006 from \$5,065,000 as at December 31, 2005. This was largely as the result of the decrease in cash and cash equivalents explained above. The other significant factor was an increase in tax provision of \$467,000.

Total assets decreased from \$26,308,000 as at December 31, 2005 to \$25,821,000 at the end of 2006. Whilst the net value of property, plant and equipment increased by \$3,309,000 as a result of capital expenditure, largely on sinking No 2 shaft, the value of current assets decreased by \$3,796,000 mostly due to the decrease in cash and cash equivalents.

Long term debt of \$11,821,000 at December 31, 2005 remained the same at December 31, 2006. Shareholders' equity decreased to \$10,024,000 at December 31, 2006 from \$11,517,000 at the end of 2005. The biggest contributing factor was the net loss of \$2,675,000. This was partly offset by the increase in Additional Paid in Capital due to stock option charges and the increase in share capital as a result of the issue of shares in lieu of interest on convertible loan notes.

## Consolidated Statement of Operations for the Quarters Ended

Quarter ended	Dec 31	Sep 30	June 30	Mar 31	Dec 31	Sep 30	June 30	Mar 31
	<u>2006</u>	<u>2006</u>	<u>2006</u>	<u>2006</u>	<u>2005</u>	<u>2005</u>	<u>2005</u>	<u>2005</u>
<b>Revenue</b>	\$ 2,957	\$ 3,600	\$ 3,819	\$ 1,496	\$ 1,615	\$ 1,440	\$ 1,295	\$ 1,349
<b>Net income (loss)</b>	\$(1,443)	\$ 78	\$ (16)	\$ (1,294)	\$ (1,705)	\$ (1,500)	\$ (2,324)	\$ (1,577)
<b>Income (loss) per share</b>	\$ (0.03)	\$ 0.001	\$ (0.0003)	\$ (0.02)	\$ (0.03)	\$ (0.03)	\$ (11.62)	\$ (10.75)

In general, the Company's revenue is showing an upward trend since commencement of operations in 2004 as production is developed towards full capacity. This is most notable for the last three quarters of 2006 and is a result of increased production and average sales price. There was a decrease in revenue in the fourth quarter of 2006 compared to the second and third quarters of 2006 as a result of lower gold sales and production. The Company retained 500 ounces of unsold gold at the refinery and 1,518 ounces at the mine site as at December 31, 2006.

Net loss decreased significantly in 2006 compared to 2005. The main differences were seen in the second and third quarters where results of net income of \$78,000 and net loss of \$16,000 respectively in 2006 compared with net losses of \$1,500,000 and \$2,324,000 for the same periods in 2005. Whilst costs have increased by 18% in 2006, revenue has increased by 108%. There was a high net loss in the fourth quarter of 2006 compared to other recent quarters. This was as a result of a number of factors. There was a decrease in revenue without any corresponding decrease in the operating costs when compared to the second and third quarters of 2006. An additional provision was made in the fourth quarter for taxes payable.

The high loss per share for the quarters up to June 30, 2005 result from there being only up to 200,000 shares outstanding prior to the Initial Public Offering on June 30, 2005 when a further 47,193,605 common shares were issued.

## Results of Operations

### Mining Operations

The following table shows the production from the Kalana Gold Mine:

	<u>2006</u>	<u>2005</u>
Tonnes milled:		
Underground ore	24,116	30,241
Coarse sand reclaimed	3,627	4,614
Total	27,743	34,855
Gold grade - grams per tonne (g/t):		
Underground ore	31.6	17.1
Coarse sand reclaimed	5.5	4.9
Total	28.2	15.5
Recovery rate - %	90.1	86.1
Gold production - ounces	22,638	14,923
Cost per tonne milled	\$317	\$155
Operating cost per ounce of gold sold	\$394	\$484

Tonnes milled in 2006 were 20% below the production achieved in 2005. Gold production at 22,638 ounces in 2006 was 52% higher than 2005 reflecting higher grades and gold recovery.

Underground mining production decreased in 2006 as mining was confined to vein 1 below the 100 level. Mining continued down dip, with increasing distance from the 100 level. Stopping productivity improved as the mining crews gained experience with improved training from expatriate supervisors. Two new mining areas were planned to be mined during the second half of 2007. These areas were not mined for the reasons described below.

It was planned to mine 9,000 tonnes from a new ore reserve block (Vein 18 North) during the second half of 2006. The stopping block was accessed by a winze from 100 level to 120 level. Water was intersected on the vein when it was exposed by development. It was difficult to continue development on 120 level due to the water inflow and it was decided to stop development. This ore reserve block will now be mined from 150 level as originally planned. Due to delays in sinking No 2 Shaft the development on 150 level is behind schedule and mining of Vein 18 North is planned only to start in quarter four of 2007. The ore reserve block will be developed up dip from 150 level to 120

level, allowing water to drain to 150 level. This water will flow via boreholes to the 180 level pump station at No 2 Shaft which is planned to be operational by September 2007.

It was planned to mine 4,000 tonnes from vein 18A south on 160 level. Development of the vein from 160 to 150 level was planned to be complete by September with stoping commencing in quarter four. 160 level is accessed from the sub incline shaft. When the haulage intersected vein 18A, the vein was a low grade, stockwork. Based on this new information, the existing interpretation of vein 18A was reviewed. The interpretation was based on two boreholes spaced 50m apart. It is possible that the stockwork changes to the main vein south of the existing haulage. Development and diamond drilling will test the vein during the next few months.

The gold grade of underground ore mined of 31.6 g/t in 2006 was 85% higher than that obtained in the previous year (17.1g/t). The average mill grade of 28.2g/t (2005 – 15.5 g/t) obtained was lower than the underground grade as it was reduced by the processing of 3,627 tonnes of coarse sand (2005 – 4,614 tonnes) at 5.5 g/t (2005 - 4.9 g/t).

Underground grades in 2006 significantly exceeded the mineral reserve grades. This was attributable to higher gold content than predicted as well as improved quality of mining leading to less dilution.

During 2006, 20,000 tonnes were mined from Vein 1 Block 11 B (C1). The average mining grade was 33.96g/t. The contained gold from the mined block contained 55% more gold than the forecast based on the adjusted higher grades (average 19.15g/t) in the December 2005 mineral reserves. Compared to the December 2004 mineral reserve grade (14.4g/t) the contained gold was 138% more than forecast.

Gold recovery in 2006 increased to 90.2%. It exceeded the prior year because of improved performance in the recovery section, lower throughput and head grades. When ore production increases in future, it is possible that the recovery rate will decrease to 84%, depending on head grades and plant performance.

Mine development totalled 1,098 metres in 2006 compared to 249 metres in 2005. The metres developed during 2006 were lower than plan due to the delay in completing the sinking of No 2 Shaft. The increase in development in quarter four followed the completion of sinking No 2 Shaft and No 1 Sub Incline Shaft and the commencement of haulage development on three levels. Productivity of the development crews has increased during the fourth quarter. Underground development increased to 476 metres in the fourth quarter of 2006.

Development on 180 level 2 shaft advanced 67m during the fourth quarter. Excavation of the access to the 180 pump station was completed. The haulage east advanced to the breakaway position for the two water storage dams.

Development on the 150 level 2 shaft advanced 54m during the fourth quarter. No advance occurred during December when the crews focused on development of the 180 level.

Development on the 160 level from the sub incline shaft progressed well with an advance of 195m for the fourth quarter.

Mine operating costs for the year ended December 31, 2006 amounted to \$9,448,000 compared with \$6,633,000 in 2005. The reasons for the increase were due to higher labour costs per employee, higher number of employees, escalation of materials costs, adverse movement in the U.S. Dollar to CFA exchange rate, taxes and one-off costs relating to mechanical breakdowns and employee costs. Cash operating cost of \$317 per tonne milled in 2006 was significantly higher than the cost per tonne in 2005 mainly because of 20% less tonnes milled and a 42% increase in operating costs. Cash operating cost per ounce sold of \$394 per ounce in 2006 decreased significantly from \$484 per ounce in 2005 due to the increase in gold production.

## Gold Sales

Gold sales data is as follows:

		2006	2005
<b>Gold ounces sold</b>	- at spot price	10,432	6,296
	- under forward contracts	12,630	7,060
	- total	<u>23,062</u>	<u>13,356</u>
<b>Average realized gold price per ounce</b>	- at spot price	\$627.86	\$438.25
	- under forward contracts	\$418.50	\$413.51
	- total	\$513.20	\$425.17
<b>Metal revenue - \$000</b>			
Gold sales if all sales were at spot prices		\$14,302	\$6,031
Net effect of forward sales		<u>(2,466)</u>	<u>(353)</u>
Total gold sales		11,836	5,678
Silver sales		<u>36</u>	<u>21</u>
Metal revenue		<u>\$11,872</u>	<u>\$5,699</u>

Gold spot prices commenced 2006 at \$530 per ounce and ended at \$632 per ounce, with the London PM Fix averaging \$604 per ounce during the year. The weakening of the US Dollar during 2006 combined with increased geopolitical risk had a positive impact on the gold price.

## Other Expenses

General and administrative costs amounted to \$2,161,000 for the year ended December 31, 2006 compared to \$2,878,000 in 2005. The decrease in expense is largely because the cost of stock compensation expenses has decreased to \$450,000 compared to \$1,126,000 in 2005. A further \$263,000 of stock compensation expense is expected to be amortized over the period to August 2008. The cost of travel and legal and tax consultancy also decreased in 2006.

Depreciation, depletion and reclamation expenses amounted to \$1,416,000 in 2006 compared to \$1,108,000 in 2005. Depletion costs are calculated on the unit-of-production basis and the increase results primarily from the increased production in 2006 compared to 2005.

Interest expense was \$795,000 for the year ended December 31, 2006 compared to \$1,357,000 in 2005. As a result of the conversion of debt to equity, which was completed on June 30, 2005, interest expense declined substantially in the second half of 2005. The full-year effect of this was seen in 2006. Furthermore, the repayment of \$2,000,000 of a term loan on December 30, 2005, has resulted in a further decline in interest expense in 2006.

## Exploration

During the year, Avnel continued with its exploration program on the 387.4 km<sup>2</sup> area property held in accordance with the Exploitation Permit. One diamond drill program totalling 2,223 metres was completed in the first quarter. A reverse circulation drill program totalling 5,672 metres was completed in the second quarter. The results of these programs have been reported in press releases and the previous MD&A's in 2006 filed on SEDAR (see www.Sedar.com). Exploration expenditure totalled \$710,000 in 2006 compared to \$1,018,000 in 2005.

In February 2006 Avnel Gold was awarded a 3 month exploration authorisation on the Niessoumala exploration area directly south of Kalana Permit. The area was included in the Or-Bagoe geochemical soil sampling program conducted in the 1980s. That survey identified a number of multi-kilometre length gold anomalies. The soil survey lines were at 1 km spacing.

Avnel collected 1,512 soil samples, using a 200m line spacing, from 3 anomalies identified in the Or-Bagoe survey and assayed 300 samples for gold. The results confirmed that gold occurs at these locations. The remaining samples will be analysed for gold and 35 other elements in 2007. A number of orpaillage pits were identified during the field work. Based on the potential for gold mineralization and the results from the three month work period, Avnel applied for an exploration permit for a portion of the Niessoumala exploration area.

On October 17, 2006, Avnel was awarded the Fougadian Exploration Permit which lies south of the Kalana permit. The permit covers an area of 150 square kilometres including a portion of the Niessoumala exploration area. The Permit has been awarded in accordance with the 1999 Mining Code and a Foundation Agreement has been signed between Avnel Mali, a 100% owned subsidiary of Avnel, and the Government of the Republic of Mali. Avnel has a 90% interest and the Malian State 10% in the permit, if a decision is made to construct a mine. The Foundation Agreement provides for the exploration and exploitation of Group 2 minerals as defined in the 1999 Mineral Code. Group 2 minerals includes gold and silver, base metals but excludes precious stones, semi-precious stones and fossils. Details are shown in the Press Release dated October 17, 2006 and a Material Change Report filed on SEDAR (see [www.sedar.com](http://www.sedar.com) and the Company's website [www.avnelgold.com](http://www.avnelgold.com))

In the fourth quarter, Avnel collected 2,027 soil samples (including 115 control samples) in the central area of the Fougadian Permit. Avnel is planning to collect 4,614 soil samples covering the remainder of the Fougadian Permit during the first half of 2007. All soil samples collected in 2006 were sieved at -33 mesh at the prep laboratory at the Kalana Mine and a 30g sub sample is planned to be submitted to the Abilab laboratory in Bamako, Mali for gold assay (fire assay). The samples will be analysed for 35 elements at a laboratory in Canada.

Avnel is recording all orpillage sites on the permit and has identified over 10,000 pits associated with the gold anomalies identified in the Or-Bagoe survey. Seven orpillage sites are identified to date. During 2007, quartz samples from some of these pits will be collected and assayed. Avnel has acquired the geophysical data from the SYSMIN project recently completed in Mali by the Government of Mali. The entirety of area of the permit was covered by this project.

Avnel instituted a system of Quality Assurance and Quality Control (QA/QC) during the Fougadian Phase 1 geochemical soil sampling program under the direct supervision of Michel Mercier, Senior Exploration Manager for the Company and the qualified person responsible for the exploration program.

### **Liquidity and Capital Resources**

As of December 31, 2006, Avnel had cash of \$1,220,000 (2005 - \$5,420,000) and working capital of \$623,000 (2005 - \$5,065,000). In the year ended December 31, 2006, operating activities generated cash funds of \$201,000, whereas in 2005, operating activities required funding of \$5,196,000. This was mainly because the net loss from continuing operations in 2006 of \$2,675,000 was substantially less than the 2005 net loss of \$7,106,000. Avnel expended \$4,402,000 on mine development and capital additions in 2006 compared to \$2,735,000 in 2005. The expenditure was related to the sinking of No 2 Shaft and the No 1 Sub Incline Shaft at the Kalana Gold Mine, haulage development and associated mining equipment. Avnel expended \$579,000 on ongoing exploration on the Kalana Permit and \$131,000 on the Fougadian Exploration Permit during 2006. A total of \$318,000 must be spent on the Fougadian Exploration Permit within the first year to meet the permit's terms.

A total of \$5,795,000, net of share issue costs and IPO expenses, was raised on June 30, 2005 when the Company completed its initial public offering with the issue of 12,393,605 units (the "Units") of the Company at a price of Cdn\$0.76 per Unit. Each Unit consists of one common share (the "Common Shares") of Avnel and one-half of one Common Share purchase warrant, each whole Common Share purchase warrant entitling the holder to purchase one Common Share (the "Warrant Shares") at a price of Cdn\$1.06 per Warrant Share at any time before 5p.m. on June 30, 2010. The Company has also granted the agents of this offering a non-transferable option to purchase 279,666 units at the offer price up to June 30, 2007.

On November 29, 2005 the Company raised a net \$6,307,000 upon the completion of the Private Placement of 7,936,000 units at Cdn\$1.00 per unit, each unit comprising one common share and one common share purchase warrant, each exercisable for two years at Cdn\$1.30 per share. The Company has also granted the agents of this offering a non-transferable option to purchase 558,600 units at the offer price up to May 29, 2007. The agent may convert the warrants into one common share at an exercise price of Cdn\$1.30 within two years (November 29, 2007) of the Private Placement.

The Company did not undertake any financing activities in 2006. On March 15, 2007 the Company raised Cdn\$3,542,000 (\$3,014,000 at the March 15, 2007 exchange rate) from a Rights Offering. 7,083,270 common shares were issued at a price of Cdn\$0.50.

Long term debt of the Company consists mainly of convertible loans provided by Elliott International L.P. and Elliott Associates L.P. (collectively "Elliott") and the Fern Trust, the two major shareholders of Avnel (the "Shareholder Loans"). At June 30, 2005 an aggregate principal amount of \$19,255,000 of the Shareholder Loans, together with accrued interest thereon in the amount of \$2,627,000, was converted into equal amounts of common shares and convertible loan notes with an aggregate principal amount of \$10,941,000. Each convertible loan note is convertible by the holder into common shares of the Company at Cdn\$0.95 per share and bears interest at the six month U.S. LIBOR plus 2% payable bi-annually. The Company may elect to pay the interest in common shares in lieu of cash and may, upon maturity, elect to repay the outstanding principal amount in common shares at Cdn\$0.95 per share if the 40-day weighted average trading price of the common shares prior to the conversion date is equal to or greater than \$1.20. The convertible loan notes mature on June 30, 2010.

Funding of \$2,800,000 was provided by shareholders in 2005 under bridge financing loans. On June 30, 2005, these loans, together with interest accrued thereon in the amount of \$80,000, were converted into a term loan due December 31, 2008, bearing interest at a rate of 8%. A total of \$2,000,000 of this term loan was repaid on December 30, 2005. As at December 31, 2006, the principal for the term loans remain at \$880,000.

### Contractual Obligations

The Company has the following contractual obligations at December 31, 2006:

Contractual Obligations - \$000	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long Term Debt (1)	11,821	-	880	10,941	-
Operating Leases (2)	177	119	58	-	-
Capital Lease	<u>16</u>	<u>16</u>			
<b>Total Contractual Obligations</b>	<b><u>\$12,014</u></b>	<b><u>\$135</u></b>	<b><u>\$938</u></b>	<b><u>\$10,941</u></b>	<b><u>\$ -</u></b>

Notes:

- (1) The long term debt of Avnel consists entirely of shareholder loans provided by Elliott and the Fern Trust, the two major shareholders of Avnel. At December 31, 2006 long term debt comprised of convertible loan notes of \$10,940,992 and a term loan of \$879,673.
- (2) Avnel's operating lease obligations consist of payments due under rental agreements in respect of its offices in London and Bamako.

### Related Party Transactions

Kalana Mine Services Limited ("Kalana Mine Services"), a UK based, wholly-owned subsidiary of Avnel, provides purchasing, facilitation, and expediting services and technical assistance to SOMIKA at cost plus a fee of 7.5%. During the year ended December 31, 2006, \$398,000 of such expenses and fees were charged to SOMIKA by Kalana Mine Services.

SOMIKA purchases explosives from African Explosives Limited ("AEL"). Mr. Ibrahim Kantao, a director of the Company and SOMIKA, is also the Director-General of AEL Mali SARL. Such purchases amounted to \$276,000 in the year ended December 31, 2006.

Avnel Cayman entered into forward sales agreements on March 18, 2004 in respect of 31,700 ounces for the period through to December 2006 at an average price of \$414.27 per ounce with Elliott, a major shareholder. The facility is margin-free up to \$2.5 million. During 2005, a number of the forward sales were rolled forward with the result that the contract has been extended to July 2007. As at December 31, 2006, the Company had sold forward 6,860 ounces of gold at an average price of \$441 per ounce. Based on the spot price of \$632 per ounce, the mark-to-market value of the Company's gold forward sales agreements was negative \$1,381,000.

The premises occupied by Avnel and Kalana Mine Services in London are leased from a company associated with the Fern Trust, a significant shareholder. The Company incurred \$109,000 in rental costs during the year ended December 31, 2006.

#### **Fourth Quarter Results**

Fourth quarter revenue of \$2,957,000 has increased by 83% compared to the fourth quarter of 2005 revenue of \$1,615,000. The reason for the increase is that 5,811 ounces of gold was sold at an average price of \$509 in the fourth quarter of 2006 compared to 3,761 ounces sold at an average price of \$429 in the fourth quarter of 2005. Net loss decreased from \$1,705,000 in the fourth quarter of 2005 to \$1,443,000 in the fourth quarter of 2006. Operating costs increased from \$1,676,000 in the fourth quarter of 2005 to \$2,776,000 in the fourth quarter of 2006. The factors for the increase in costs are the increased number of employees, higher labour cost per employee, an adverse movement in the CFA to U.S. Dollar exchange rate, escalation of materials costs and higher costs in relation to gold sales such as royalties, export fees, smelting and transportation costs and taxes.

Cash and cash equivalents decreased from \$2,017,000 at the start of the fourth quarter to \$1,220,000 at December 31, 2006, a decrease of \$797,000. Cash provided by operating activities in the quarter was \$753,000. However, this was more than offset by the expenditure on property, plant and equipment of \$1,550,000.

Significant changes in balance sheet values in the quarter are the provision for retirement and rehabilitation obligation which has increased by \$325,000 to \$774,000 as a result of a new estimate and an increase in the tax creditor by \$389,000 to \$744,000.

#### **Business Risks**

The risks associated with Avnel and the effect on future operating results and financial position of the Company are set out in detail under the heading "Risk Factors" in the Prospectus dated May 27, 2005 and the Annual Information Form dated March 30, 2007.

The Company faces risks associated with underground mining such as rock conditions, water, geological faults, variable vein widths, dilution and power supply. The international mining industry is facing a shortage of skilled personnel and the Company faces risks in attracting and retaining skilled employees. The Company operates in a remote location in Mali and is reliant on the transport systems to deliver equipment and materials which are purchased in South Africa or Europe. There is a risk that such equipment and materials may not always be available on site when required

The Company faces risk in respect of its exposure to gold prices. As at December 31, 2006, Avnel has forward sales of gold for delivery in 2007 of 6,860 ounces, approximately 50% of its forecast gold production through to July 2007, at an average gold price of \$441 per ounce. Avnel adopted its forward sales program with a major shareholder to achieve a higher level of confidence in achieving its near-term cash flow objectives. Without this program, it is estimated that a 10% movement in the gold price away from the assumed spot price of \$620 per ounce would impact 2007 cash flow by approximately \$1,435,000. With the hedge program, the same movement in the gold price would result in a \$1,010,000 movement.

All gold revenues and a portion of operating costs are in U.S. dollars. The Company has not hedged its foreign exchange risk relating to its non-U.S. dollar expenses. The following table illustrates the sensitivity of operating costs and capital expenditures in 2007 to a movement of 10% in the South African Rand (the "Rand") and CFA Franc (the exchange of which is fixed to the Euro), the two key currencies for the Kalana project, against the U.S. dollar. An appreciation of 10% by the CFA Franc or Rand against the U.S. dollar would lead to an increase in Avnel's current financial year's costs by the percentages shown in the table below. An appreciation of the U.S. dollar by 10% against the CFA Franc or Rand would reduce the planned operating costs and capital expenditures by the corresponding percentages.

The impact of 10% currency movements on 2007 Budgeted Operating Costs would be as follows:

<u>Currency</u>	<u>Operating Cost</u>
CFA Franc or Euro	6.1%
Rand	1.6%

The Company will require ongoing financing to fund its planned operation and exploration programs. No assurance can be given that such financing can be raised on commercially acceptable terms.



Avnel maintains insurance against risks that are typical in the gold mining industry. Although the Company maintains insurance in amounts that it believes to be adequate, the insurance coverage maintained may not be adequate in the event of unforeseen circumstances. Avnel does not maintain political risk insurance.

The Company is committed to environmental protection, to safe operations and to the control of environmental risks. The Company adheres to the requirements of the Malian Government and has adopted policies and procedures as expected in the mining industry. The Company is committed to maintaining the aforementioned risks at levels as low as can be reasonably achieved, taking into account social and economic factors, and that continued improvement in environmental and health and safety performance be achieved.

### **Critical Accounting Estimates**

The consolidated financial statements of the Company have been prepared in accordance with U.S. GAAP. Management is required to make various estimates and judgements in determining the reported amounts of assets and liabilities, revenues and expenses for each period presented and in the disclosure of commitments and contingencies. Management considers the following critical accounting policies reflect its more significant estimates and judgements used in the preparation of the consolidated financial statements.

The consolidated financial statements have been presented on the basis that the Company is a going concern. Accordingly, the financial statements do not include adjustments relating to the carrying value of assets, the amounts and classification of liabilities, or other adjustments that might result should the Company be unable to continue as a going concern.

All costs, other than acquisition costs, are expensed prior to the establishment of proven and probable reserves. Gains or losses resulting from the sale or abandonment of properties are included in operations. Acquisition and development costs associated with properties brought into production are charged to operations using the units of production method based on estimated proven and probable reserves which can be recovered. Costs of start-up activities and on-going costs to maintain production are expensed as incurred. Production facilities and equipment are stated at cost and are amortized over the estimated proven and probable reserves which can be recovered from the related property.

The Company evaluates the carrying value of its properties and equipment when events or changes in circumstances warrant. With respect to properties with proven and probable reserves, an impairment loss is recognized when the estimated future cash flows expected to result from the use of the asset are less than the carrying amount of the asset.

The fair value of a retirement or rehabilitation obligation is recognized as an asset and a liability in the period when it is incurred. The liability is discounted and an accretion expense is recognized using the credit adjusted risk free rate in effect when the liability is incurred.

Transactions expressed in foreign currencies are translated into U.S. dollars at the rate of exchange prevailing on the date of transaction. Monetary assets and liabilities expressed in foreign currencies are re-converted into U.S. dollars at the rates of exchange prevailing on the balance sheet date.

The financial statements of overseas subsidiaries are remeasured into their functional currency. Mining properties and other non-current assets are remeasured at historical rates. Monetary assets and liabilities are remeasured at current rates, except depreciation and amortization, which are remeasured at historical rates. Revenue and expense transactions are remeasured at the average rate for the period. Remeasurement gains and losses are included in income.

### **Financial Instruments**

As at December 31, 2006, the Company had sold forward 6,860 ounces of gold at an average price of \$441 per ounce. The Company believes that these forward sales qualify as normal sales contracts under SFAS 133 and will record the revenues when the gold sold forward is delivered and proceeds are received. The facility is margin-free, up to a maximum exposure of \$2.5 million.

The estimated fair values of the Company's other financial instruments approximate carrying values at December 31, 2006. The Company has no other financial instruments or long-term commitments outstanding.

#### **Disclosure of Outstanding Share Data**

As at March 29, 2007, the Company had issued 63,749,457 common shares.

The following table shows the number of options or rights to purchase common shares of the Company as at March 29, 2007.

Warrants issued through the IPO on June 30, 2005	6,518,713
Warrants issued through the Private Placement on November 29, 2005	8,392,748
Agents' warrants related to the IPO	441,291
Broker's warrants related to the private placement	1,175,236
Convertible Loan Notes	13,433,235
Minority shareholder warrants	1,545,832
CEO Compensation Options	2,500,000
Long Term Incentive Plan	1,599,000
<b>Total as at March 29, 2007</b>	<b>35,606,055</b>

#### **Outlook**

For 2007, Avnel is planning gold production of 23,000 ounces at an average operating cost of approximately \$397 per ounce of gold produced, net of royalties. Tonnes milled is planned to be approximately 31,000 tonnes, 28% higher than 2006, at an average head grade of 26.5 g/t. The decrease in head grade from 2006 is anticipated based on the commencement of production from Vein 18 which has a reserve grade of 15g/t.

Under the plan, 76% of the ore mined will be from Vein 1 below 100 level. During the first half of the year the ore will be accessed via winzes which mean that mining conditions will remain difficult due to up-dip scraping and difficult water control. Limited raise access from the sub incline shaft 160 level will be in place by the middle of the second quarter which will improve water control although ore will still be scraped up-dip. Water will be collected on the 160 level and pumped to 100 level until drain holes are commissioned from 160 level to 180 level south at the end of quarter three. A critical area of the operation will be to ensure the pumping system on 160 level operates efficiently. If there is a failure in the system, the bottom of the sub incline shaft may be flooded, delaying production.

From July 2007, all production from vein 1 will be mined up dip with ore scraped down to the 160 level. Ore will be scraped into short ore passes and be drawn from ore control chutes into ore hoppers. Ore will be hoisted via the sub incline shaft No 1 to 100 level and then transported to No 1 shaft. In quarter four, no ore will be hoisted up No 1 shaft. Instead ore on 160 level will be tipped into an ore pass down to the 180 level south and then trammed to No 2 Shaft.

24% of the ore will be mined from Vein 18 and Vein 18 A. Access will be via the sub incline shaft (160 level) and 2 Shaft (150 & 180 level). All ore will be mined up dip enabling ore to be scraped down to the haulage level. Water in the stopes will either drain to the haulage level or be pumped from the stope face to the raise and then gravitate to the haulage level.

Ore production on 150 and 180 level is dependent on completing the haulage development on these two levels. Ore development can not start until the 180 level pump station at No 2 shaft is commissioned in September 2007, where after the pumping on 160 level will no longer be a critical risk. This facility must be operational to handle the water anticipated to be intersected once ore veins are exposed, specifically at vein 18 North block. A delay in commissioning the pump station will have a knock on effect on ore production.

Mine development was behind schedule in 2005 and 2006. The delay in sinking No 2 shaft and the water ingress on vein 18 will impact the planned build up in underground production. Ore production was expected to increase to 60,000 tonnes in 2007 and it is now forecast that underground production will increase from 23,000 tonnes in 2006 to 32,000 tonnes in 2007, with the objective of developing the mine to attain its design throughput rate of 60,000 tonnes per annum on a sustainable basis.

It is planned to advance 1,813 metres during 2007. Capital cost to complete the equipping of No 2 shaft, 180 level pump station, haulage development on 150, 160 and 180 levels, establishment of a two year tailings facility, gold plant projects and general infrastructure is planned to be \$4,100,000.

Total operating cost is planned to be \$9,217,000 million net of royalties, a slight increase over the 2006 operating cost of \$9,092,000 million net of royalties. The mine operation is planned to produce a positive cash margin of \$3,400,000 million pre capital expenditure and prior to accounting for depreciation. Using an average gold price of \$568 per ounce, management believes that approximately \$3,970,000 million of the cash resources of the Company will be utilised to fund capital expenditures, mainly required to expand production to the planned 54,000 tonnes in 2008 and 60,000 tonnes in 2009 per annum, \$360,000 for exploration, working capital of \$790,000 and corporate expenses of \$1,310,000. The Company has raised \$3,014,000 prior to expenses from a rights offering in March 2007. The Company is forecast to have \$1,200,000 cash at year end and will require additional financing to meet its development and exploration strategy going forward in 2008.

#### **Disclosure Controls and Procedures and Internal Control over Financial Reporting**

Disclosure controls and procedures are designed to provide reasonable assurance that material information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to permit timely decisions regarding public disclosure.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the company's disclosure controls and procedures. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures, as defined in Multilateral Instrument 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings, are effective to ensure that information required to be disclosed in reports filed or submitted by the Company under Canadian securities legislation is recorded, processed, summarized and reported within the time period specified in those rules.

Management has designed the internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. During the most recent year end there were no changes in the Company's internal control over financial reporting that materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

Due to the small size of the Company, there are certain aspects of the Company's internal control system that do not have an adequate segregation of duties. This is not uncommon in a company the size of Avnel. The Company will review the internal controls over financial reporting and take whatever action, if any, is considered appropriate to minimize any potential risks from this weakness.

#### **Additional Information and Continuous Disclosure**

This MD&A has been prepared as of March 30, 2007. Additional information is available in the historical consolidated financial statements of Avnel and Avnel Gold, Limited and the related notes thereto which are included in the Prospectus dated May 27, 2005 and the Amendment No.1 to the Prospectus dated June 22, 2005, the Annual Information Form dated March 30, 2007, and through regular filings of press releases, which are available on the Canadian System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com).