

Alhambra Resources Ltd.
Management's Discussion and Analysis of Financial Condition
and Results of Operations
For the Six Months Ended June 30, 2006

This Management's Discussion and Analysis ("MD&A") focuses on key items from the unaudited interim consolidated financial statements for Alhambra Resources Ltd. (also referred to as "Alhambra" or the "Company") for the six months ended June 30, 2006 and the factors reasonably expected to impact future operations and results as prepared on August 28, 2006. This discussion should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other matters may occur which could affect the Company in the future. This discussion should be read in conjunction with the audited Consolidated Financial Statements of the Company for the year ended December 31, 2005 and the related notes.

This MD&A was reviewed and approved by the Company's audit committee and board of directors on August 28, 2006. Additional information on the Company is available under the Company's profile on SEDAR at www.sedar.com

All dollar amounts are Canadian unless otherwise stated.

Forward-Looking Information

Certain statements contained in the following MD&A constitute forward-looking statements. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from actual future results and achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statements were made. Readers are also advised to consider such forward-looking statements while considering the risks set forth below.

Non-GAAP Financial Measures

Cash flow from operations is defined as loss from continuing operations adjusted for stock-based compensation, depreciation, depletion and amortization and unrealized foreign exchange gain.

Business Overview

The Company was incorporated on January 27, 1993 and amalgamated with its wholly-owned subsidiaries, Signature Capital Corp. and Tarco Oil & Gas Ltd., effective January 1, 2002.

The Company is in the business of the exploration for and development of mineral properties and effective May 1, 2006, the production of gold and silver in the Republic of Kazakhstan ("Kazakhstan"). The Company holds a 100% working interest in two exploration licenses totaling approximately 2.7 million acres located in north central Kazakhstan (the "Uzboy Project").

Highlights

Effective May 1, 2006, the Company began commercial operations from the oxide portion of the Uzboy gold deposit therefore, the consolidated statements of income (loss) and deficit for the three and six months ended June 30, 2006 reflect operations from the Company's wholly-owned subsidiary, Saga Creek Gold Company LLP ("Saga Creek") for the months of May and June, 2006. Because of seasonal variances in operating conditions, management believes operating efficiencies can only be reasonably assessed over a complete operating cycle.

From December 2004 to April 30, 2006, the Company conducted a heap leach test program at the Uzboy project to test the equipment and processes built and established to produce gold. During that period the Company produced and sold a total of 16,314 troy ounces ("ozs.") of gold and 2,970 ozs of silver for a total proceeds of nearly \$9.3 million. At April 30, 2006 a further 15,700 ozs of recoverable gold had been stacked and was in various stages of processing for sale.

In the months of May and June, the Company sold a further 1,906 ozs of gold and 623 ozs of silver. An additional 3,561 ozs of recoverable gold was stacked bringing the total recoverable gold in work in process at June 30, 2006 to 17,355 ozs. Management believes the Company is still on target to produce 25,000 ozs of gold for the year as the pace of production should increase through the remaining months in 2006, due to the stacking of new ore on a monthly basis for the remainder of the year.

On June 30, 2006 a feasibility study independently conducted by ACA Howe International Limited ("Howe") was completed on the oxide portion of the Uzboy gold deposit (the "Report"). The Report in its entirety has been filed on Sedar at www.sedar.com. In the Report, Howe concluded "the Uzboy Project has positive and robust economics enabling a statement of reserves". The gold resource estimated, using a 0.5 gram per tonne cutoff (including oxide, transitional and primary mineralization explored to August 2005) is estimated to be 293,338 ozs in the measured category, 112,354 ozs in the indicated category and 110,919 ozs in the inferred category.

The Company continued its aggressive US\$ 3,000,000 planned capital expenditure program during the second quarter. Approximately Cdn\$ 900,000 was spent on exploration which included 2,058 metres of diamond drilling and 4,257 meters of reverse air blast ("RAB") drilling. The main components of the exploration program during the second quarter are highlighted below. The analytical results of these activities are currently pending.

- Two diamond drills were used to test the horizontal and depth extension of the primary mineralization intersected in the West zone in 2005. Testing of the depth extension of the primary gold mineralization in the East zone also commenced during the quarter
- A total of 1,298 metres of RAB drilling were completed to test the possible extensions of oxide gold mineralization previously outlined on the Central zone of the Uzboy gold deposit. The average depth of the RAB holes was 12 meters.
- A total of 2,629 metres of RAB drilling was completed in an area where RAB drilling in 2005 located 16 individual gold anomalies. The center of the area hosting these anomalies is located approximately seven kilometers northeast of the Uzboy gold deposit. The average depth of the RAB holes completed in the anomalies tested to the end of the quarter was 14 metres.

- In-fill trenching (at 30 to 50 metre intervals) to explore the area between the trenches completed on the Mamay zone in 2005 was completed. The 2005 trenching program located a significant zone of gold-silver mineralization that measures 800 metres long by 250 metres wide. A total of 7,595 linear metres in 44 trenches was completed over three kilometers of strike length.
- A total of 330 metres of RAB drilling was completed to test the extension of the oxide gold mineralization located in 2005 at Kirtoge. The RAB drilling encountered thicker than expected overburden in several parts of this zone and KGK drilling will be required to test these areas.
- Approximately 2,100 metres of RAB drilling were completed in the Mesgelsor zone during the quarter. The samples collected to date have been submitted to the laboratory.

The construction of a resin stripping plant and operations base continued with expenditures for the second quarter 2006 totaling nearly \$1,020,000. The Company continues to utilize the services of a third party to strip the gold from the resin to produce cathodic sediment. The cathodic sediment is shipped to Europe for refining and sale. Management believes that this critical component of the gold production process must be controlled by the Company and therefore made a decision early in 2005 to build its own plant. The construction of the plant remains on schedule to be commissioned in the last quarter of 2006.

Warrant holders continued to show their support for the Company as \$4,631,892 was received from the issuance of 6,569,056 common shares upon the exercise of warrants during the second quarter of 2006. This brought the total warrants exercised to June 30, 2006 to 9,901,616 for a total proceeds of \$6,928,887. There remains outstanding as of June 30, 2006 an additional 5,472,781 warrants which expire on or before September 5, 2006. At the time of this MD&A, an additional 4,575,882 common shares for a total proceeds of \$3,423,166 had already been issued. Given the current trading price of the Company's common shares, it is expected that these warrants will be fully exercised.

Financial Review

Results of continuing operations

In December 2004, the Company commenced a test heap leach operation on the oxide portion of the West zone of the Uzboy gold deposit to test the equipment and processes constructed and implemented to produce gold. Management believed that it was necessary to test the operation for at least one year to determine the operating parameters through an entire operating cycle and to ensure that a viable operation existed before going into commercial operation. Effective May 1, 2006 the Company declared commercial operations for accounting purposes. As a result, the financial statements for the second quarter of 2006 include the results of operations from the Uzboy gold deposit for the months of May and June, 2006.

Revenue

Revenue is recognized from the sale of gold and silver when the price is determinable, the product has been delivered and title has been transferred to the customer and collection of the sales price is reasonably assured. The Company ships cathodic sediment to its agent in Switzerland who supervises the refining and sale of the gold and silver on behalf of the Company.

During the months of May and June, 2006, the Company sold 1,906 ozs of gold at an average price of \$696.83 and 623 ozs of silver at an average price of \$13.29. Total revenue for the period was \$1,335,941.

Operating expenses

Operating expenses consist of all costs associated with the production of gold and silver, (including direct costs incurred in the mining, leaching and resin stripping processes as well as depreciation of equipment used in each process (“process operating costs”)), transportation and refining of the cathodic sediment, a net smelter royalty and royalties paid to the government of Kazakhstan. All process operating costs are charged to work in progress and are expensed on the basis of the quantity of gold sold as a percentage of total gold mined.

Operating costs for the months of May and June, 2006 totaled \$860,013 or \$451.21 per oz of gold sold.

General and administrative expenses

General and administrative expenses for the second quarter of 2006 related to continuing operations increased to \$596,859 from the \$113,597 recorded in the comparable period in 2005. For the six months ended June 30, 2006, general and administrative expenses relating to continuing operations increased to \$946,855 from the \$266,330 recorded in the comparable 2005 period.

Part of the increase in both the second quarter of 2006 and the six-month period ended June 30, 2006 was a result of the start up of commercial operations at Uzboy on May 1, 2006. Up until April 30, 2006, all general and administrative costs for Saga Creek were charged to pre-production costs as part of heap leach test initiated in December 2004. Saga Creek’s general and administrative costs for the months of May and June, 2006 were \$202,364.

The remainder of the variance relates to increased expense for corporate activities. In 2006 the Company decided to increase its profile in the investment community and to improve its communications with shareholders and potential investors. Mr. Ihor P. Wasylkiw was hired as Vice President and Chief Information Officer to manage that process. During 2005, the cost of this activity was significantly lower as the Company had terminated contracts with consultants engaged in investor relations activities. In addition, during 2005, the Company shared office premises and some employees with another company. This relationship ended in late 2005. Since that time many of these costs have been born 100% by Alhambra.

Interest expense

For reporting purposes, the Company nets interest income on funds held on deposit against interest expense. Net interest for the second quarter of 2006 was \$33,085, an increase of \$13,491 over the 2005 amount of \$19,594. For the six months ended June 30, 2006, interest expense totaled \$48,914, a decrease of \$10,074 from the \$58,988 recorded in the comparable 2005 period.

With the start up of commercial operations, interest incurred by Saga Creek was expensed beginning on May 1, 2006. For the months of May and June, 2006, \$32,794 was charged to interest expense related to the Pre-Payment Gold Sales Facility Agreement (“Advances”) (note 13(b) to the interim consolidated financial statements). This facility bears interest at LIBOR plus 8%.

With the conversion of the convertible debenture on March 30, 2006 into common shares of the Company (note 4 to the interim consolidated financial statements), the only debt currently remaining relates to the Advances.

Stock-based compensation

Due primarily to the high volatility of the Company’s stock price, this calculation gives a significant value to stock options which must be expensed during their vesting period. The amount of this expense for the second quarters of 2006 and 2005 was \$195,640 and \$377,776, respectively. For the six months ended June 30, 2006 and 2005, stock-based compensation expense was \$515,238 and \$407,815 respectively. In May 2005, the Company issued 1,520,000 options. This issue resulted in a large stock based compensation expense charged in the second quarter of 2005 thus accounting for the large increase over the second quarter of 2006. In February of 2006, the Company issued 1,350,000 options, which resulted in the increase in the six months ended 2006 over the comparable 2005 six month period.

Depreciation, depletion and accretion

Prior to the start up of commercial operations on May 1, 2006, all depreciation, depletion and accretion (“DD&A”) related to the Uzboy heap leach mine was capitalized as part of pre-production expenses. Starting May 1, 2006 the Company began expensing depreciation, depletion and accretion to the extent it relates to the production of gold. DD&A expense for the second quarter of 2006 was \$146,995 as compared to \$2,680 for the comparable quarter in 2005. For the six months ended, June 30, 2006 and 2005, DD&A expense totaled \$149,467 and \$5,150 respectively.

Cash flow

Cash utilized in continuing operations was \$211,714 in the second quarter of 2006 compared to \$130,998 in the second quarter of 2005. Positive cash flow from mining operations at Saga Creek of \$223,900 for the months of May and June was offset primarily by the \$280,898 increase in corporate general and administration expense in the quarter.

For the six months ended June 30, 2006, cash utilized in continuing operations was \$565,388 as compared to \$345,786 for the same period in 2005. Again the positive cash flow from operations contributed by the Saga Creek operation was more than offset by an increase in general and administration expense for the corporate office of \$478,161, thus accounting for the variance.

Net Loss

The Company incurred a net loss of \$554,349 for the second quarter of 2006, compared to a net loss from continuing operations of \$521,284 for the second quarter of 2005. While the Saga Creek operation contributed positively to earnings in the amount of \$80,716 for the months of May and June as did a decrease in stock-based compensation expense of \$182,136, these positive variances only partially offset the higher cash flow utilized in operations by the corporate office.

Net loss for the six months ended June 30, 2006 was \$1,230,093 as compared to a net loss for the same period in 2005 of \$774,799. The increased loss was again primarily due to the higher cash flow utilized in operations plus an increase in stock-based compensation of in 2006 of \$107,423. This increase in the loss was again partially offset by the positive contributions to earnings from the Saga Creek operation.

Based on a weighted average number of common shares of 56,510,501 and 48,756,930, the Company's net loss per common share from continuing operations for the second quarters of both 2006 and 2005 was \$0.01. For the six months ended June 30, 2006 and 2005, net loss per share from continuing operations was \$0.02 on weighted average number of shares outstanding of 54,832,531 and 44,476,176 respectively.

Liquidity and capital resources

During the second quarter of 2006, Alhambra received \$4,631,892 from the issue of 6,569,056 common shares upon the exercise of warrants issued pursuant to private placements completed in 2005 and 2004. An additional \$159,625 was received on the issue of 392,500 common shares upon the exercise of stock options. This brings the total cash received for the six months ended June 30, 2006 to \$7,227,012 from the exercise of 9,901,616 warrants and 770,000 options. The majority of this cash has been used to fund capital expenditures with the excess to be used in the Company's Uzboy project as required. In the first quarter of 2006, a further 1,321,353 common shares were issued upon the settlement of the \$792,812 convertible debenture.

At June 30, 2006 the Company had \$5,358,893 of cash and cash equivalents and a total of \$1,834,982 in other working capital. Included in the other working capital as of June 30, 2006, was \$3,205,205 in work in progress. This represents the costs incurred to June 30, 2006 in the mining, leaching and smelting of gold that has yet to be sold. The Company estimates that the recoverable gold related to this work in progress is 17,355 oz, which will be sold within the next twelve months. Included as a reduction in other working capital as of June 30, 2006 was \$823,582 outstanding pursuant to a Pre-Payment Gold Sales Facility Agreement whereby the Company has a right to

receive up to US\$750,000 as a pre-payment for gold to be sold to the purchaser (see note 13(b) to interim consolidated financial statements).

As a result of the private placements completed in 2005 and 2004, Alhambra had warrants outstanding at June 30, 2006 that are exercisable into 5,472,781 common shares at an average price of \$0.75 per common share. Subsequent to the June 30, 2006, 4,575,882 common shares were issued on the exercise of outstanding warrants, for gross proceeds of \$3,423,166. Based on the current trading price of the Company's common shares, it is anticipated that all remaining warrants will be exercised prior to the final date of expiry on September 5, 2006. With the proceeds expected to be received from the conversion of the warrants as well as the proceeds from the sale of gold, it is not anticipated at this time that the Company will require any additional financing in 2006. The decision on future financings is, of course, dependent upon the results of the 2006 exploration program as well as any other opportunities that may be identified during the year.

Related party transactions

During the second quarter of 2006, the Company paid \$36,000 (2005 - \$30,000) in consulting fees to a company controlled by the President and Chief Operating Officer of Alhambra bringing the total for the six months ended June 30, 2006 and 2005 to \$72,000 and \$60,000 respectively. Of this amount, \$23,400 (2005 - \$22,500) was capitalized to mining assets in the second quarter while \$50,400 (2005 - \$45,000) was capitalized for the six months ended June 30, 2006.

During the second quarter of 2006, the Company incurred and expensed as legal services, \$24,943 in costs from a law firm in which an officer of the Company is a partner. The total for the six months ended June 30, 2006 was \$35,576. The officer was appointed in the first quarter of 2006.

Subsequent events

Subsequent to the June 30, 2006, 4,575,882 common shares of the Company were issued upon the conversion of warrants for a total proceeds of \$3,423,166.

The Company has no other proposed transactions other than what is disclosed as part of subsequent events.

Financial instruments

The fair values of accounts receivable, deposits and prepaid expenses, work in progress, accounts payable and accrued liabilities and advances are approximated by their carrying values because of their short-term nature or because they bear interest at market rates.

The Pre-Payment Gold Sales Facility Agreement is denominated in US\$ dollars and therefore the Company is subject to the risk of fluctuating exchange rates between the Cdn\$ and US\$.

Off Balance Sheet arrangements

The Company has no off balance sheet arrangements except the lease agreement on premises as disclosed in note 13(c) to the interim consolidated financial statements.

Disclosure of outstanding share data

	As of June 30, 2006	Change in 2006	Issued in 2006	As of August 28, 2006
Common shares issued and outstanding	62,696,199	–	4,575,882	67,272,081
Common shares issuable upon exercise of vested stock options	3,505,000	–	–	3,505,000
Common shares issuable upon exercise of warrants	5,472,781	(4,575,882)	–	896,899
Common shares fully diluted	71,673,980	(4,575,882)	4,575,882	71,673,980

At June 30, 2006, there were 62,696,199 common shares issued and outstanding and 71,673,980 fully diluted common shares after giving effect to the exercise of all outstanding warrants and vested stock options. Subsequently, up to August 28, 2006, an additional 4,575,882 common shares were issued pursuant to the exercise of warrants. (Refer to “Subsequent Events”).

Disclosure of material components of expenditures

Expenditures on mining assets for the quarter ended June 30, 2006 were \$2,556,408. This included a credit of \$730,888 from the sale of 1,039 ozs. of gold and 427 ozs. of silver in April as part of the heap leach test. This compares to \$839,862 of revenue capitalized to pre-production costs for the second quarter of 2005. Actual capital expenditures for the quarter therefore totaled \$3,287,296, which compares to \$4,032,375 (before capitalization of sales revenue) for the second quarter of 2005.

During the second quarter of 2006 the Company incurred \$1,127,000 of costs for buildings, machinery and equipment of which \$1,020,000 related to the construction of the resin stripping plant and related facilities. This brought the total expended on buildings, machinery and equipment for the year to approximately \$2,000,000. Exploration costs for the second quarter of 2006 totaled nearly \$1,140,000 bringing the total for the year to \$1,540,000. A further \$900,000 was spent on the Company’s heap leach test prior to the start up of commercial operations on May 1, 2006 bringing the total costs incurred in the heap leach test to May 1, 2006 to \$2,600,000. Finally \$220,000 of cash was expended to acquire the Dot property. During the second quarter of 2005 approximately \$750,000 was spent on exploration, \$650,000 on construction of the resin stripping plant, with the remainder of the capital expenditures being incurred for the heap leach test program.

During the second quarter of 2006, general and administrative expenses from continuing operations were \$596,859. Included in the 2006 amount was \$202,364 of general and administrative costs directly related to the operating of Saga Creek. Corporate overhead costs accounted for the remaining \$394,495, which compares to the \$113,597 of corporate overhead costs incurred in the second quarter of 2005. Employee costs accounted for 42% (\$166,000) of the total corporate general and administration costs for the second quarter of 2006. In the comparable 2005 period employee costs were also 42% of the total (\$48,000). With the startup of commercial operations, costs for head office employees working directly on the Uzboy project that had been capitalized as pre-production costs were expensed starting May 1, 2006. In addition, new employees were added to manage the Company’s investor relations program which was expanded in 2006. Costs related to the maintenance of Alhambra as a public company including investor relations, stock exchange and corporate trust services costs accounted for 26% (\$103,000) of total general and administrative

expenses for the second quarter of 2006 as compared to 21% (\$24,000) over the same period in 2005. The increase in public company costs was the result of the Company's decision to increase its profile in the investment community. In 2005 this cost was significantly lower as the Company had terminated contracts with consultants engaged in investor relations activities. Office expenses in 2006 of \$83,000 (2005 - \$31,000) accounted for a further 21% (2005 - 27%) of general and administrative expenses. Prior to September 2005, Alhambra shared office space with another company.

Business risks

The risks and uncertainties affecting the Company are unchanged from that described in the Company's management and discussion and analysis of the fiscal year ended December 31, 2005

Summary of quarterly results (\$)

	2005		2006	
	September	December	March	June
Loss from continuing operations	(209,900)	(271,312)	(675,744)	(525,421)
Basic and diluted loss per share – continuing operations	(0.00)	(0.01)	(0.01)	(0.01)
Net loss for the period	(209,900)	(425,146)	(675,744)	(525,421)
Basic and diluted income (loss) per share	(0.00)	(0.02)	(0.01)	(0.01)
Diluted loss per share	N/A	N/A	N/A	N/A

	2004		2005	
	September	December	March	June
Loss from continuing operations	(174,644)	(159,260)	(253,415)	(521,384)
Basic and diluted loss per share – continuing operations	(0.01)	(0.00)	(0.01)	(0.01)
Net loss for the period	(209,900)	(425,146)	(675,744)	(525,421)
Basic and diluted income (loss) per share	(0.00)	0.00	(0.00)	0.01