

APOLLO GOLD CORP  
Form 10-Q  
November 14, 2006

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 001-31593

APOLLO GOLD CORPORATION  
(Exact name of Registrant as Specified in Its Charter)

**Yukon Territory, Canada**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**Not Applicable**  
(I.R.S. Employer Identification No.)

**5655 South Yosemite St., Suite 200**  
**Greenwood Village, Colorado 80111-3220**  
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: **(720) 886-9656**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one).

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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At November 10, 2006, there were 142,232,286 common shares of Apollo Gold Corporation outstanding.

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## STATEMENTS REGARDING FORWARD LOOKING INFORMATION

This Quarterly Report on Form 10-Q contains forward looking statements as defined in the *Private Securities Litigation Reform Act of 1995* with respect to our financial condition, results of operations, business prospects, plans, objectives, goals, strategies, future events, capital expenditure, and exploration and development efforts.

Forward-looking statements can be identified by the use of words such as “may,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “intends,” “continue,” or the negative of such terms, or other comparable terminology. The statements include comments regarding:

- our ability to effectively remediate the east wall instability problems at the Montana Tunnels mine and our plan to bring the Montana Tunnels mine back into production in February 2007;

  - future positive cash flow from the Montana Tunnels mine;

- future financial contributions by Elkhorn Tunnels, LLC, our joint venture partner in respect of the Montana Tunnels mine;

  - the establishment and estimates of mineral reserves and resources;

    - production and production costs;

      - cash operating costs;

      - total cash costs;

      - grade;

      - feasibility studies;

      - expenditures;

      - exploration;

      - permits;

      - expansion plans;

      - plans for Black Fox and Huizopa;

      - closure costs;

      - cash flows;

      - liquidity;

      - estimates of environmental liabilities;

- our ability to obtain future financing to fund our estimated expenditure and capital requirements;

  - anticipated exploration, development and corporate overhead expenditures;

· factors impacting our results of operations;

· application of Sarbanes-Oxley 404 reporting requirements and our ability to meet those reporting requirements; and

· the impact of adoption of new accounting standards.

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These forward looking statements are subject to numerous risks, uncertainties and assumptions including: additional operational and remediation problems at the Montana Tunnels mine; the failure of Elkhorn Tunnels, LLC to make the expected contributions under the joint venture in respect of the Montana Tunnels mine; unexpected changes in business and economic conditions; metallurgy, processing, access, availability of materials, equipment, supplies and water; determination of reserves; delay in recommencing production at the Montana Tunnels mine; higher than anticipated remediation or operating costs at the Montana Tunnels mine; lower than anticipated production at the montana Tunnels mine; inability to continue or complete planned work programs at Black Fox or Huizopa; changes in project parameters; costs and timing of development of new reserves; results of current and future exploration activities; results of pending and future feasibility studies; political or economic instability, either globally or in the countries in which we operate; local and community impacts and issues; timing of receipt of government approvals; accidents and labor disputes; environmental costs and risks; competitive factors, including competition for property acquisitions; availability of external financing on reasonable terms or at all; and the factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2005 under the heading "Risk Factors." We disclaim any obligation to update forward looking statements, whether as a result of new information, future events or otherwise.

### **ACCOUNTING PRINCIPLES, REPORTING CURRENCY AND OTHER INFORMATION**

Apollo Gold Corporation prepares its consolidated financial statements in accordance with accounting principles generally accepted in Canada and publishes its financial statements in United States dollars. This Quarterly Report on Form 10-Q should be read in conjunction with our consolidated financial statements and related notes included in this quarterly report, as well as our annual financial statements for the fiscal year ended December 31, 2005 included in our Annual Report on Form 10-K. Certain classifications have been made to the prior period financial statements to conform with the current period presentation.

Unless stated otherwise, all dollar amounts are expressed in United States dollars.

References to "we," "our," "us," the "Company" or "Apollo" mean Apollo Gold Corporation and its consolidated subsidiaries, to any one or more of them, as the context requires.

### **NON-GAAP FINANCIAL INFORMATION**

Cash operating, total cash and total production costs are non-GAAP financial measures and are used by management to assess performance of individual operations as well as a comparison to other gold producers. We have included cash operating costs information to provide investors with information about the cost structure of our mining operations.

The term "cash operating costs" is used on a per ounce of gold basis. Cash operating costs per ounce is equivalent to direct operating cost as found on the Consolidated Statements of Operations, less production royalty expenses and mining taxes but includes by-product credits for payable silver, lead and zinc.

The term "total cash costs" is equivalent to cash operating costs plus production royalties and mining taxes.

The term "total production costs" is equivalent to total cash costs plus non-cash costs including depreciation and amortization.

This information differs from measures of performance determined in accordance with generally accepted accounting principles (GAAP) in Canada and the United States and should not be considered in isolation or a substitute for measures of performance prepared in accordance with GAAP. These measures are not necessarily indicative of operating profit or cash flow from operations as determined under GAAP and may not be comparable to similarly titled measures of other companies. See Item 2, Management's Discussion and Analysis of Financial Condition and

Results of Operations, for a reconciliation of these non-GAAP measures to our Statements of Operations.

**PART I**

**FINANCIAL INFORMATION**

**ITEM 1.**

**FINANCIAL STATEMENTS**

These consolidated financial statements should be read in conjunction with the financial statements, accompanying notes and other relevant information included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission on March 31, 2006.



**APOLLO GOLD CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands of U.S. dollars)

(Unaudited)

	September 30, 2006	December 31, 2005
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and cash equivalents	\$ 1,978	\$ 127
Accounts receivable	256	2,638
Prepays	417	400
Inventories	1,333	1,708
Total current assets	3,984	4,873
Property, plant and equipment	46,645	40,045
Restricted certificates of deposit	7,554	17,043
Deferred financing costs	345	584
<b>TOTAL ASSETS</b>	<b>\$ 58,528</b>	<b>\$ 62,545</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable	\$ 1,949	\$ 6,802
Accrued liabilities	2,020	1,841
Notes payable	2,801	596
Property and mining taxes payable	895	1,172
Total current liabilities	7,665	10,411
Due to Elkhorn Tunnels, LLC (Note 4)	3,077	-
Accrued severance	370	383
Notes payable	55	75
Convertible debenture	7,376	6,601
Accrued site closure costs	13,713	12,634
<b>TOTAL LIABILITIES</b>	<b>32,256</b>	<b>30,104</b>
Continuing operations (Note 1)		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 6)	153,670	148,295
Issuable common shares	231	231
Equity component of convertible debentures	1,809	1,809
Note warrants	1,062	781
Contributed surplus	10,876	10,561
Deficit	(141,376)	(129,236)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>26,272</b>	<b>32,441</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 58,528</b>	<b>\$ 62,545</b>

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

**APOLLO GOLD CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands of U.S. dollars, except share and per share amounts)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Revenue from sale of minerals	\$ 372	\$ 13,351	\$ 10,177	\$ 36,264
Operating expenses				
Direct operating costs	3,211	14,162	13,957	40,273
Depreciation and amortization	324	672	1,282	2,006
General and administrative expenses	997	866	3,279	3,732
Stock-based compensation	126	171	315	525
Accretion expense - accrued site closure costs	237	242	711	636
Exploration and business development	188	173	788	731
(Gain) loss on sale of property, plant and equipment	3	42	7	(1,323)
	5,086	16,328	20,339	46,580
Operating loss	(4,714)	(2,977)	(10,162)	(10,316)
Other income (expenses)				
Interest income	99	105	253	278
Interest expense	(726)	(747)	(1,939)	(1,940)
Foreign exchange loss and other	(29)	5	(42)	(28)
Loss from continuing operations for the period	(5,370)	(3,614)	(11,890)	(12,006)
Loss from discontinued operations for the period (Note 5)	-	(3,599)	(250)	(5,954)
Net loss for the period	\$ (5,370)	\$ (7,213)	\$ (12,140)	\$ (17,960)
Basic and diluted net loss per share from:				
Continuing operations	\$ (0.04)	\$ (0.04)	\$ (0.10)	\$ (0.12)
Discontinued operations	-	(0.03)	-	(0.06)
	\$ (0.04)	\$ (0.07)	\$ (0.10)	\$ (0.18)
Basic and diluted weighted-average number of shares outstanding	121,997,402	106,556,451	120,131,131	100,106,695

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

**APOLLO GOLD CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

(In thousands of U.S. dollars)

(Unaudited)

	Share Capital		Equity Component				Total	
	Number of Shares	Amount	Issuable Common Shares	Convertible Debentures	Note Warrants	Contributed Surplus		Deficit
Balance, December 31, 2004	90,973,120	\$ 141,795	\$ 231	\$ 1,815	\$ 781	\$ 9,627	\$ (107,028)	\$ 47,221
Units issued for cash	4,199,998	2,587	-	-	-	194	-	2,781
Shares issued for increase in Huizopa interest	1,000,000	410	-	-	-	-	-	410
Shares issued for cash	10,000,000	3,183	-	-	-	-	-	3,183
Conversion of convertible debentures	33,333	23	-	(6)	-	-	-	17
Engagement fee shares and warrants	350,000	100	-	-	-	143	-	243
Completion fee shares	900,000	197	-	-	-	-	-	197
Stock-based compensation	-	-	-	-	-	597	-	597
Net loss	-	-	-	-	-	-	(22,208)	(22,208)
Balance, December 31, 2005	107,456,451	148,295	231	1,809	781	10,561	(129,236)	32,441
Units issued for cash	11,650,000	3,488	-	-	-	-	-	3,488
Shares issued for 2005 stock-based compensation	2,290,408	955	-	-	-	-	-	955
Reduction of exercise price of Note Warrants (Note 6(b))	-	-	-	-	305	-	-	305
Note Warrants exercised	600,000	264	-	-	(24)	-	-	240
Shares issued for services	1,325,000	668	-	-	-	-	-	668
Stock-based compensation	-	-	-	-	-	315	-	315
Net loss	-	-	-	-	-	-	(12,140)	(12,140)
Balance, September 30, 2006	123,321,859	\$ 153,670	\$ 231	\$ 1,809	\$ 1,062	\$ 10,876	\$ (141,376)	\$ 26,272

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

**APOLLO GOLD CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands of U.S. dollars)

(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2006	2005	2006	2005
<b>Operating activities</b>				
Net loss for the period	\$ (5,370)	\$ (7,213)	\$ (12,140)	\$ (17,960)
Items not affecting cash:				
Depreciation and amortization	324	672	1,282	2,006
Amortization of deferred financing costs	80	80	239	239
Loss from discontinued operations	-	3,599	250	5,954
Reduction in exercise price of Note Warrants (Note 6(b))	-	-	305	-
Stock-based compensation	126	171	315	525
Shares issued for services	668	-	668	-
Accretion expense - accrued site closure costs	237	242	711	636
Accretion expense - convertible debenture	271	221	775	850
(Gain) loss on sale of property, plant and equipment	3	42	7	(1,323)
Other	21	-	57	-
Net change in non-cash operating working capital items	470	(614)	(1,243)	1,025
Discontinued operations	-	872	(250)	1,358
Net cash used in operating activities	(3,170)	(1,928)	(9,024)	(6,690)
<b>Investing activities</b>				
Property, plant and equipment expenditures	(591)	(1,037)	(5,029)	(4,736)
Proceeds from disposal of property, plant and equipment	-	9	92	2,000
Restricted certificate of deposit and other assets	(525)	(733)	9,488	(1,584)
Discontinued operations	-	(318)	-	1,003
Net cash (used in) provided by investing activities	(1,116)	(2,079)	4,551	(3,317)
<b>Financing activities</b>				
Proceeds on issuance of shares	-	-	3,488	5,944
Proceeds from exercise of warrants	240	-	240	-
Notes payable	309	-	309	-
Payments of notes payable	(315)	(192)	(763)	(756)
Funding by Elkhorn Tunnels, LLC (Note 4)	3,050	-	3,050	-
Discontinued operations	-	(368)	-	(1,758)

Net cash (used in) provided by financing activities	3,284	(560)	6,324	3,430
Net (decrease) increase in cash and cash equivalents	(1,002)	(4,567)	1,851	(6,577)
Cash and cash equivalents, beginning of period	2,980	4,876	127	6,886
Cash and cash equivalents, end of period	\$ 1,978	\$ 309	\$ 1,978	\$ 309
<b>SUPPLEMENTAL CASH FLOW INFORMATION</b>				
Interest paid	\$ 349	\$ 298	\$ 899	\$ 923
Income taxes paid	\$ -	\$ -	\$ -	\$ -

During the three and nine months ended September 30, 2006, property, plant and equipment totaling \$2,640 was acquired by issuing a promissory note.

During the three months ended September 30, 2005, property, plant and equipment of \$99 was acquired under a capital lease agreement.

During the nine months September 30, 2005, the Company issued 1,000,000 shares to Argonaut Mines LLC (“Argonaut”) in connection with the restructuring of the Huizopa interest in Mexico. Share capital and property, plant and equipment both increased by \$410 as a result of this transaction.

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

**APOLLO GOLD CORPORATION**

**Notes to the Condensed Consolidated Financial Statements**

**Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**1. CONTINUING OPERATIONS**

These consolidated financial statements are prepared on the basis of a going concern which assumes that Apollo Gold Corporation (“Apollo” or the “Company”) will realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. To date the Company has funded its operations through (i) issuance of debt and equity securities, (ii) funding from joint venture partners (Note 4), (iii) the sale of the Florida Canyon Mine (an open pit heap leach operation located in the State of Nevada), the Standard Mine (an open pit heap leach operation situated 8 kilometers south of the Florida Canyon Mine) and four exploration properties located near the Florida Canyon Mine (collectively, the “Nevada Assets”) in November 2005 to Jipangu, Inc. (“Jipangu”) plus (iv) the sale of other surplus assets. The Company’s ability to continue as a going concern is dependent on its ability to continue to issue debt and equity securities, and/or generate cash flow from Montana Tunnels.

The Company estimates that with its current period end cash balance of \$2.0 million supplemented by the monies raised in the equity offerings completed in October and November (as described in more detail in Note 10(a)) and the projected cash positive contribution from the joint ventured Montana Tunnels mine, it will have sufficient funds to finance the current work programs at the Black Fox development project (the “Black Fox Project”) and the Huizopa exploration project (the “Huizopa Project”), as well as corporate overhead. However, the Company will continue to explore financing opportunities to further develop and construct the Black Fox Project and advance its exploration program at the Huizopa Project. Apollo may raise additional funds from the sale of debt or equity securities, which may include Canadian flow-through financing to further fund exploration activities at the Black Fox Project. The availability, amount, terms and timing of this financing are not certain at this time.

If the Company is unable to generate cash flow from Montana Tunnels and/or secure additional financing, it may be unable to continue as a going concern and material adjustments would be required to the carrying value of assets and liabilities and balance sheet classifications used.

**2. NATURE OF OPERATIONS**

Apollo is engaged in gold mining including extraction, processing, refining and the production of other co-product metals, as well as related activities including exploration and development of mineral deposits principally in North America. The Company currently owns the Montana Tunnels mine (the “Mine”), an open pit mine and mill located in the State of Montana. Mining in the open pit was suspended in October 2005 due to pit wall instability. Following the suspension of the open pit mine operations the mill produced gold doré and lead-gold and zinc-gold concentrates from low grade ore stockpiles until May 12, 2006. On July 28, 2006, the Company entered into a joint venture agreement (“JV Agreement”) with Elkhorn Tunnels, LLC (“Elkhorn”), an affiliate of Calim Private Equity LLC (“Calim”), in respect of the Mine. With the expected financial contributions from Elkhorn in connection with the joint venture, the Company believes that it will be able to recommence milling operations in early 2007 (see Note 4). Mining operations resumed in September 2006. The Company also owns the Diamond Hill mine, currently on care and maintenance, also located in the State of Montana. In connection with the joint venture agreement that the Company entered into with Elkhorn in respect of the Montana Tunnels mine, the Company entered into an option agreement with Elkhorn Goldfields Inc. (“EGI”), an affiliate of Elkhorn, pursuant to which the Company granted EGI an option to purchase the Diamond Hill mine for \$800,000.



**APOLLO GOLD CORPORATION**

**Notes to the Condensed Consolidated Financial Statements**

**Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**2. NATURE OF OPERATIONS (continued)**

Apollo has a development property, the Black Fox Project, which is located near the Township of Matheson in the Province of Ontario, Canada. Apollo also owns Mexican subsidiaries which own or have the right to acquire concessions at the Huizopa Project, located in the Sierra Madres in Chihuahua, Mexico.

**3. SIGNIFICANT ACCOUNTING POLICIES**

These unaudited consolidated interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and except as described in Note 9, conform in all material respects with accounting principles generally accepted in the United States ("U.S. GAAP"). The accounting policies followed in preparing these financial statements are those used by the Company as set out in the audited financial statements for the year ended December 31, 2005. Certain information and note disclosures normally included in consolidated financial statements prepared in accordance with Canadian GAAP have been omitted. These interim financial statements should be read together with the Company's audited financial statements for the year ended December 31, 2005.

In the opinion of management, all adjustments considered necessary for fair presentation have been included in these financial statements. Interim results are not necessarily indicative of the results expected for the fiscal year.

Certain of the comparative figures have been reclassified to conform to the current period presentation.

**4. DUE TO ELKHORN TUNNELS, LLC**

**(a) Joint Venture Agreement at Montana Tunnels**

On July 28, 2006, the Company entered into a JV Agreement with Elkhorn in respect of the Montana Tunnels mine which calls for Elkhorn to contribute \$13 million over a five-month period. The money contributed will be used initially to remediate the east wall instability problems encountered at the Mine during September and early October 2005, which led to the suspension of mining on October 21, 2005, and thereafter to move the Mine back towards commercial production. Highlights of the JV Agreement are:

- Elkhorn is entitled to a 50% interest in the Mine when it has made its full contribution of \$13 million.
- Montana Tunnels Mining, Inc. ("MTMI") will be the operator of the Mine. A separate committee consisting of two designees from each of MTMI and Elkhorn will oversee the joint venture.
- If Elkhorn contributes at least \$5 million but fails to make its full contribution of \$13 million, then it will receive a 3% interest in the Mine for each \$1 million contributed.



**APOLLO GOLD CORPORATION**

**Notes to the Condensed Consolidated Financial Statements**

**Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**4. DUE TO ELKHORN TUNNELS, LLC (continued)**

- If Elkhorn fails to contribute at least \$5 million then its contribution will be converted to a promissory note (the "Note") equal to the amount actually contributed, plus interest, payable only out of future positive cash flows from the Mine or in the event the Mine is sold or otherwise financed. The Note would bear interest at the rate of 6% per annum and payments of principal and interest on the Note would be payable within 30 days after the end of each calendar quarter, beginning with the end of the first full calendar quarter during which the Mine is cash flow positive. If Elkhorn's failure to contribute at least \$5 million is the result of a breach of the JV Agreement by Apollo, or otherwise for cause, then the Note would bear interest at the rate of 12% per annum and the Note plus interest would be payable not later than the fifth anniversary thereof.
- When Elkhorn has contributed the full \$13 million, then (a) Elkhorn will be entitled to recover interest on that amount and (b) Elkhorn will receive 65% and Apollo will receive 35% of the positive free cash flow from the Mine until such time as Elkhorn has recovered its full contribution of \$13 million. At that time, Apollo would become entitled to 60% and Elkhorn 40% of the positive free cash flow from the Mine, until both parties have received an equal amount. Thereafter, the sharing would revert to 50/50.
- If Elkhorn earns less than a 50% interest in the Mine, then it will be entitled to recover interest on the amount actually contributed by it, and after payment of that interest each party will receive its proportionate share of positive free cash flow.

As of September 30, 2006, Elkhorn had contributed \$3.1 million in connection with the JV Agreement which contributions are recorded as Due to Elkhorn Tunnels, LLC in the accompanying Consolidated Balance Sheet since Elkhorn's contributions were short of the \$5 million required to earn an interest in the Mine as of such date (see Note 10(b)).

**(b) Additional Agreements with EGI**

In addition to the JV Agreement, Apollo entered into two other agreements with EGI, an affiliate of Calim. The first agreement is an option agreement pursuant to which EGI was granted an option to purchase Apollo's Diamond Hill mine for \$800,000. The option has an exercise term of two years. The second agreement is a mill operating and option agreement pursuant to which EGI will have the right to have MTMI process the ore from EGI's Elkhorn mine through the 1,000 ton per day Diamond Hill mill which is situated within the Montana Tunnels mill complex. The milling agreement also provides EGI a two-year option to purchase the Diamond Hill mill for \$1 million.

**APOLLO GOLD CORPORATION****Notes to the Condensed Consolidated Financial Statements****Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**5. DISCONTINUED OPERATIONS**

In November 2005, the Company sold the Nevada Assets to Jipangu for \$14.0 million in cash.

The following table presents summarized financial information related to discontinued operations:

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Revenue from sale of minerals	\$ -	\$ 6,582	\$ -	\$ 14,677
Direct operating costs	-	5,935	-	13,829
Depreciation and amortization	-	-	-	776
Accretion expense	-	280	-	737
Royalty expenses	-	65	-	231
Exploration and business development	-	28	-	217
Gain on sale of property, plant and equipment	-	-	-	(3,615)
Impairment	-	3,861	-	8,425
	-	10,169	-	20,600
Operating loss	-	(3,587)	-	(5,923)
Interest expense	-	(12)	-	(69)
Realized and unrealized gain on commodity contracts	-	-	-	38
Loss on disposal of discontinued operations	-	-	(250)	-
Loss from discontinued operations for the period	\$ -	\$ (3,599)	\$ (250)	\$ (5,954)

**6. SHARE CAPITAL****(a) Shares issued in 2006**

(i) On January 26, 2006, the Company completed a private placement of 11,650,000 units with Jipangu at Cdn\$0.35 per unit for proceeds of \$3.5 million. Each unit consists of one common share of the Company and 0.17167 of a warrant for a total of 2,000,000 warrants, with each whole warrant exercisable for two years at Cdn\$0.39 for one common share of the Company.

(ii) On February 27, 2006, the Company issued 2,290,398 common shares of the Company at Cdn\$0.48 per share to officers of the Company, as approved by the Company's Board of Directors in December 2005. In connection with this, the Company announced on January 23, 2006 that the number of executive officers would be reduced from seven to three, effective February 18, 2006 and the Company entered into severance agreements with the four departing officers pursuant to which an aggregate of 1,187,175 common shares were issued to the officers as part of their severance. Also on January 23, 2006, the Company entered into amended employment agreements with the three remaining executive officers pursuant to which the officers agreed to reduce their base salaries by an aggregate of

\$170,000 per annum in exchange for an aggregate of 1,103,223 common shares.

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**APOLLO GOLD CORPORATION****Notes to the Condensed Consolidated Financial Statements****Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**6. SHARE CAPITAL (continued)**

(iii) On August 29, 2006, the Company issued 400,000 common shares for investor relations services at \$0.67 per share.

(iv) On September 12, 2006, the Company issued 925,000 common shares at \$0.43 per share to Standard New York Securities, Inc. as a completion fee related to the JV Agreement in respect of MTMI.

**(b) Warrants**

The following summarizes outstanding warrants as at September 30, 2006:

<b>Date Issued</b>	<b>Number of Warrants</b>	<b>Number of Shares</b>	<b>Exercise Price</b> Exercisable in US\$	<b>Expiry Date</b>
October 19, 2004	1,000,000	1,000,000	\$ 0.80	October 19, 2006
November 4, 2004	1,400,133	1,400,133	0.80	November 4, 2006
December 31, 2004	6,224,999	6,224,999	1.00	December 31, 2006
November 4, 2004	4,413,600	4,413,600	0.40	November 4, 2007
November 4, 2004	240,000	240,000	0.80	November 4, 2007
November 4, 2004	1,396,000	1,396,000	0.80	November 4, 2007
January 7, 2005	3,149,998	3,149,998	1.00	January 7, 2007
	17,824,730	17,824,730		
			Exercisable in Cdn\$	
December 23, 2002	3,000,000	3,000,000	Cdn\$ 3.25	December 23, 2006
June 30, 2005	1,250,000	1,250,000	Cdn\$ 0.40	June 30, 2007
January 26, 2006	2,000,000	2,000,000	Cdn\$ 0.39	January 26, 2008
	6,250,000	6,250,000		
	24,074,730	24,074,730		

In addition, 1,250,000 broker compensation warrants were issued and were immediately exercisable on January 7, 2005. Each broker compensation warrant is exercisable at \$0.75 into one equity unit comprised of one common share of the Company and 0.75 of a share purchase warrant, with each whole share purchase warrant exercisable into one common share of the Company at \$1.00 per common share. The broker compensation warrants expire on January 7,

2007. The share purchase warrants are exercisable for two years from the date of issue.

On January 6, 2006, the Company agreed to reduce the exercise price on 5,013,600 warrants issued as attachments to the convertible debentures ("Debentures") in November 2004 from \$0.80 to \$0.40 per common share. The reduction in exercise price was in consideration for pledging the Company's Black Fox property to The Canada Trust Company (the "Secured Party") as substitute collateral for the Debentures, which were previously secured by an \$11.0 million restricted cash deposit. The Secured Party is trustee for the holders of the Debentures. The reduction in the exercise price was effective January 16, 2006, and applies to all warrants attached to the Debentures except for the 240,000 warrants held by the Company's insiders, which remain exercisable at \$0.80 per common share. The Company recorded an additional cost of \$305,000 as a result of this reduction of the exercise price.

**APOLLO GOLD CORPORATION****Notes to the Condensed Consolidated Financial Statements****Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**6. SHARE CAPITAL (continued)****(c) Options**

A summary of information concerning outstanding stock options at September 30, 2006 is as follows:

	Fixed Stock Options		Performance-based Stock Options	
	Number of Common Shares	Weighted Average Exercise Price	Number of Common Shares	Weighted Average Exercise Price
Balances, December 31, 2005	3,874,100	\$ 1.15	1,794,582	\$ 0.80
Options granted	433,000	0.55	-	-
Options cancelled	(342,250)	1.08	(254,061)	0.80
Balances, September 30, 2006	3,964,850	\$ 1.09	1,540,521	\$ 0.80

**(i) Fixed stock option plan**

The Company has a stock option plan that provides for the granting of options to directors, officers, employees and service providers of the Company.

The following table summarizes information concerning outstanding and exercisable fixed stock options at September 30, 2006:

Options Outstanding			Options Exercisable	
Number Outstanding	Expiry Date	Weighted Average Exercise Price per Share	Number Exercisable	Weighted Average Exercise Price per Share
950,000	December 31, 2006	\$ 1.16	950,000	\$ 1.16
686,500	February 18, 2013	2.24	686,500	2.24
261,000	March 10, 2014	2.05	261,000	2.05
25,000	May 19, 2014	1.44	25,000	1.44
23,000	August 10, 2014	0.95	23,000	0.95
1,186,350	March 10, 2015	0.65	593,175	0.65
100,000	August 4, 2015	0.27	50,000	0.27
300,000		0.20	-	-

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	December 12, 2015				
125,000	March 28, 2016	0.65	62,500	0.65	
200,000	May 23, 2016	0.53	-	-	
108,000	August 10, 2016	0.48	-	-	
3,964,850		\$ 1.09	2,651,175	\$ 1.39	

(ii) Performance-based stock option plan

As of September 30, 2006 the 1,540,521 performance-based stock options exercisable at \$0.80 were fully vested and have an expiry date of June 25, 2007.

**APOLLO GOLD CORPORATION****Notes to the Condensed Consolidated Financial Statements****Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**6. SHARE CAPITAL (continued)****(d) Stock-based compensation**

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

	<b>Nine months ended September 30,</b>	
	<b>2006</b>	<b>2005</b>
Risk free interest rate	3.9%	3.8%
Dividend yield	0%	0%
Volatility	89%	74%
Expected life in years	6	5

**7. INCOME TAXES**

The Company did not record a recovery for income taxes for the period ended September 30, 2006 as the net loss carry forwards are fully offset by a valuation allowance.

**8. SEGMENTED INFORMATION**

Apollo operates the Montana Tunnels mine in the United States and the Black Fox development project in Canada. The reportable segments have been determined at the level where decisions are made on the allocation of resources and capital and where performance is measured. The Nevada Assets have been reported as discontinued operations (see Note 5). The accounting policies for these segments are the same as those followed by the Company as a whole.

Amounts as at September 30, 2006 are as follows:

	<b>Montana Tunnels</b>	<b>Black Fox</b>	<b>Corporate and Other</b>	<b>Total</b>
Cash and cash equivalents	\$ 549	\$ 27	\$ 1,402	\$ 1,978
Other non-cash current assets	1,385	64	557	2,006
	1,934	91	1,959	3,984
Property, plant and equipment	15,346	30,026	1,273	46,645
Restricted certificates of deposit	6,950	604	-	7,554
Deferred financing costs	-	-	345	345
Total assets	\$ 24,230	\$ 30,721	\$ 3,577	\$ 58,528
Current liabilities	\$ 5,283	\$ 246	\$ 2,136	\$ 7,665
Due to Elkhorn Tunnels, LLC (Note 4)	3,077	-	-	3,077
Accrued severance	-	-	370	370
Notes payable and convertible debenture	-	55	7,376	7,431
Accrued site closure costs	13,345	368	-	13,713
Total liabilities	\$ 21,705	\$ 669	\$ 9,882	\$ 32,256





**APOLLO GOLD CORPORATION****Notes to the Condensed Consolidated Financial Statements****Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**8. SEGMENTED INFORMATION (continued)**

Amounts as at December 31, 2005 are as follows:

	<b>Montana Tunnels</b>		<b>Black Fox</b>		<b>Corporate and Other</b>		<b>Total</b>
Cash and cash equivalents	\$ 8	\$	15	\$	104	\$	127
Other non-cash current assets	4,218		100		428		4,746
	4,226		115		532		4,873
Property, plant and equipment	13,917		24,794		1,334		40,045
Restricted certificates of deposit	5,465		581		10,997		17,043
Deferred financing costs	-		-		584		584
Total assets	\$ 23,608	\$	25,490	\$	13,447	\$	62,545
Current liabilities	\$ 5,444	\$	221	\$	4,746	\$	10,411
Accrued severance	-		-		383		383
Notes payable and convertible debenture	-		66		6,610		6,676
Accrued site closure costs	12,634		-		-		12,634
Total liabilities	\$ 18,078	\$	287	\$	11,739	\$	30,104

Amounts for the three and nine month periods ended September 30, 2006 and 2005, respectively, are as follows:

	<b>Three months ended September 30, 2006</b>						
	<b>Montana Tunnels</b>		<b>Black Fox</b>		<b>Corporate and Other</b>		<b>Total</b>
Revenue from sale of minerals	\$ 372	\$	-	\$	-	\$	372
Direct operating costs	3,211		-		-		3,211
Depreciation and amortization	298		-		26		324
General and administrative expenses	-		-		997		997
Stock-based compensation	-		-		126		126
Accretion expense - accrued site closure costs	237		-		-		237
Exploration and business development and other	-		-		191		191
	3,746		-		1,340		5,086
Operating loss	(3,374)		-		(1,340)		(4,714)
Interest income	76		-		23		99
Interest expense	(109)		-		(617)		(726)
Foreign exchange loss and other	-		-		(29)		(29)
Loss from continuing operations	\$ (3,407)	\$	-	\$	(1,963)	\$	(5,370)
Investing activities							
Property, plant and equipment expenditures	\$ 2,640	\$	586	\$	5	\$	3,231



**APOLLO GOLD CORPORATION****Notes to the Condensed Consolidated Financial Statements****Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**8. SEGMENTED INFORMATION (continued)**

	Nine months ended September 30, 2006			
	Montana Tunnels	Black Fox	Corporate and Other	Total
Revenue from sale of minerals	\$ 10,177	\$ -	\$ -	\$ 10,177
Direct operating costs	13,957	-	-	13,957
Depreciation and amortization	1,199	-	83	1,282
General and administrative expenses	-	-	3,279	3,279
Stock-based compensation	-	-	315	315
Accretion expense - accrued site closure costs	711	-	-	711
Exploration and business development and other	-	-	795	795
	15,867	-	4,472	20,339
Operating loss	(5,690)	-	(4,472)	(10,162)
Interest income	190	-	63	253
Interest expense	(127)	-	(1,812)	(1,939)
Foreign exchange loss and other	-	-	(42)	(42)
Loss from continuing operations	\$ (5,627)	\$ -	\$ (6,263)	\$ (11,890)
Investing activities				
Property, plant and equipment expenditures	\$ 2,640	\$ 4,908	\$ 121	\$ 7,669

	Three months ended September 30, 2005			
	Montana Tunnels	Black Fox	Corporate and Other	Total
Revenue from sale of minerals	\$ 13,351	\$ -	\$ -	\$ 13,351
Direct operating costs	14,162	-	-	14,162
Depreciation and amortization	615	-	57	672
General and administrative expenses	-	-	866	866
Stock-based compensation	-	-	171	171
Accretion expense	242	-	-	242
Exploration and business development and other	-	-	215	215
	15,019	-	1,309	16,328
Operating loss	(1,668)	-	(1,309)	(2,977)
Interest income	-	-	105	105
Interest expense	(14)	-	(733)	(747)
Foreign exchange loss and other	-	-	5	5
Loss from continuing operations	\$ (1,682)	\$ -	\$ (1,932)	\$ (3,614)
Investing activities				
Property, plant and equipment expenditures	\$ 106	\$ 870	\$ 160	\$ 1,136



**APOLLO GOLD CORPORATION****Notes to the Condensed Consolidated Financial Statements****Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**8. SEGMENTED INFORMATION (continued)**

	Nine months ended September 30, 2005			
	Montana Tunnels	Black Fox	Corporate and Other	Total
Revenue from sale of minerals	\$ 36,264	\$ -	\$ -	\$ 36,264
Direct operating costs	40,273	-	-	40,273
Depreciation and amortization	1,885	-	121	2,006
General and administrative expenses	-	-	3,732	3,732
Stock-based compensation	-	-	525	525
Accretion expense	636	-	-	636
Exploration and business development	-	-	731	731
Gain on sale of property, plant and equipment	(1,365)	-	42	(1,323)
	41,429	-	5,151	46,580
Operating loss	(5,165)	-	(5,151)	(10,316)
Interest income	-	-	278	278
Interest expense	(52)	-	(1,888)	(1,940)
Foreign exchange loss and other	-	-	(28)	(28)
Loss from continuing operations	\$ (5,217)	\$ -	\$ (6,789)	\$ (12,006)
Investing activities				
Property, plant and equipment expenditures	\$ 197	\$ 4,359	\$ 689	\$ 5,245

**9. DIFFERENCES BETWEEN CANADIAN AND U.S. GAAP**

The Company prepares its consolidated financial statements in accordance with Canadian GAAP. The following adjustments and/or additional disclosures would be required in order to present the financial statements in accordance with U.S. GAAP and with practices prescribed by the U.S. Securities and Exchange Commission for the three and nine month periods ended September 30, 2006 and 2005.

Material variances between financial statement items under Canadian GAAP and the amounts determined under U.S. GAAP are as follows:

**Consolidated Balance Sheet  
September 30, 2006**

	Property Plant and Equipment	Deferred Financing	Convertible Debenture	Share Capital	Equity Component of Convertible Debentures	Contributed Surplus	Deficit
As at September 30, 2006, Canadian GAAP	\$ 46,645	\$ 345	\$ 7,376	\$ 153,670	\$ 1,809	\$ 10,876	\$ (141,376)

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Impairment of property, plant and equipment, and change in depreciation and amortization(a)	(4,077)	-	-	-	-	-	(4,077)
Black Fox development costs(b)	(21,863)	-	-	-	-	-	(21,863)
Convertible debenture(c)(i)	-	134	966	(1)	(1,809)	123	855
Convertible debenture(c)(ii)	-	-	-	-	-	20,675	(20,675)
Flow-through common shares	-	-	-	(238)	-	-	238
As at September 30, 2006, U.S.							
GAAP	\$ 20,705	\$ 479	\$ 8,342	\$ 153,431	\$ -	\$ 31,674	\$ (186,898)

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**APOLLO GOLD CORPORATION****Notes to the Condensed Consolidated Financial Statements****Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**9. DIFFERENCES BETWEEN CANADIAN AND U.S. GAAP (continued)****Consolidated Balance Sheet  
December 31, 2005**

	<b>Property Plant and Equipment</b>	<b>Deferred Financing</b>	<b>Convertible Debt</b>	<b>Share Capital</b>	<b>Equity Component of Convertible Debt</b>	<b>Contributed Surplus</b>	<b>Deficit</b>
As at December 31, 2005, Canadian GAAP	\$ 40,045	\$ 584	\$ 6,601	\$ 148,295	\$ 1,809	\$ 10,561	\$ (129,236)
Impairment of property, plant and equipment, and change in depreciation and amortization(a)	(4,260)	-	-	-	-	-	(4,260)
Black Fox development costs(b)	(19,181)	-	-	-	-	-	(19,181)
Convertible debenture(c)(i)	-	227	1,512	(1)	(1,809)	123	401
Convertible debenture(c)(ii)	-	-	-	-	-	20,675	(20,675)
Flow-through common shares	-	-	-	(238)	-	-	238
As at December 31, 2005, U.S. GAAP	\$ 16,604	\$ 811	\$ 8,113	\$ 148,056	\$ -	\$ 31,359	\$ (172,713)

Under U.S. GAAP, the net loss and net loss per share would be adjusted as follows:

	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Loss from continuing operations for the period based on Canadian GAAP	\$ (5,370)	\$ (3,614)	\$ (11,890)	\$ (12,006)
Change in depreciation of property, plant and equipment (a)	-	134	183	432
Black Fox Project development costs (b)	(587)	(871)	(2,682)	(4,359)
Convertible debenture ((c)(i))	161	(416)	454	9
Loss from continuing operations for the period based on U.S. GAAP	(5,796)	(4,767)	(13,935)	(15,924)
Loss from discontinued operations for the period based on Canadian GAAP	-	(3,599)	(250)	(5,954)
Commodity contracts loss (d)	-	-	-	1,340
Standard Mine development costs	-	(526)	-	(840)
Loss from discontinued operations for the period based on U.S. GAAP	-	(4,125)	(250)	(5,454)
	\$ (5,796)	\$ (8,892)	\$ (14,185)	\$ (21,378)



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Net loss for the period based on U.S.

GAAP

Comprehensive loss	\$	(5,796)	\$	(8,892)	\$	(14,185)	\$	(21,378)
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Basic and diluted loss per share in  
accordance with U.S. GAAP:

Continuing operations	\$	(0.05)	\$	(0.04)	\$	(0.12)	\$	(0.16)
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Discontinued operations		-		(0.04)		-		(0.05)
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Net loss per share - U.S. GAAP, basic and diluted	\$	(0.05)	\$	(0.08)	\$	(0.12)	\$	(0.21)
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**APOLLO GOLD CORPORATION**

**Notes to the Condensed Consolidated Financial Statements**

**Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**9. DIFFERENCES BETWEEN CANADIAN AND U.S. GAAP (continued)**

**(a) Impairment of property, plant and equipment**

Under Canadian GAAP, write-downs for impairment of property, plant and equipment are determined using current proven and probable reserves and mineral resources expected to be converted into mineral reserves. In 2002, under U.S. GAAP, write-downs were determined using current proven and probable reserves. Accordingly, for U.S. GAAP purposes, an impairment of property, plant and equipment and an adjustment to the related depreciation has been recorded.

**(b) Black Fox Project**

Under Canadian GAAP, mining development costs at the Black Fox Project have been capitalized. Under U.S. GAAP, these expenditures are expensed as incurred. Accordingly, for U.S. GAAP purposes, a reduction in property, plant and equipment of \$21.9 million has been recorded as at September 30, 2006.

**(c) Convertible debenture**

*(i)* Under Canadian GAAP, the convertible debentures were recorded as a compound financial instrument including detachable note warrants. On issuance in November 2004, under U.S. GAAP, the detachable note warrant is similarly treated as an equity instrument with the remainder of the convertible debentures treated as a liability. Further, under U.S. GAAP, the beneficial conversion feature determined using the effective conversion price based on the proceeds allocated to the convertible debenture in accordance with EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments", is allocated to contributed surplus. This discount on the debenture is recognized as additional interest expense immediately as the debt is convertible at the date of issuance. Canadian GAAP does not require the recognition of any beneficial conversion feature.

*(ii)* Under Canadian GAAP, the convertible debentures were recorded as an equity instrument on issuance in March 2002. Under U.S. GAAP, on issuance, the convertible debenture would have been recorded as a liability and reclassified to equity only upon conversion. Further, under U.S. GAAP, the beneficial conversion feature was allocated to contributed surplus and the Company recognized debenture issuance costs of \$20.7 million. Canadian GAAP does not require the recognition of any beneficial conversion feature.

**(d) Discontinued operations**

Prior to January 1, 2004, under U.S. GAAP, unrealized gains and losses on the put and call option contracts were recorded in the statement of operations. As of January 1, 2004, the Company adopted the provisions of CICA Accounting Guideline 13, *Hedging Relationships* and unrealized gains and losses on these contracts are now recorded in the statement of operations under Canadian GAAP.

**(e) Comprehensive income**

SFAS No. 130, "Reporting Comprehensive Income" ("SFAS 130") establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. SFAS 130 requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement. For the Company, the only component of comprehensive loss is the net loss for the period.

**APOLLO GOLD CORPORATION**

**Notes to the Condensed Consolidated Financial Statements**

**Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**9. DIFFERENCES BETWEEN CANADIAN AND U.S. GAAP (continued)**

*(f)* Statement of cash flows

Under Canadian GAAP, mining development costs at the Black Fox Project are included in cash flows from investing activities in the consolidated statements of cash flows. Under U.S. GAAP, these expenditures are included in cash flows from operating activities. Accordingly, under U.S. GAAP, the consolidated statements of cash flows for the three and nine months ended September 30, 2006 would reflect an increase in cash provided by investing activities of \$0.6 million and \$2.7 million and for the three and nine months ended September 30, 2005 an increase of \$0.9 million and \$4.4 million, respectively, and a corresponding increase in cash used in operating activities.

*(g)* Share-Based Payment

As of January 1, 2006, the Company adopted the provisions of SFAS No. 123(R), "Share-Based Payment". The adoption of this standard did not impact the Company's financial position or results of operations.

**10. SUBSEQUENT EVENTS**

*(a)* Issuance of stock

*(i)* On October 30, 2006, the Company completed an offering of 2,222,221 flow-through units of the Company at Cdn\$0.45 per unit to the MineralFields Group for net proceeds of Cdn\$903,000. Each flow-through unit is comprised of one flow-through common share of the Company and one-half of one share purchase warrant, each whole warrant exercisable into one common share of the Company for a period of two years from closing at an exercise price of Cdn\$1.00 for the first twelve months and Cdn\$1.15 for the last twelve months. In connection with this offering, 166,666 broker warrants were issued. Each broker warrant is exercisable at Cdn\$0.45 for two years into one equity unit with each equity unit comprised of one common share of the Company and one-half of one share purchase warrant. The broker's share purchase warrants are exercisable into one common share of the Company for a period of two years from closing at an exercise price of Cdn\$1.00 for the first twelve months and Cdn\$1.15 for the last twelve months.

*(ii)* On November 9, 2006, the Company completed an offering of approximately 16.7 million units of the Company at \$0.30 per unit for net proceeds of approximately \$4.6 million. Each unit sold in the offering consists of one common share and one-half of one warrant to purchase one common share at \$0.50 exercisable for three years after closing. The warrants contain provisions that provide that, subject to certain exceptions, if the Company sells, grants an option to purchase or otherwise disposes, issues or reprices any common shares (or any securities that are convertible into or exercisable for common shares) at a price per share less than \$0.50 per share, then the exercise price of the warrants will be reduced to such price. In connection with this offering, approximately 1.2 million underwriter's warrants were issued with the same terms as described above.

**APOLLO GOLD CORPORATION**

**Notes to the Condensed Consolidated Financial Statements**

**Nine month period ended September 30, 2006**

(Stated in U.S. dollars; tabular amounts in thousands)

(Unaudited)

**10. SUBSEQUENT EVENTS (continued)**

**(b) Contributions by Elkhorn in respect of the JV Agreement**

As of November 14, 2006, Elkhorn has contributed \$5,000,000 in connection with the JV Agreement representing an additional \$1,950,000 since September 30, 2006 which is sufficient for Elkhorn to earn an initial 15% interest in the Mine (see Note 4).

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### All Dollar amounts are expressed in United States Dollars

The following discussion and analysis should be read in conjunction with the accompanying consolidated financial statements and related notes. The financial statements have been prepared in accordance with generally accepted accounting principles in Canada (Canadian GAAP). For a reconciliation to GAAP in the United States (U.S. GAAP), see Note 9 to the attached consolidated financial statements.

In this Form 10-Q, the terms "cash operating cost," "total cash cost" and "total production cost" are non-GAAP financial measures and are used on a per ounce of gold sold basis. Cash operating costs per ounce is equivalent to direct operating cost as found on the Consolidated Statements of Operations, less production royalty expenses and mining taxes but includes by-product credits for payable silver, lead, and zinc production. Total cash costs is equivalent to cash operating costs plus production royalties and mining taxes. The term "total production costs" is equivalent to total cash costs plus non-cash costs including depreciation and amortization.

Certain of the comparative figures have been reclassified to conform with the current period presentation.

### RECONCILIATION OF CASH OPERATING AND TOTAL PRODUCTION COSTS PER OUNCE

(\$ in thousands)	Three months ended		Nine months ended	
	September 30,	September 30,	September 30,	September 30,
	2006(1)	2005	2006(1)	2005
Gold ounces sold	—	14,104	4,959	39,073
Direct operating costs	n/a(1)	\$ 14,162	\$ 13,957	\$ 40,273
Less: Mining taxes, royalty expenses		345	282	932
By-product credits		6,929	6,906	19,280
Cash operating cost		6,888	6,769	20,061
Cash operating cost per ounce		\$ 488	\$ 1,365	\$ 513
Cash operating costs		6,888	6,769	20,061
Add: Mining taxes, royalty expenses		345	282	932
Total cash costs		7,233	7,051	20,993
Total cash cost per ounce		\$ 513	\$ 1,422	\$ 537
Total cash costs		7,233	7,051	20,993
Add: Depreciation & amortization (operations only)		615	1,199	1,885
Total production costs		7,848	8,250	22,878
Total production cost per ounce		\$ 556	\$ 1,664	\$ 586

(1)The Montana Tunnels mine ceased milling operations on May 12, 2006; therefore, no metal products were produced after that date.

### BACKGROUND AND RECENT DEVELOPMENTS

We are principally engaged in the exploration, development and mining of gold. We own the Montana Tunnels mine, an open pit mine and mill located near Helena, Montana, which produced gold doré and lead-gold and zinc-gold concentrates until May 12, 2006. On July 28, 2006, the Company entered into a joint venture agreement ("JV Agreement") with Elkhorn Tunnels, LLC ("Elkhorn") in respect of the Montana Tunnels mine. With the expected financial contributions from Elkhorn in connection with the joint venture, the Company believes that it will be able to

remediate the pit wall instability and recommence mill operations in February 2007. We also own the Diamond Hill mine, currently on care and maintenance, also located in the State of Montana. In connection with the joint venture agreement that we entered into with Elkhorn in respect of the Montana Tunnels mine, the Company entered into an option agreement with Elkhorn Goldfields Inc. ("EGI"), an affiliate of Elkhorn, pursuant to which the Company granted EGI an option to purchase the Diamond Hill mine for \$800,000.

We also own a development property, the Black Fox project, which is located near the township of Matheson in the Province of Ontario, Canada. Additionally, we own Mexican subsidiaries which own or have the right to acquire concessions of the Huizopa exploration property located in the Sierra Madres in Chihuahua, Mexico.

## Recent Events

### Montana Tunnels

On July 28, 2006, we entered into a joint venture agreement pursuant to which Elkhorn may make scheduled financial contributions in exchange for up to a 50% interest in the Montana Tunnels mine. With the expected financial contributions from Elkhorn, we plan to bring the Montana Tunnels mine back into production in February 2007. Recruitment of equipment maintenance personnel commenced on August 10, 2006 followed by the hiring of mine operating personnel during the first week of September. On September 10, 2006 remediation within the open pit recommenced and at September 30, 2006, 642,000 tons of waste had been mined. As at November 8, 2006, the tonnage mined had risen to approximately 3,000,000 tons. The overall remediation plan, which was developed in conjunction with a third party consultant Knight Piesold, calls for the unloading of 5,000,000 tons from the upper benches of the open pit to mitigate rock fall hazards. The plan also calls for a new, wider haul ramp and the removal of 2,500,000 tons of waste from the pit bottom. We expect the mill to commence operations in February 2007. As at September 30, 2006, Elkhorn had contributed \$3,050,000 towards its earn-in requirement of \$13,000,000. As at November 14, 2006, Elkhorn had contributed \$5,000,000, which is sufficient for Elkhorn to earn an initial 15% interest in the Montana Tunnels mine.

In connection with the remediation, on August 1, 2006, we financed the purchase of four CAT 785 haul trucks (the "Trucks") with a \$2,640,000 promissory note payable to the Great American Group (the "Great American Note"). The Great American Note accrues interest at the rate of 1.5% per month and matures on December 1, 2006. The Great American Note is secured by the Trucks. We expect to replace the Great American Note with additional financing with a longer maturity.

### Black Fox

At Black Fox we continued work on updating the gold resources and new resource and reserve numbers were filed in a Canadian National Instrument 43-101 on August 14, 2006. The new resource and reserve numbers are as follows:

	<b>Tonnes 000's</b>	<b>Grade g Au/t</b>	<b>Grade Oz Au/t</b>	<b>Ounces</b>
Open Pit - Material				
Reserve (1)	3,062	4.56	0.147	448,800
Indicated Resource	2,356	3.27	0.105	
Inferred Resource	6,626	4.00	0.129	
Underground - Material				
Indicated Resource	1,004	9.66	0.311	
Inferred Resource	1,228	9.71	0.312	

(1) We report no reserves at Black Fox under SEC Industry Guide 7, which requires a final bankable feasibility study.

### *Non-Reserve Mineral Resources*



*Cautionary Note to US Investors concerning estimates of Indicated Mineral Resources.* This Management's Discussion and Analysis uses the term "indicated mineral resources". We advise US investors that while the term is recognized and required by Canadian regulations, the US Securities and Exchange Commission does not recognize it. US investors are cautioned not to assume that any part or all of the mineral deposits in these categories will ever be converted into mineral reserves.

*Cautionary Note to US Investors concerning estimates of Inferred Mineral Resources.* This Management's Discussion and Analysis uses the term "inferred mineral resources". We advise US investors that while the term is recognized and required by Canadian regulations, the US Securities and Exchange Commission does not recognize it. "Inferred mineral resources" have a great amount of uncertainty as to their existence, and great uncertainty as to their economic and legal feasibility. It cannot be assumed that all or any part of an inferred mineral resource will ever be upgraded to a higher category. In accordance with Canadian rules, estimates of inferred mineral resources cannot form the basis of feasibility or other economic studies. US investors are cautioned not to assume that part or all of the inferred mineral resource exists, or is economically or legally minable.

### **Huizopa**

At Huizopa, on February 9, 2006, we entered into an agreement with the Ejido Huizopa ("Ejido"), the owner of 12,800 hectares of land that covers our mining concessions in Huizopa ("Ejido Land"), pursuant to which we have the right to use Ejido Land for all activities necessary for the exploration, development, and production of potential ore deposits in our Huizopa project area.

## Finance, corporate and other developments

Upon closing of the sale of our Nevada assets to Jipangu Inc. (“Jipangu”) on November 18, 2005, \$11.0 million of the \$14.0 million purchase price was deposited as substitute collateral for the Apollo 12% Series 2004-B secured convertible debentures (“Debentures”), which were previously secured by the Nevada assets. In January 2006, after meeting certain conditions, we replaced the \$11.0 million cash collateral with our Black Fox property as security for the Debentures, which resulted in \$8.4 million additional funds being available to the Company after paying \$2.6 million (Cdn\$3.0 million) to release an existing lien over the Black Fox property. In connection with the substitution of collateral for the Debentures we reduced the exercise price on 5,013,600 of the note warrants attached to the Debentures from \$0.80 to \$0.40 per common share. The Company recorded an additional cost of \$0.3 million as a result of this reduction of the exercise price.

On January 26, 2006, we completed a \$3.5 million private placement to Jipangu of 11,650,000 equity units priced at Cdn\$0.35 per unit with each unit consisting of one of our common shares and 0.17167 of a warrant, with each whole warrant exercisable for two years at Cdn\$0.39 for one of our common shares.

On January 23, 2006, we announced that we would reduce the number of executive officers from seven to three, effective February 18, 2006. We entered into severance agreements with the four departing officers, pursuant to which the departing officers received termination packages consisting of a combination of cash and Company common stock and as a result, an aggregate of 1,187,175 common shares were issued at Cdn\$0.48 per share to the departing officers.

Also on January 23, 2006, the Company entered into amended employment agreements with the three remaining executive officers pursuant to which the officers agreed to reduce their base salaries by an aggregate of \$170,000 per annum in exchange for an aggregate of 1,103,223 common shares at Cdn\$0.48 per share.

On October 30, 2006, the Company completed an offering of 2,222,221 flow-through units of the Company at Cdn\$0.45 per unit to the MineralFields Group for net proceeds of Cdn\$903,000. Each flow-through unit is comprised of one flow-through common share of the Company and one-half of one share purchase warrant, each whole warrant exercisable into one common share of the Company for a period of two years from closing at an exercise price of Cdn\$1.00 for the first twelve months and Cdn\$1.15 for the last twelve months. In connection with this offering, 166,666 broker warrants were issued. Each broker warrant is exercisable at Cdn\$0.45 for two years into one equity unit with each equity unit comprised of one common share of the Company and one-half of one share purchase warrant. The broker’s share purchase warrants are exercisable into one common share of the Company for a period of two years from closing at an exercise price of Cdn\$1.00 for the first twelve months and Cdn\$1.15 for the last twelve months.

On November 9, 2006, the Company completed an offering of approximately 16.7 million units of the Company at \$0.30 per unit for net proceeds of approximately \$4.6 million. Each unit sold in the offering consists of one common share and one-half of one warrant to purchase one common share at \$0.50 exercisable for three years after closing. The warrants contain provisions that provide that, subject to certain exceptions, if the Company sells, grants an option to purchase or otherwise disposes, issues or reprices any common shares (or any securities that are convertible into or exercisable for common shares) at a price per share less than \$0.50 per share, then the exercise price of the warrants will be reduced to such price. In connection with this offering, approximately 1.2 million underwriter’s warrants will be issued with the same terms as described above.

**Production from Continuing Operations & Metals Price Averages**

The table below summarizes our production of gold, silver and other metals, as well as average metal prices, for each period indicated:

	<b>Nine months ended September 30, 2006(1)</b>	<b>Year Ended December 31, 2005</b>	<b>Year Ended December 31, 2004</b>
Production:			
Gold (ounces)	4,959	44,099	33,743
Silver (ounces)	116,004	524,722	970,751
Lead (pounds)	1,196,317	10,428,061	10,064,265
Zinc (pounds)	3,040,058	22,380,136	26,222,805
Average metal prices:			
Gold - London bullion mkt. (\$/ounce)	\$ 603	\$ 445	\$ 409
Silver - London bullion mkt. (\$/ounce)	\$ 11.21	\$ 7.31	\$ 6.66
Lead - LME (\$/pound)	\$ 0.53	\$ 0.44	\$ 0.40
Zinc - LME (\$/pound)	\$ 1.36	\$ 0.63	\$ 0.48

(1) The Montana Tunnels mine ceased production operations on May 12, 2006; therefore, no metal products were produced after that date.

**MATERIAL CHANGES IN RESULTS OF OPERATIONS*****Three Months Ended September 30, 2006 Compared to the Three Months Ended September 30, 2005*****Revenue from the Sale of Minerals.**

Revenue from continuing operations for the three months ended September 30, 2006 decreased 97% to \$0.4 million from \$13.4 million for the same period in 2005. The decrease in revenue is due to the cessation of milling on May 12, 2006 with the revenue recorded in the quarter being a negotiated final adjustment of concentrate deliveries made prior to May 12, 2006.

The following presents the key statistics for the Montana Tunnels operation for the three months ended September 30, 2006 and 2005, respectively:

	<b>Three months ended September 30, 2006 (1)(2)</b>	<b>2005</b>
Tons mined	641,934	4,217,617
Tons milled	-	1,299,610
Gold grade oz/ton	n/a	0.0150
Zinc grade %	n/a	0.42
Gold ounces	-	14,104
Silver ounces	-	129,736
Lead pounds	-	3,389,443
Zinc pounds	-	7,401,636
Total cash costs per ounce	n/a	\$ 513
Total production costs per ounce	n/a	\$ 556
Total revenue (\$millions)	\$ 0.4	\$ 13.4

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Capital expenditures (\$millions)	\$	2.6	\$	0.1
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(1) The Montana Tunnels mine recommenced mining operations in September 2006 and mined 641,934 tons of waste.  
(2)The Montana Tunnels mine ceased milling operations on May 12, 2006; therefore, no metal products were produced after that date. Revenue recorded during the third quarter 2006 was from a negotiated final adjustment of concentrate deliveries made prior to May 12, 2006.

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The decrease in production in the third quarter 2006 compared to the third quarter 2005 is a result of the cessation of milling in May 2006. Capital expenditures of \$2.6 million at the Montana Tunnels mine were for the purchase of four additional haul trucks to be used as part of the remediation of the mine.

### **Operating Expenses.**

*Direct Operating Expenses.* Direct operating costs, which includes mining costs, processing costs and smelting and refining charges, for the three months ended September 30, 2006 decreased 77% to \$3.2 million from \$14.2 million for the three months ended September 30, 2005. The decrease in costs is a result of the cessation of all production operations at the Montana Tunnels mine on May 12, 2006 until August 10, 2006 when mining and recruitment of operational personnel recommenced following the signing of the JV agreement with Elkhorn.

*Depreciation and Amortization.* Depreciation and amortization expenses were \$324,000 and \$672,000 for the three months ended September 30, 2006 and 2005, respectively.

*General and Administrative Expenses.* General and administrative expenses were \$1.0 million and \$0.9 million for the three months ended September 30, 2006 and 2005, respectively. A decrease in general and administrative expenses due to reduced numbers of personnel and lower audit and accounting expenses was offset by the issuance of 925,000 common shares to Standard New York Securities Inc., valued at \$400,000, issued as payment of fees for services provided in connection with Montana Tunnels joint venture.

*Stock-Based Compensation.* In January 2004, the Company adopted the fair value method of accounting for stock options as set out in CICA Handbook section 3870, Stock-Based Compensation and Other Stock-Based Payments. Stock-based compensation was \$126,000 and \$171,000 for the three months ended September 30, 2006 and 2005, respectively.

*Accretion Expense.* Accrued accretion expense was \$237,000 for the three months ended September 30, 2006 compared to \$242,000 for the same period in 2005, respectively, primarily due to accrued site closure costs at the Montana Tunnels mine.

*Exploration and Business Development Expense.* Expenses for exploration and development, consisting of drilling and related expenses at our exploration properties, totaled \$188,000 and \$173,000 for the three months ended September 30, 2006 and 2005, respectively. The expenses have remained relatively the same from 2005 as there has been no increase in activity at our Huizopa exploration project.

*Total Operating Expenses.* As a result of these expense components, our total operating expenses decreased 69% to \$5.1 million for the three months ended September 30, 2006, from \$16.3 million for the three months ended September 30, 2005.

### **Other Income (Expenses).**

*Interest Income and Interest Expense.* We realized interest income of \$99,000 and interest expense of \$726,000 during the three months ended September 30, 2006 compared to \$105,000 in interest income and \$747,000 in interest expense during the three months ended September 30, 2005. Included in interest expense for the three months ended September 30, 2006 is \$76,000 for the \$2.6 million financing of the purchase of four additional haul trucks at Montana Tunnels, most of the remainder being interest accretion on the convertible debenture.

**Loss from Continuing Operations.**

As a result of the foregoing, the Company incurred a loss from continuing operations of \$5.4 million, or \$0.04 per share, for the three months ended September 30, 2006, as compared to a loss of \$3.6 million, or \$0.04 per share, for the three months ended September 30, 2005.

**Loss from Discontinued Operations.**

For the three months ended September 30, 2006, loss from discontinued operations was nil, compared to a loss of \$3.6 million, or \$0.03 per share, for the three months ended September 30, 2005.

*Florida Canyon Mine and Standard Mine.* As part of the sale of the Nevada assets, the Florida Canyon and Standard mines were sold on November 18, 2005 and therefore had no activity in the three month period ended September 30, 2006. For the three months ended September 30, 2005 revenues at these two mines were \$6.6 million and operating costs were \$10.2 million.

**Net Loss.**

For the three months ended September 30, 2006, we incurred a net loss of \$5.4 million, or \$0.04 per share, as compared to a net loss of \$7.2 million, or \$0.07 per share, for the three months ended September 30, 2005.

***Nine months Ended September 30, 2006 Compared to the Nine months Ended September 30, 2005*****Revenue from the Sale of Minerals.**

Revenue from continuing operations for the nine months ended September 30, 2006 decreased 72% to \$10.2 million from \$36.3 million for the same period in 2005. The decrease in revenue is due to the cessation of milling on May 12, 2006 and milling lower grade stockpiled ore until the cessation of milling.

The following presents the key statistics for the Montana Tunnels operation for the nine months ended September 30, 2006 and 2005, respectively:

	<b>Nine months ended September 30,</b>	
	<b>2006 (1)(2)</b>	<b>2005</b>
Tons mined	3,256,605	13,606,591
Tons milled	1,426,512	3,965,389
Gold grade oz/ton	0.0078	0.014
Zinc grade %	0.20	0.36
Gold ounces	4,959	39,073
Silver ounces	116,004	421,479
Lead pounds	1,196,317	9,273,121
Zinc pounds	3,084,152	19,800,021
Total cash costs per ounce	\$ 1,422	\$ 537
Total production costs per ounce	\$ 1,664	\$ 586
Total revenue (\$millions)	\$ 10.2	\$ 36.3
Capital expenditures (\$millions)	\$ 2.6	\$ 0.2

(1) The Montana Tunnels mine recommenced mining operations in September 2006.

(2) The Montana Tunnels mine ceased milling operations on May 12, 2006; therefore, no metal products were produced after that date.

The decrease in production at the Montana Tunnels mine for the nine months ended September 30, 2006 compared to the same period 2005 is a result of the discontinuation of mining in October 2005 and the cessation of milling in May 2006. The increase in cash and production costs per ounce are mainly the result of (1) milling lower grade ore through May 12, 2006, (2) holding costs of the mine after metal production ceased and (3) waste removal as part of the remediation of the open pit during September 2006.

## **Operating Expenses.**

*Direct Operating Expenses.* Direct operating costs, which includes mining costs, processing costs and smelting and refining charges, for the nine months ended September 30, 2006 decreased 65% to \$14.0 million from \$40.3 million for the nine months ended September 30, 2005. The decrease in costs is a result of (1) ceasing mining in the open pit in October 2005 and (2) ceasing all production operations at the Montana Tunnels mine on May 12, 2006 until August 10, 2006 when recruitment of operational personnel began and mining recommenced September 2006 following the signing of the JV agreement with Elkhorn.

*Depreciation and Amortization.* Depreciation and amortization expenses were \$1.3 million and \$2.0 million for the nine months ended September 30, 2006 and 2005, respectively.

*General and Administrative Expenses.* General and administrative expenses were \$3.3 million and \$3.7 million for the nine months ended September 30, 2006 and 2005, respectively. This decrease is due to a reduction in the number of personnel and lower audit and accounting expenses, which was partially offset by an increase in legal and other professional services.

*Stock-Based Compensation.* In January 2004, the Company adopted the fair value method of accounting for stock options as set out in CICA Handbook section 3870, Stock-Based Compensation and Other Stock-Based Payments. Stock-based compensation was \$315,000 and \$525,000 for the nine months ended September 30, 2006 and 2005, respectively. This decrease is due to a reduction in personnel.

*Accretion Expense.* Accrued accretion expense was \$711,000 compared to \$636,000 for the nine months ended September 30, 2006 and 2005, respectively, primarily due to accrued site closure costs at the Montana Tunnels mine.

*Exploration and Business Development Expense.* Expenses for exploration and development, consisting of drilling and related expenses at our exploration properties, totaled \$788,000 and \$731,000 for the nine months ended September 30, 2006 and 2005, respectively.

*Gain on Sale of Property, Plant and Equipment.* A \$1.3 million gain on the sale of spare mining equipment at Montana Tunnels was realized during the nine months ended September 30, 2005, while during the same period in 2006, a loss of \$7,000 was realized.

*Total Operating Expenses.* As a result of these expense components, our total operating expenses decreased 56% to \$20.3 million for the nine months ended September 30, 2006, from \$46.6 million for the nine months ended September 30, 2005.

## **Other Income (Expenses).**

*Interest Income and Interest Expense.* We realized interest income of \$253,000 and interest expense of \$1.9 million during the nine months ended September 30, 2006 compared to \$278,000 in interest income and \$1.9 million in interest expense during the nine months ended September 30, 2005.

## **Loss from Continuing Operations.**

As a result of the foregoing, the Company incurred a loss from continuing operations of \$11.9 million, or \$0.10 per share, for the nine months ended September 30, 2006, as compared to a loss of \$12.0 million, or \$0.12 per share, for the nine months ended September 30, 2005.





### **Loss from Discontinued Operations.**

For the nine months ended September 30, 2006, loss from discontinued operations was \$0.3 million, compared to a loss of \$6.0 million, or \$0.06 per share, for the nine months ended September 30, 2005.

*Florida Canyon Mine and Standard Mine.* As part of the sale of the Nevada assets, the Florida Canyon and Standard mines were sold on November 18, 2005 and therefore had no activity during the nine month period ended September 30, 2006. For the nine months ended September 30, 2005 revenues at these two mines were \$14.7 million and operating costs were \$20.6 million.

### **Net Loss.**

For the nine months ended September 30, 2006, we incurred a net loss of \$12.1 million, or \$0.10 per share, as compared to a net loss of \$18.0 million, or \$0.18 per share, for the nine months ended September 30, 2005.

### **MATERIAL CHANGES IN LIQUIDITY**

To date, we have funded our operations primarily through issuances of debt and equity securities, funding from joint venture partners, the sale of the Nevada assets and the sale of surplus assets. At September 30, 2006, we had cash of \$2.0 million, compared to cash of \$0.1 million at December 31, 2005. The increase in cash since December 31, 2005 is primarily the result of investing cash inflows of \$4.6 million and financing cash inflows of \$6.3 million, offset by operating cash outflows of \$9.0 million.

During the nine months ended September 30, 2006, investing activities totaled \$4.6 million. The \$11.0 million held as cash collateral security for the Debentures that was in restricted cash at December 31, 2005, was released in January 2006. Capital expenditures for the further development of the Black Fox project were \$4.9 million, which included the final payment of \$2.6 million to the former owners of Black Fox. Investing activities includes \$1.4 million for the funding of the Montana Tunnels reclamation liability.

During the nine months ended September 30, 2006, financing activities provided \$6.3 million in cash, which includes \$3.5 million from the completion of a private placement with Jipangu for 11,650,000 equity units at \$0.30 (Cdn\$0.35) per share. Each unit consists of one common share of the Company and 0.17167 of a warrant for a total of 2,000,000 warrants, with each whole warrant exercisable for two years at Cdn\$0.39 for one common share of the Company. Contributions from Elkhorn in connection with the Montana Tunnels joint venture were \$3.1 million. Payments of notes payable accounted for a cash outflow of \$0.8 million. Additionally, we financed the purchase of four haul trucks with a \$2.6 million promissory note due December 1, 2006. We expect to replace the note with additional longer term financing.

We estimate that with our current period end cash balance of \$2.0 million supplemented by the monies raised in the equity offerings completed in October and November (as described in more detail in Note 10(a) to the financial statements) and the projected cash positive contribution from the joint ventured Montana Tunnels mine, we will have sufficient funds to finance the current work programs at the Black Fox development project (the "Black Fox Project") and the Huizopa exploration project (the "Huizopa Project"), as well as corporate overhead. However, we will continue to explore financing opportunities to further develop and construct the Black Fox Project and continue our exploration program at the Huizopa Project. We may raise additional funds from the sale of debt or equity securities, which may include Canadian flow-through financing to further fund exploration activities at the Black Fox Project. The availability, amount, terms and timing of this financing are not certain at this time.

Our ability to raise capital is highly dependent upon the commercial viability of our projects and the associated prices of precious metals. Because of the significant impact that changes in the prices of gold and silver have on our financial

condition, declines in these metals prices may negatively impact short-term liquidity and our ability to raise additional funding for long-term projects. In the event that cash balances decline to a level that cannot support our operations, our management will defer certain planned capital expenditures and exploration activities as needed to conserve cash for operations. There can be no assurance that we will be successful in generating adequate funding for planned capital expenditures, environmental remediation and reclamation expenditures and for exploration expenditures.

## **DIFFERENCES BETWEEN CANADIAN AND U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)**

The Company reports under Canadian GAAP and reconciles to U.S. GAAP. The application of U.S. GAAP has a significant effect on the net loss and net loss per share. For a detailed explanation see Note 9 of our interim financial statements.

## **CRITICAL ACCOUNTING ESTIMATES AND POLICIES**

The preparation of financial statements in conformity with generally accepted accounting principals requires management to make a variety of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting periods covered by the financial statements.

## **CONTRACTUAL OBLIGATIONS**

The Company has several outstanding equipment leases and financings. In connection with the remediation of the open pit at Montana Tunnels, we financed the purchase of four CAT 785 haul trucks (the "Trucks") on August 1, 2006, with a \$2,640,000 promissory note payable to the Great American Group (the "Great American Note"). The Great American Note accrues interest at the rate of 1.5% per month and matures on December 1, 2006. The Great American Note is secured by the Trucks. We expect to replace the Great American Note with additional financing with a longer maturity.

## **OFF BALANCE SHEET ARRANGEMENTS**

On July 28, 2006, the Company entered into a JV Agreement with Elkhorn in respect of the Montana Tunnels mine ("the Mine") which calls for Elkhorn to contribute \$13 million over a five-month period. The money contributed will be used initially to remediate the east wall instability problems encountered at the Mine during September and early October 2005, which led to the suspension of mining on October 21, 2005, and thereafter to move the Mine back towards commercial production. If Elkhorn were to fail to make its financial contributions, the Company would be required to seek other financing sources to obtain the funds necessary to remediate the Mine and bring it back into commercial production. Highlights of the JV Agreement are:

- Elkhorn is entitled to a 50% interest in the Mine when it has made its full contribution of \$13 million.
- Montana Tunnels Mining, Inc. ("MTMI") will be the operator of the Mine. A separate committee consisting of two designees from each of MTMI and Elkhorn will oversee the joint venture.
- If Elkhorn contributes at least \$5 million but fails to make its full contribution of \$13 million, then it will receive a 3% interest in the Mine for each \$1 million contributed.

- If Elkhorn fails to contribute at least \$5 million then its contribution will be converted to a promissory note (the "Note") equal to the amount actually contributed, plus interest, payable only out of future positive cash flows from the Mine or in the event the Mine is sold or otherwise financed. The Note would bear interest at the rate of 6% per annum and payments of principal and interest on the Note would be payable within 30 days after the end of each calendar quarter, beginning with the end of the first full calendar quarter during which the Mine is cash flow positive. If Elkhorn's failure to contribute at least \$5 million is the result of a breach of the JV Agreement by Apollo, or otherwise for cause, then the Note would bear interest at the rate of 12% per annum and the Note plus interest would be payable not later than the fifth anniversary thereof.
- When Elkhorn has contributed the full \$13 million, then (a) Elkhorn will be entitled to recover interest on that amount and (b) Elkhorn will receive 65% and Apollo will receive 35% of the positive free cash flow from the Mine until such time as Elkhorn has recovered its full contribution of \$13 million. At that time, Apollo would become entitled to 60% and Elkhorn 40% of the positive free cash flow from the Mine, until both parties have received an equal amount. Thereafter, the sharing would revert to 50/50.
- If Elkhorn earns less than a 50% interest in the Mine, then it will be entitled to recover interest on the amount actually contributed by it, and after payment of that interest each party will receive its proportionate share of positive free cash flow.

As of September 30, 2006, Elkhorn had contributed \$3.1 million in connection with the JV Agreement which contributions are recorded as Due to Elkhorn Tunnels, LLC in the Consolidated Balance Sheet since Elkhorn's contributions were short of the \$5 million required to earn an interest in the Mine as of such date. As of November 14, 2006, Elkhorn has contributed \$5.0 million in connection with the JV Agreement, representing an additional \$1.9 million since September 30, 2006, which is sufficient for Elkhorn to earn an initial 15% interest in the Mine.

## **ENVIRONMENTAL**

The Company's current environmental liabilities are at Montana Tunnels and Black Fox. As of September 30, 2006, we have accrued \$13.7 million related to reclamation, severance and other closure requirements at Montana Tunnels (\$13.3 million) and Black Fox (\$0.4 million), an increase of \$1.1 million from December 31, 2005. These liabilities are covered by a combination of surety bonds, restricted cash and property totaling \$18.5 million at September 30, 2006. We have accrued the present value of management's estimate of the liability as of September 30, 2006.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our exposure to market risk includes, but is not limited to, the following risks: changes in interest rates on our investment portfolio, changes in foreign currency exchange rates and commodity price fluctuations.

### **Interest Rate Risk**

Other than a convertible debenture with a fixed coupon rate of 12% per annum and the 1.5% per month Great American Note which was issued on August 1, 2006, we have minimal debt and thus no material interest rate exposure related to debt. When appropriate we invest excess cash in short-term debt instruments of the United States and Canadian governments and their agencies on both a fixed and variable interest rate basis. Our restricted certificates of deposit are invested in long-term debt instruments of the United States and Canadian governments and their agencies on a fixed interest rate basis. Over time the rates received on such investments may fluctuate with changes in economic conditions. As a result our investment income may fall short of expectations during periods of lower interest rates. We estimate that given the cash balances expected during 2006, a one percent change in interest rates would result in a \$50,000 change in interest income. We may in the future actively manage our exposure to interest rate risk.



### **Foreign Currency Exchange Rate Risk**

Most of the Company's activities at its Black Fox project are transacted in Canadian dollars and some of the Company's cash balances are therefore maintained in Canadian dollars. Since the Company's reporting currency is the U.S. dollar, foreign currency gains and losses on its Canadian dollar cash balances can result in volatile net losses and earnings, and adversely affect the Company's financial position and results of operations.

### **Commodity Price Risk**

The profitability of the Company's operations will be dependent upon the market price of gold. Gold prices fluctuate widely and are affected by numerous factors beyond the control of the Company. The level of interest rates, the rate of inflation, the world supply of gold and the stability of exchange rates can all cause significant fluctuations in prices. Such external economic factors are in turn influenced by changes in international investment patterns, monetary systems and political developments. The price of gold has fluctuated widely in recent years, and future price declines could cause some projects to become uneconomic, thereby having a material adverse effect on the Company's business and financial condition.

Furthermore, reserve calculations and life-of-mine plans using significantly lower gold prices could result in material write-downs of the Company's investment in mining properties and increased amortization.

In addition to adversely affecting the Company's reserve estimates and its financial condition, declining gold prices could require a reassessment of the feasibility of a particular project. Such a reassessment may be the result of a management decision or may be required under financing arrangements related to a particular project. Even if the project is ultimately determined to be economically viable, the need to conduct such a reassessment may cause delays in the implementation of the project.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Disclosure Controls and Procedures**

Apollo maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to Apollo's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required financial disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b) under the Exchange Act. Based upon, and as of the date of this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective, because of the material weaknesses discussed below. In light of the material weaknesses described below, we performed additional analysis and other post-closing procedures to ensure our consolidated financial statements were prepared in accordance with generally accepted accounting principles. Accordingly, management believes that the financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

We identified a material weakness for the year ended December 31, 2005. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. In January 2006, a major restructuring and streamlining at the corporate office significantly changed the design and structure of the internal controls and procedures at the corporate level. We lacked appropriate review of non-routine or complex accounting matters, related accounting entries, and appropriate documentation, disclosure and application of Canadian and U.S. GAAP, primarily due to a lack of sufficient personnel with a level of technical accounting expertise commensurate with our reporting requirements. As of this date our management has not had sufficient time to evaluate these controls and therefore believes this material weakness still exists.

### **Changes in Internal Control**

Related to the reduction in staffing at the Montana Tunnels mine in mid October 2005 and an additional reduction in staffing in early May 2006, at which time the mine ceased production operations, our controls at that location are not operating as previously designed related to segregation of duties over procurement, inventory control and accounting duties. Corporate management has increased its involvement with day-to-day oversight and management of the Montana Tunnels mine, but as of this date, management has not had sufficient time to evaluate these controls and therefore believes the change in controls is significant enough to be reported as a material weakness. In an effort to address this material weakness, staffing additions have been made and staffing requirements and other changes in control are being evaluated as the future operational requirements of the Montana Tunnels mine are being determined.

We intend to continue to monitor our internal controls, and if further improvements or enhancements are identified, we will take steps to implement such improvements or enhancements. As a result of the changes disclosed above, there were changes in our internal control over financial reporting, which have materially affected, or are reasonably likely to materially affect, such internal controls.

## **PART II**

## **OTHER INFORMATION**

### **ITEM 1.**

### **LEGAL PROCEEDINGS**

In May 2006, a purported class action lawsuit was filed in U.S. District Court Missoula Division of Montana by 14 former employees at our Montana Tunnels mine alleging (i) violations of the Worker Adjustment and Retraining Notification Act of 1988 (the "WARN Act") and the Montana Wage Act and (ii) breach of contract. The allegations relate to the termination of the employees following the cessation of mining in October 2005. Specifically, the plaintiffs allege that we gave deficient WARN Act notice and are seeking damages for back pay and benefits. We believe that we have meritorious defenses in this suit and are vigorously defending ourselves against these claims.

### **ITEM 1A. RISK FACTORS**

Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2005 sets forth information relating to important risks and uncertainties that could materially adversely affect our business, financial condition or results of operations. Those risk factors continue to be relevant to understanding our business, financial condition and operating results. Certain of those risk factors have been updated in this Quarterly Report on Form 10-Q to provide updated information, as set forth below.



**We have experienced operational problems at our Montana Tunnels mine and temporarily ceased production operations.**

Since the sale of our Nevada assets in November 2005, all of our revenues have been derived from our milling operations at the Montana Tunnels mine, which is a low grade mine. Historically, the Montana Tunnels mine has been unprofitable. During 2004, we experienced problems related to the milling of low-grade ore at the Montana Tunnels mine, which negatively affected our revenues and earnings. Throughout 2005, we experienced operational problems, particularly in the open pit, leading to the suspension of mining on October 21, 2005 for safety reasons due to increased wall activity in the open pit. After the suspension of mining and until May 12, 2006, we were able to continue to produce gold doré, lead-gold and zinc-gold concentrates from milling low grade stockpiled ore. However, on May 12, 2006, all operations ceased at the Mine and it was placed on care and maintenance. On July 28, 2006, we entered into a joint venture agreement with Elkhorn Tunnels, LLC, an affiliate of Calim Private Equity LLC, in respect of the Montana Tunnels mine pursuant to which Elkhorn is making scheduled financial contributions in exchange for up to a fifty percent interest in the Mine. Recruitment of equipment maintenance personnel commenced on August 10, 2006 followed by the hiring of mine operating personnel during the first week of September. On September 10, 2006 remediation within the open pit recommenced. With the expected financial contributions from Elkhorn under joint venture agreement, we believe that we will be able to remediate the pit wall instability and recommence mill operations in early 2007. However, there can be no assurances that our joint venture partner will make the expected financial contributions or that we will be able to remediate the pit wall instability.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

<b><u>Exhibit</u></b>	<b><u>Title of Exhibit</u></b>
<b><u>No.</u></b>	

- |      |  |
|------|--|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act                             |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act                             |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act |

**SIGNATURES**

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**APOLLO GOLD CORPORATION**

Date: November 14, 2006

/s/ R. DAVID RUSSELL

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R. David Russell, President and  
Chief Executive Officer

Date: November 14, 2006

/s/ MELVYN WILLIAMS

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Melvyn Williams,  
Chief Financial Officer and Senior Vice President  
Finance and Corporate Development

**Index to Exhibits**

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