uruguay mineral exploration inc.

Management Discussion & Analysis
for the period ended August 31,2006

Prepared as at: October 12, 2006

Management's discussion and analysis ("MD&A") provides a discussion of the Company's financial and operating results for the quarter ended August 31, 2006 with comparisons to previous quarters.

This MD&A accompanies, and should be read in conjunction with, the unaudited interim financial statements of Uruguay Minerals Exploration Inc ("UME" or "Company") for the three month period ended August 31, 2006. All amounts are expressed in thousands of US$, unless otherwise indicated. The reader should also refer to the audited financial statements for the two years ended May 31 2006 and 2005. This management discussion and analysis is effective as of October 12, 2006.

HIGHLIGHTS

Highlights for the three months ended August 31, 2006 include.

- Gold production of 19,175 ounces at an average cash cost of $US 332 per ounce compared to 25,163 ounces at an average cash cost of $US 212 in the prior financial year. Production levels were lower than expected due to delays in accessing higher grade ore in the Arenal pit. During the quarter a new pod of ore was discovered and developed at the intersection of the South Vein and San Gregorio East. This zone will provide additional flexibility in ore scheduling over the remainder of the financial year.
- Net profit after tax of $ 2,567 or $ .054 basic earnings per share compared to $ 2,240 or $ .048 basic earnings per share in the corresponding period of the prior financial year.
- Cash flow from operations was $ 3,503 before non-cash working capital movements. This compares to 4,189 in the same period last year.
- Sales were $ 12,177 and the average price of gold sold was $ 568 per ounce compared to $ 11,721 at an average price of $ 432 in the corresponding period of the prior financial year.
- The next phase of the program to define resources at Argentinita has continued to return encouraging results including:

RCARG 163	9m @ 1.77 g/t Au from 117m
RCARG 165	15m @ 3.30 g/t Au from 103m
RCARG 170	11m @ 1.67 g/t Au from 115m
RCARG 170	5m @ 1.15 g/t Au from 139m
RCARG 170	7m @ 4.14 g/t Au from 154m
RCARG 172	9m @ 1.26 g/t Au from 114m
DHARG-01	6.45m @ 1.12 g/t Au from 140.05m
DHARG-02	13.35m @ 1.01 g/t Au from 111.55m
DHARG-02	4.20m @ 3.99 g/t Au from 143.4m
DHARG-02	3.1m @ 0.74 g/t Au from 147.6m
DHARG-03	8.05m @ 3.02 g/t Au from 177.2m

- A drill program of 26 drill holes at Crucera has confirmed mineralization associated with the shear zone and has demonstrated that the mineralization is open to the south and down dip. Highlights of the drill program are presented below.

RC-CA-01	5m @ 3.73 g/t Au from 40m
RC-CA-02	8m @ 7.05 g/t Au from 45m
RC-CA-08	9m @ 2.72 g/t Au from 48m
RC-CA-09	5m @ 3.18 g/t Au from 47m
RC-CA-10	4m @ 2.95 g/t Au from 56m
RC-CA-18	4m @ 12.41 g/t Au from 50m
RC-CA-23	15m @ 2.94 g/t Au from 28m
RC-CA-24	13m @ 3.98 g/t Au from 26m

(Thousands of United States Dollars, except where indicated)

FINANCIAL PERFORMANCE

Sales

Sales for the quarter were $ 12,177 resulting from the sale of 20,809 ounces of gold at an average price of $US 568 per ounce. Sales for the corresponding quarter of 2005 were $11,721, which resulted from the sale of 26,049 ounces of gold at an average price of $ 432 per ounce. During the quarter 6,089 ounces were delivered into gold derivatives contracts at an average price of $ 477 per ounce and 14,720 ounces were sold at spot prices.

Operating Earnings

Net profit after tax for the quarter was $ 2,567 or basic earnings per share of $ 0.054. This compared to a profit of $ 2,240 or basic earnings per share of $ 0.048 for the first quarter of 2005. Operating profit for the quarter was $ 3,413 compared to $ 3,906 in the corresponding quarter of the prior year. While financial performance was in line with the comparative prior of the prior financial year a higher average sales price generated an additional $ 2,830 in sales revenues for the current quarter that was offset by lower production and sales volumes.

Metal Production

Production for the first quarter was 19,175 ounces compared to 25,163 ounces for the corresponding quarter of the prior financial year. The reduction in production between the two quarters is a result of lower head grade (2.11 g/t compared to 2.63 g/t) and lower recovery (91% compared to 95%).

Lower recovery is mainly attributable to high silver grades in the Arenal ores together with a lack of electrowinning capacity to remove silver from the circuit on a timely basis. Additional electrowinning capacity will be installed before the end of October and will improve capacity.

The average grade of material mined from Arenal during the quarter was lower than the total average for Arenal due to planned sequencing of the pit. As a result of the pit wall slip last financial year and the subsequent re-assessment by geotechnical consultants, pit design parameters and modifications to the excavation sequence have affected the ore grade available for individual quarters and mining productivity. Overall reconciliation of production to reserves remains robust.

During the quarter a new mineralized zone was discovered and developed at the intersection of the South Vein with the San Gregorio pit. This mineralized zone has the potential to make an important contribution of 50,000 to 100,000 tonnes at 2.5g/t to 3 g/t in the current financial year to increase flexibility in achieving production targets. Additional exploration work will also be performed in the coming quarters to assess the full extent of this mineralization.

Production statistics are summarized below.

Quarterly production statistics

	Q2 Nov 2004	Q3 Feb 2005	Q4 May 2005	Q1 Aug 2005	Q2 Nov 2005	Q3 Feb 2006	Q4 May 2006	Q1 Aug 2006
Ore processed (tonnes)	307,993	275,849	306,238	312,016	312,881	313,967	327,665	315,310
Head Grade (g/t Au)	1.70	2.24	2.67	2.63	2.71	2.68	2.51	2.09
Recovery	94.5%	95.2%	95.2%	95.3%	93.2%	93.9%	92.46%	90,62%
Gold produced (ounces)	15,934	18,896	24,844	25,163	25,323	25,451	25,350	19,175

Expenses

Operating expenses were $ 6,749 in the quarter after deferring $ 354 in deferred stripping costs. Cash cost per ounce for the quarter were $ 330 per ounce. For the corresponding quarter of the prior financial year they were $ 5,760 after deferring $ 795 in deferred stripping costs. Cash cost per ounce for the corresponding quarter of the prior financial year were $ 212 per ounce. Cash costs were higher than the corresponding quarter of the prior financial year due to the higher strip ratio of 5.59 (compared to 4.34) that was effective from 1 July 2006 and lower production for the quarter. Operating costs per tonne of ore mined and processed were in line with expectations.

Amortization and depreciation expense was $ 2,015 for quarter compared to $ 1,749 in the prior year. The increase in expense relates to the capitalization of additional equipment during the prior financial year.

Other Revenues and Expenses

Corporate expense were $936 for the quarter compared to $ 592 for the corresponding quarter of the prior financial year. The current quarter includes a termination payment of $ 200 for Michael Schwabe who was replaced during the quarter by the new Vice President of Exploration George Schroer.

The current quarter's earnings include a gain of $ 1,247 for the fair valuation of non-hedge gold financial derivatives. The corresponding quarter of the prior year included a loss of $ 197. The gain in the current quarter reflects the winding down of the company's hedge book.

The Company issued 631.000 stock options during the quarter. 421,000 options were issued at a price of $CAD 5.29 to Chris Clark as part of his termination benefits. These options vested on issue and the corresponding expense was recorded in the prior financial year. An additional 210.000 options were issued of which 190,000 were issued at a price of $ CAD 4.77 and 20,000 at a price of $ CAD 4.10 to other staff members and contractors. These options vest in three equal annual portions after one, two and three years. The stock option expense for the quarter was $ 251 against nil in the corresponding quarter of the prior year.

FINANCIAL POSITION

Cash and other liquid resources

At August 31, 2006 UME had cash resources of $ 8,545 compared to $ 8,931 at 31 May 2006. Cash flow from operations for the quarter was $ 3,225 after using $ 278 for non-cash working capital items. This compared to $ 4,548 after a contribution of $359 from non-cash working capital items in the corresponding quarter of the prior year.

Capital Expenditure

Expenditure on property plant and equipment for the quarter was $ 2,002. Net payments of $ 1,050 were also made for the acquisition of the Net Profit Interest and $ 347 for deferred equipment acquisition during the quarter. Payments for property plant and equipment include purchase of an additional diamond drill rig for $ 303, and $ 639 of prestrip of San Gregorio East and the South Vein essential to providing additional ore sources during the current and future financial years.

Exploration expenditure, excluding near mine drilling that is included in mine properties, was $ 1,376 for the quarter. Of this $ 815 was invested in near mine exploration activities including drilling at Argentinita, Laurales and San Gregorio. The remaining expenditure we associated with drilling and other field work at Casupa and Mal Abrigo.

(Thousands of United States Dollars, except where indicated)

Financing

During the quarter 280,000 employee options were converted into shares to provide proceeds of $ 326. 250,000 warrants were also exercised to provide proceeds of $ 825. At August, 2006 UME had 500,000 options on convertible notes after 250,000 options expired unexercised during the quarter. There were also, 2,918,000 outstanding stock options (1,838,000 of which are exercisable) and 48,054,930 common shares outstanding.

EXPLORATION AND DEVELOPMENT

General

The exploration function was restructured during the quarter. George Schroer was appointed as Vice President Exploration, replacing Mike Schwabe who stepped down after 9 years with the Company. Two senior geologists were also recruited to focus on gold exploration in the Dom Feliciano belt, the Eastern end of the Isla Crystalina belt and the Florida Belt. These new employees will commence during the second quarter.

Key exploration highlights for the quarter (and subsequent to period end) were:

- At the Argentinita project a drill programme is underway to upgrade resources and convert these resources to reserves. The first phase of this programe will finish in October with the resource estimate completed for release in mid January. The programme has continued to return encouraging results including.

RCARG 163	9m @ 1.77 g/t Au from 117m
RCARG 165	15m @ 3.30 g/t Au from 103m
RCARG 170	11m @ 1.67 g/t Au from 115m
RCARG 170	5m @ 1.15 g/t Au from 139m
RCARG 170	7m @ 4.14 g/t Au from 154m
RCARG 172	9m @ 1.26 g/t Au from 114m
DHARG-01	6.45m @ 1.12 g/t Au from 140.05m
DHARG-02	13.35m @ 1.01 g/t Au from 111.55m
DHARG-02	4.20m @ 3.99 g/t Au from 143.4m
DHARG-02	3.1m @ 0.74 g/t Au from 147.6m
DHARG-03	8.05m @ 3.02 g/t Au from 177.2m

Mineralization is open at depth and exploration drilling will continue into 2007. Surface exploration is also accelerating throughout the Zapucay shear zone with a ground magnetics survey and soil sampling programme planned for the second and third quarters to cover the key structures within the district.

- A drill program of 26 drill holes was completed on the Crucera property. The program was designed to confirm mineralization reported by the previous owner. The drill program confirmed mineralization associated with the shear zone and has demonstrated that the mineralization is open to the south and down dip. Highlights of the drill program are presented below.

RC-CA-01	5m @ 3.73 g/t Au from 40m
RC-CA-02	8m @ 7.05 g/t Au from 45m
RC-CA-08	9m @ 2.72 g/t Au from 48m
RC-CA-09	5m @ 3.18 g/t Au from 47m
RC-CA-10	4m @ 2.95 g/t Au from 56m
RC-CA-18	4m @ 12.41 g/t Au from 50m
RC-CA-23	15m @ 2.94 g/t Au from 28m
RC-CA-24	13m @ 3.98 g/t Au from 26m

Follow-up drilling is planned for the 2007 financial year.

(Thousands of United States Dollars, except where indicated)

- Review of the the Lascano airborne gravity/mag survey has been completed and 4 drill sites have been selected for drill testing. Drilling was delayed for a month to allow completion of near mine resource drilling and will now commence in November 2006.

- The airborne gravity and magnetics surveys completed by Bell Geophysics in the prior financial year are in the process of being evaluated. Casupa (Au), and Minas de Corrales (Au) evaluations are completed and results are being used in conjunction with on going exploration in these two districts. Maria Albina (Pb-Zn), Retamosa (Pb-Zn), and Rivera (diamonds) projects airborne geophysical results are in the process of being evaluated.

- Mal Abrigo nickel prospect in the Florida Belt was progressed during the quarter. Two drill holes were completed in the prospect last quarter and reported mixed results. Disseminated sulfide were encountered in both drill holes with one hole reporting 20% sulfide over a drill hole intercept length of 2.7 meters. A petrographic study of the core confirmed Ni and Cu sulfide mineralogy. Assay results indicate low grade concentration of these two elements. Max min surveys during the next quarter will target additional anomalies.

Isla Cristalina Belt

Arenal and San Gregorio.

Mapping, geochemical surveys and ground geophysics continued over selected parts of the entire district. Drilling was concentrated on Arenal and San Gregorio

Ground magnetic as well as airborne magnetic survey was completed over selected parts of the district to help define structural controls to mineralization in new and existing exploration areas. Due to the encouraging results in identifying structures a larger program has been designed for the western third of the district to cover the main structural corridor between Zapuchay and San Gregorio and the Cerro Blanco and Nuevo Australia areas north west of San Gregorio.

At Arenal drilling confirmed the south east plunge of the mineralized system. Step-out drilling to the northwest, northeast and north of the deposit returned no positive results. A drilling program is in progress to condem the area of the river diversion to the west of the deposit. Drilling is also underway under the river to further upgrade resources and allow for more accurate mine planning.

Drilling in and around the San Gregorio pit was completed. Drilling has improved the confidence of previous resource estimates in San Gregorio East, West and Rieles. Significant results were obtained from Veta Sur, a relatively narrow vein located at the south end of San Gregorio deposits. Au mineralization reported from this northeast trending vein is presented below. Further development and exploration is planned by the mining group to add this resource to the production stream. Highlights from Veta Sur drilling are presented below.

VSRC-03	2m @ 1.1 g/t Au from 11m
VSRC-06	2m @ 5.00 g/t Au from 13m
VSRC-10	3m @ 1.68 g/t Au from 28m
VSRC-12	4m @ 5.92 g/t Au from 15m
VSRC-13	3m @ 17.71 g/t Au from 16m
VSRC-14	2m @ 1.26 g/t Au from 13m
VSRC-15	2m @ 1.18 g/t Au from 31m
VSRC-16	2m @ 3.79 g/t Au from 13m
VSRC-17	4m @ 2.55 g/t Au from 16m
VSRC-17	1m @ 3.06 g/t Au from 40m
VSRC-21	2m @ 1.53 g/t Au from 16m
VSRC-22	4m @ 7.42 g/t Au from 17m
VSRC-23	2m @ 2.71 g/t Au from 22m

(Thousands of United States Dollars, except where indicated)

Zapucay Shear Zone

Field exploration work is presently being done on the entire shear zone. Exploration work at Zapucay has focused on testing a model that gold mineralization has originated from one of the many intrusive granites in the area, and has been at concentrated structurally within shadow zones associated with stresses along the main Zapucay shear.

Historically, a number of small, shallow, quartz vein-associated deposits had been mined in this area, including Zapucay, Argentinita and Lavadero. Zapucay was mined by the Company in 2003 and 2004 yielding 471,000 tonnes at an average grade of 2.05 g/t Au.

Recent, deeper RC drilling at Argentinita has encountered a second shallow-dipping mineralized zone beneath the near-surface veins which were mined historically. Work is now underway to locate the controlling structures which, it is postulated, may lead to higher temperature, shear-hosted zones or porphyry-style mineralization associated with late phase granite emplacement.

Recent results from Argentinita to date include:

RCARG 163	9m @ 1.77 g/t Au from 117m
RCARG 165	15m @ 3.30 g/t Au from 103m
RCARG 170	11m @ 1.67 g/t Au from 115m
RCARG 170	5m @ 1.15 g/t Au from 139m
RCARG 170	7m @ 4.14 g/t Au from 154m
RCARG 172	9m @ 1.26 g/t Au from 114m
DHARG-01	6.45m @ 1.12 g/t Au from 140.05m
DHARG-02	13.35m @ 1.01 g/t Au from 111.55m
DHARG-02	4.20m @ 3.99 g/t Au from 143.4m
DHARG-02	3.1m @ 0.74 g/t Au from 147.6m
DHARG-03	8.05m @ 3.02 g/t Au from 177.2m

These preliminary results indicate that a mineable resource will be defined at Argentinita, which lies approximately 1 kilometre south of the Zapucay mine, and an infill drill program has commenced which will permit the Argentinita resource to be modeled.

Other Exploration

The company has hired a senior geologist, Alex Raab as the Regional Manager of gold projects outside of the Isla Cristalina Belt. Alex will start with the company in mid November.

Four projects, Presidente Terra, Chamizo, Casupa, and Texas, have been set as priorities for the first 12 months. Database compilation, validation and organization of the date on these projects will be completed by year end.

Dom Feliciano Mobile Belt

Texas and Presidente Terra are two projects that lie within the Dom Feliciano Belt. On both projects historic data will be compiled and re-evaluated and systematic exploration programs developed to test these projects within 12 months. Both projects have very encouraging historical results with areas to be tested. Regional stream sediment anomalies around these projects also exist and need to be followed up to explain the source of the anoomoly. From this work new drill targets will be generated for testing in the second half of 2007.

Florida Greenstone Belt

(Thousands of United States Dollars, except where indicated)

Chamizo and Casupa are priority projects that lie within the Florida Green Stone Belt. Data compilation, validation and organization are underway. Historic as well as new data collected in the next 6 months will be used to re-evaluate these projects and create drill targets for testing during 2007.

At Chamizo preliminary work by the Company in 2002 confirmed the existence of stratigraphically controlled gold mineralization at Chamizo, which lies within the Florida greenstone belt, approximately 120 km west north-west of Montevideo. The target is defined by a nearly 4 km long soil gold anomaly.

The Crucera vein is one of a number (30) of sub-parallel veins within a broader project grouping known as the Casupa Project.

A drill program of 26 drill holes was completed on the Crucera property. The program was designed to confirm mineralization reported by the previous owner. The drill program confirmed mineralization associated with the shear zone. Highlights of the drill program are presented below.

RC-CA-01	5m @ 3.73 g/t Au from 40m
RC-CA-02	8m @ 7.05 g/t Au from 45m
RC-CA-08	9m @ 2.72 g/t Au from 48m
RC-CA-09	5m @ 3.18 g/t Au from 47m
RC-CA-10	4m @ 2.95 g/t Au from 56m
RC-CA-18	4m @ 12.41 g/t Au from 50m
RC-CA-23	15m @ 2.94 g/t Au from 28m
RC-CA-24	13m @ 3.98 g/t Au from 26m

The drill program confirmed the grade and form of mineralization reported by previous operators. The program also defined mineralization to an average depth of 40 meters along the entire strike length of 600 meters. The best intercepts reported, RC-CA-23 and RC-CA-24 lie at the SE end of the drill program indicating the system remains open to the SE and down dip.

The recently completed airborne geophysical survey results have given better definition to possible structural controls to the known mineralization at Crucera. A moderately high gravity lineament trend is associated with the NW trending zone of mineralization.

Lascano Geophysical Anomaly

The airborne gravity/magnetics survey of the Lascano geophysical anomaly was completed in February 2006. The data has been compiled and studied by Robert Ellis, consulting geophysists. His work has further refined and defined the geophysical anomalies which total two to three large circular features. The results from his work have located four sites for relatively shallow drill testing of the magnetic and gravity anomalies. It is theorized from this work that the anomaly is composed of a slightly higher density intrusive rock like syenite surrounded by less dense basin fill sediments. The original theory was that the anomaly was composed of a highly dense rock with massive sulfide association. The drill program is designed to test these theories. Drilling should take place in the last quarter of the year.

Rivera Diamonds

Sampling in the prospective areas has continued during the first quarter. The sampling program follows on from work by previous operators and is designed to more specifically target areas of greater potential for geophysics and drilling.

The project is located in a structurally active area of the Rio de la Plata Craton in northern Uruguay. The company has previously recovered G9 and G10 garnets, and chrome spinels whose chemistry is indicative of a diamond stability field source. Results from this years sampling program has augmented these results.

Historically micro-diamonds and macro-diamonds have also been recovered from the region. All samples are processed at Diatech Heavy Mineral Laboratories in Perth, Western Australia.

Mal Abrigo Nickel Project

Mal Abrigo is a ultamafic layered complex of gabbro to norite in composition. The project has been explored in the past by the Uruguay mines department, DINAMIGE. The rock has been described as being a layered accumulate which locally contains disseminated immiscible sulfides. Petrographic work on the sulfides from the property have defined pyrrhotite which has exsolved pentlandite (iron sulfide) and chalcopyrite.

Two drill holes were completed in the prospect in the last quarter with mixed results. Disseminated sulfide was encountered in both drill holes with only one hole reporting 20% sulfide over a drill hole intercept length of 2.7 meter. Petrographic study of this drill hole intercept indicates trace amounts of chalcopyrite Fe,CuS_2 and exsolved pentlandite $(Fe,Ni)_9S_8$ from pyrrhotite. Disseminated sulfide has been reported from 20 meters depth to the end of the drill hole. Locally greater then 1% disseminated sulfide is reported though the average for the entire hole is a less than 1%.

Analytical results from this intercept were disappointing and reported a maximum value of 122 ppm Ni. Disseminated portions of the deposit report Ni values up to 244 ppm. The results have proven that the system has generated immiscible sulfides and has the correct chemistry.

A max min geophysical survey has been completed over a portion of the property and a number of strong anomalies have been identified. Follow up work on these anomalies is planned in the coming months.

OUTLOOK

The Company plans to maintain plant throughput at an average of 100,000 tonnes per month for the current financial year. The Company's production target is to achieve annual production in the current financial year of 100,000 ounces of gold. At this production level cash cost per ounce for the full financial year is targeted to be $240/oz per ounce.

FINANCIAL INSTRUMENTS

UME does not enter into financial instruments for trading or speculative purposes. The levels of derivatives contracts entered into will be consistent with forecast production and must ultimately be capable of satisfaction through by delivery.

In December 2004 the Company entered into a matched collar for 50,000 ounces with a strike price for the put of $US 400/oz and a strike price for the call of $US 436/oz. This contract required deliveries of 2,500 ounces per month and at August 31 2006 all ounces had been delivered.

In October 2005 the Company entered into a matched collar for 10,000 ounces with a strike price for the put of $ 436 per ounce and a strike price of the call of $ 486,50 per ounce. This contract requires deliveries of 2,500 ounces per month with deliveries commencing in July 2006. At August 31 2006 5,000 ounces remain to be delivered.

The Company has established a policy that permits a maximum of 25% of planned monthly production to be hedged for a period of 18 months. Given current production levels this equates to 37,500 ounces over an 18 month period.

RELATED PARTY TRANSACTIONS

The Company has no related party transactions.

(Thousands of United States Dollars, except where indicated)

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The Company's contractual obligations and commitments are as follows

	Total	Less than 1 Year	1-2 Years	2-3 years	3-4 years	4-6 Years
Convertible notes (a)	2,100	1,050	1,050			
Finance Lease	471	171	171	129		
Deferred Equipment payments	510	510				
Asset Retirement obligations	1,665		245	112	116	1,192

(a) As a part of the agreement for the purchase of the net profit interest, as explained in Note 5a and 8d of the financial statements, an additional US$ 1,050 is also payable after the third anniversary date, if the average monthly price of gold for the previous 36 months exceeds US$ 400 per ounce.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Company's financial statements requires management to make certain estimates which affect the amounts reported in the consolidated statements and related notes. The accounting estimates considered to be significant to the Company include in-process inventories, net future income and resource tax assets and liabilities, the physical and economic lives of mining assets and mine closure and site restoration costs.

Potential shareholders and prospective investors should be aware that these statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those suggested by the forward-looking statements. Shareholders are cautioned not to place undue reliance on forward-looking information. By its nature, forward-looking information involves numerous assumptions, inherent risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and various future events will not occur. The Company undertakes no obligation to update publicly or otherwise revise any forward-looking information whether as a result of new information, future events or other such factors which affect this information, except as required by law

Economic lives of mining assets and recoverable value

The economic lives of UME's mining operations and any development asset is based upon the individual mine's mineral reserves. UME's resources and reserves are calculated in accordance with the standards established under the Australasian Institute of Mining and Metallurgy Code of Mineral Resource Estimation, which is the basis of reporting used by the Australian Stock Exchange.

The Company reviews and evaluates the estimated future discounted net cash flows of its mines and development properties to ensure that they exceed the carrying value for each property. These calculations rely on estimated reserves and/or resources, estimated future commodity price and production costs. At each reporting period end, UME reviews the recoverable value of its mining assets. At May 31, 2006, no write down of the carrying value of these assets was appropriate.

Share based Compensation

UME has chosen to use the fair value method to account for stock-based employee compensation plans. The calculation of this benefit relies on estimates of the anticipate life of the option and the volatility of the company's share price.

Mine closure and site restoration

UME has estimated the ultimate asset retirement obligation costs for its operations at their expected respective closure and site restoration dates. The discounted value of these asset retirement obligations as at August 31 2006 was $ 1,665 and is included in the mine closure and site restoration liability. The $ 263K unamortized balance of asset retirement costs as at August 31, 2006 is included in property, plant and equipment. While care was taken to estimate the asset retirement obligations, these amounts are estimates of expenditures that are not due until future years. In addition, UME's asset retirement obligations are reviewed and assessed periodically on an asset by asset basis. Should there be a change in the estimate, the discounted amount of that change would be included in property, plant and equipment as an asset retirement cost with an offsetting amount accrued as an asset retirement obligation. The asset retirement cost would be amortized on a units-of-production basis over the estimated life of the mine while the asset retirement obligation would be accreted through earnings to its ultimate undiscounted amount.

Deferred Stripping Costs

Effective October 1, 2004 as a result of developing a complete mine plan for the Arenal deposit the Company adopted the industry practice of deferring stripping costs. Previously the company had expensed these costs as it could not reasonably estimate the life of mine strip ratio for deposits being mined.

Using the deferred stripping accounting method mining costs associated with waste rock removed in excess of the life of mine average are deferred and charged to operations on the basis of the average strip ratio for the life of the mine. When the cumulative strip ratio is less than the life of mine average, a provision for future stripping is made.

The average strip ratio for the mine life was estimated to May 31 2006 to be 4.34:1. During the period the strip ratio was revised to 5.59:1.

The amount charged to operating costs is therefore subject to management's ability to estimate the stripping ratio over the life of mine. Any changes to this estimate could have a material affect on the financial statements.

The waste to ore ratio and the remaining life of the mine are both regularly assessed by management to ensure the carrying value and rates of depletion are appropriate.

RISK FACTORS

UME's net earnings in the near-term are affected principally by its mining operations and, in the longer term, will be affected primarily by the success or failure of its exploration and development activities. The Board recognizes that the exploration and development of natural resources is a speculative activity that involves a large numbers of uncertainties, and a degree of financial risk. Accordingly the Board considers the risks to which the Corporation is exposed as part of its regular operations, and keeps these under review.

The principal risks are considered to be those set out below.

Sensitivity to commodity prices and foreign exchange rates

UME's revenues, net earnings and cash flow from operations are affected materially by changes in the price of gold. Gold has historically been subject to large price fluctuations, and is affected by factors which are unpredictable, including international economic and political conditions, speculative activities, the relative exchange rate of the US dollar with other currencies, inflation, global and regional levels of supply and demand and the gold inventory levels maintained by producers and others.

UME's gold sales are priced in US dollars while its operating costs are predominantly incurred in US dollars, Canadian dollars and Uruguayan pesos. UME has financial exposure to foreign exchange fluctuations in the Uruguayan peso and the Canadian dollar relative to the US dollar.

Exploration, Mining and Operational Risks

UME's longer term strategy depends to a certain extent on its ability to find commercial quantities of minerals within Uruguay, and to obtain and retain appropriate access to these minerals. The Board cannot guarantee that it will be able to identify appropriate properties, or negotiate acquisitions, on favourable terms.

UME currently has one producing asset, the Minas de Corrales gold project. As more of its projects mature, the Board expects that more projects will develop into producing assets. In common with all mining operations, there is uncertainty, and therefore risk, associated with operating parameters and costs. Whilst costs can be budgeted with a reasonable degree of confidence, operating parameters can be difficult to predict and are often affected by factors outside the Group's control. In addition, other risks, including industrial accidents, technical failures, labour disputes and environmental hazards are also beyond the Group's control.

The nature of resource and reserve quantification studies means that there can be no guarantee that estimates of quantities and grades of minerals will be available to extract. The resources and reserves stated have been quantified according to the Australasian Institute of Mining and Metallurgy Code of Mineral Resource Estimation, which is the basis of reporting used by the Australian Stock Exchange.

The Company's business activities are also affected to varying degrees by government regulations respecting, among other things, tax, royalties, mining legislation and environmental legislation changes.

Title Risks

All prospecting, exploration and mining licenses and titles in Uruguay are granted by the Government of Uruguay for finite periods of time. The Government is bound by strict rules of priority of application, and security of title once granted. However Uruguay is a sovereign state, and there can be no guarantee that the State will continue to grant or respect mining titles, and that the titles of the properties will not be challenged or negated for political or legal reasons.

Individual titles expire from time to time and UME manages the process of retaining its rights by re-application or conversion to other forms of title relevant to each stage of development. The process of re-application involves some risk however, as released titles must fall open before they can be re-applied for.

Political and Economic Risks

Although political conditions in Uruguay are relatively stable, political and economic conditions have not been stable in the countries that surround it. Changes may occur in Uruguay's political, fiscal and legal system that might affect the ownership or operation of the Group's interests, including inter alia, changes in exchange control regulations, expropriation of mining rights, changes of government and in legislative and regulatory regimes.

Arenal Pit Expansion

In order to mine approximately 60% of the reserves remaining in the Arenal pit the pit must be expanded to the west and a river diversion completed. This diversion requires environmental approval to divert the Corrales River. Studies have been performed by the Company and external independent advisors to assess the environmental impact of diverting the river. These studies concluded that the river can be diverted without significant affect on river flows, flora and fauna. Based on these studies a submission has been made to the Uruguayan environmental authorities seeking this permission and the company is confident that this environmental approval will be granted. Should such environmental approval not be granted the reserves contained in the Arenal pit would have to be revised.

QUARTERLY RESULTS

Quarterly Results
(in thousands of US$ except where otherwise noted)

	Qtr 2 Nov 2004	Qtr 3 Feb 2005	Qtr 4 May 2005	Qtr 1 Aug 2005	Qtr 2 Nov 2005	Qtr 3 Feb 2006	Qtr 4 May 2006	Qtr 1 Aug 2006
Gold sold (ounces)	14,397	17,591	22,904	26,049	23,832	23,230	27,284	20,809
Average sales price ($/oz)	422	428	422	432	456	510	543	568
Cash operating cost ($/oz)	363	245	229	212	182	203	243	332
Operating revenues	6,328	7,874	10,284	11,721	11,326	12,167	15,992	12,177
Net profit interest	-	-	(253)	(306)	(329)	0	0	0
Operating expenses	(5,468)	(4,767)	(5,818)	(5,760)	(4,970)	(5,289)	(5,995)	(6,749)
Contribution Margin	860	3,107	4,213	5,655	6,027	6,878	9,997	5,428
Administration	(701)	(1,348)	(1,015)	(592)	(655)	(705)	(1,531)	(1,187)
Depreciation and amortization	(694)	(1,293)	(1,785)	(1,749)	(2,567)	(2,181)	(2,245)	(2,015)
Interest and financing costs	(71)	(99)	(189)	(93)	(81)	(137)	(28)	(88)
Other	(1,829)	842	710	(183)	(643)	(1,108)	(833)	1,275
Income Tax	-	-	610	(798)	(137)	(425)	(1,283)	(846)
Net income (loss) for the period	(2,435)	1,209	2,544	2,240	1,944	2,322	4,077	2,567
Basic earnings (loss) per share	(0.056)	0.028	0.056	0.048	0.042	0.050	0.090	0.054
Cash flow from (used in) operations	(121)	(316)	2,173	4,548	2,794	3,599	7,445	3,225
Cash from financing	2,258	2,719	2,221	224	36	168	1502	1,119
Cash invested	(3,354)	(2,490)	(1,791)	(2,835)	(3,925)	(6,520)	(3,606)	(4,730)
Cash on hand	2,985	2,898	5,501	7,382	6,287	3,590	8,931	8,545
Total Assets	35,644	37,782	42,651	46,635	51,918	51,963	60,008	62,651
Shareholders Equity	19,311	22,513	31,321	33,728	36,236	40,048	45,239	48,639

NON GAAP MEASURES

Cash flow from operations, contribution margin and cash cost per ounce are not measures that have any standardized meaning prescribed by Canadian GAAP and are considered non GAAP measures. Therefore these measures may not be comparable to similar measures presented by other issuers. These measures have been presented in this MD&A as additional information regarding the company’s financial performance and financial position.

Cash flow from operations is calculated by adding back non-cash items to earnings. Contribution margin has been calculated by deducting operating expenses from sales. Operating expenses include movements in inventories but exclude operating depreciation and amortization.

Cash cost per ounce are determined according to the Gold Institute Standard and consist of site costs for all mining, processing, administration, royalties, refining charges, silver credits and inventory adjustments relating to metal production. Capital expenditure, depreciation and amortisation and financing costs are not included. Cash costs are total cash costs divided by gold ounces produced. This calculation is detailed below.

	Quarter 1 Aug 2005	Quarter 2 Nov 2005	Quarter 3 Feb 2006	Quarter 4 May 2006	Quarter 1 Aug 2006
Operating expenses (000)	5,760	4,970	5,289	5,995	6,749
Other (000)	(424)	(362)	(131)	168	(383)
Total cash costs (000)	5,336	4,608	5,158	6,163	6,366
Gold production in ounces	25,163	25,323	25,451	25,350	19,175
Total cash costs per ounce	212	182	203	243	332

Forward Looking Statements

Certain information contained in this Management Discussion and Analysis constitutes “forward- looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 and forward looking information under applicable Canadian Securities Legislation. Such forward-looking statements or information, included but not limited to those with respect to prices for gold, estimated future production, estimated costs of production, the Company’s hedging policy involve 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 any future results, performance or achievements expressed or implied by such forward looking statements or information. Important factors that could cause actual results to differ materially from those in the forward looking statements contained herein, include among others, gold price, weather, exploration results, development and mining activities, geotechnical assumptions, environmental approvals and the availability of technical personnel.

Uruguay Mineral Exploration Inc.
Schedule of Deferred Exploration and Development Costs
(Unaudited)
(Thousands of United States Dollars, except where indicated)

	May 31, 06	Expenditures	Abandonments/ Transfers	August 31, 06
Minas de Corrales Gold Belt (1)				
Acquisition	$ 125	-	-	$ 125
Exploration	3,249	732	-	3,981
Deferred administration	63	83	-	146
	3,437	815	-	4,252
Base Metals Projects (2)				
Acquisition	105	-	-	105
Exploration	4,162	282	-	4,444
Deferred administration	1,059	32	-	1,091
	5,326	314	-	5,640
Other Gold Projects (3)				
Acquisition	480	-	-	480
Exploration	777	127	-	904
Deferred administration	397	14	-	411
	1,654	141	-	1,795
Diamonds Projects (4)				
Acquisition	65	-	-	65
Exploration	378	95	-	473
Deferred administration	37	11	-	48
	480	106	-	586
Regional Exploration (5)				
Acquisition	-	-	-	-
Exploration and overhead	287	-	-	287
	$ 11,184	1,376	-	$ 12,560

No amounts directly related to these projects were expensed.

Each of the major project areas is described below. Details of work performed in the current financial year on each of the projects are included in the Company's Exploration Report for 2007 and details of work for 2007 are included in the Exploration report and Outlook statement in this Management Discussion and Analysis.

1. Minas de Corrales Gold Project ("MCGP"):
The MCGP is situated in an inlier of Proterozoic rocks approximately 110 km in length and 40 km in width. It is located in the north of Uruguay approximately 450 km from Montevideo. The San Gregorio processing plant and existing San Gregorio mining operations are located on the western end of the belt. The two largest deposits discovered to-date are the San Gregorio deposit, which has produced over 500,000 ounces since it was discovered in the mid 1880's, and the Arenal deposit, which was discovered in 2004. To May 31 2006 152,000 ounces have been mined from Arenal and a further 303,000 remain in reserves to be mined. Both the San Gregorio and Arenal deposits are open at depth

2. Base Metals Projects:
These include the *Dom Feliciano Mobile Belt* iron/copper/gold project where a substantial belt of copper and gold anomalism has been identified approximately 300 km north-east of Montevideo. At *Mal Abrigo*, located approximately 140 km WNW of Montevideo, a large, layered mafic/ultramafic complex is the subject of study for nickel/copper/platinoids. Disseminated copper and nickel sulphides are visible at the surface in a number of places. At *Lascano*, located approximately 250 kilometers north-east of Montevideo, a very strong gravity high approximately 70 kilometers long by up to 40 kilometers wide is considered to be a capable of hosting Norilsk-style nickel mineralisation. At Carpinteria, which is situated approximately 500 km north of Montevideo, an extensive sequence of komatiitic basalts and ultramafic flows with strong nickel anomalism is currently being evaluated.

3. Other Gold Projects. These include Presidente Terra, which is located approximately 240 kilometers north east of Montevideo, where work conducted during 2000 and 2001 identified high-grade mineralized float over a 12 km strike length of a large gold-mineralized shear system. This project has been on hold due to competing priorities. Mirta, which is located near Colonia in the south-west of Uruguay, is a complex, shear-hosted gold deposit and the company has been assessing the mineralisation controls in order to define further drill targets. The deposit is characterized by a series of short, plunging, high-grade ore zones contained within a broader, low-grade mineralisation envelope. At Chamizo, which is located approximately 120 km ENE of Montevideo, a gold-bearing metamorphosed acid tuff is being investigated. A new gold project Casupa, located 100 km north of Montevideo, has been generated and a drill program is planned for this area.

4. Diamonds including Cinco Rios Project. This project is located in the North of Uruguay and includes the Minas de Corrales area as well as the properties obtained with the acquisitions of Cinco Rios SA. Systematic drainage sampling has identified an area where positive kimberlite indicator minerals are clustered, and a close-space airborne gravity survey is scheduled for May 2006. The company has previously recovered several macro-and micro-diamonds, together with G9 and G10 garnets from this area.

5. Regional Exploration. The company has an ongoing program of identifying and field-checking geochemical anomalies obtained from reviewing data held within the Company's proprietary data-base. Where appropriate successful prospects are designated and allocated to the major project groupings shown above.