



## **QGX LTD.**

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### **Management Discussion and Analysis of Financial Results**

This section provides an analysis of the operating and financial results of QGX Ltd. (“QGX” or the “Company”) for the three month period ended March 31, 2007 and the three month period ended March 31, 2006, and should be read in conjunction with our interim financial statements and notes thereto for the period ended March 31, 2007 (the “Interim Statements”) as well as our audited financial statements and the notes thereto for the years ended December 31, 2006 and 2005 (the “Annual Statements”).

This MD&A has been prepared in conformity with National Instrument 51-102 F1 and has been approved by the Board of Directors. The information contained within is current as of May 1, 2007 unless otherwise noted.

#### **Overview**

QGX has been engaged in mineral exploration in Mongolia since its inception in 1994. The common shares of the Company are listed for trading on the Toronto Stock Exchange under the symbol “QGX”.

At March 31, 2007, the Company held 71 mineral exploration licenses in Mongolia covering approximately 7980 sq. km. The Company’s most advanced properties are the Baruun Naran coal project in southern Mongolia and the Golden Hills copper-gold-silver project in western Mongolia, as discussed below.

#### **Principal Properties**

**Baruun Naran:** The Baruun Naran project is located in southern Mongolia, approximately 500 km south of Ulaanbaatar, the capital of Mongolia, and 270 km north of the Chinese border. It is also approximately 22 km southwest of the large Tavan Tolgoi coking and thermal coal deposit. The project occurs within a single exploration license totaling 953 sq km. QGX acquired 100 percent of this license in 2003.

QGX began exploring the Baruun Naran license in the early spring of 2005, where coal occurs within the Tavan Tolgoi Formation. The Company drilled 213 holes during 2006, bringing the property total to approximately 350 drill holes over the last two years. Extensive geophysical programs have been conducted on the property to guide the exploration drilling program. Work to date has been focused on an area approximately 2 km x 10 km in size with the majority of the drill holes concentrated within a 1 km x 6.5 km portion of this block.

On June 7, 2006 the Company announced an initial resource estimate for the project, independently prepared by McElroy Bryan Geological Services Pty. Ltd. of Sydney, Australia ("MBGS"), of 47.5 million tonnes of "measured", 60.0 million tonnes of "indicated" (107.5 million tonnes of "measured & indicated") coal resources and an additional 48 million tonnes of "inferred" resource. QGX filed a copy of the NI 43-101 compliant report prepared by MBGS dated July, 2006 (the "MBGS Report") on SEDAR on July 24, 2006.

**Golden Hills:** The Golden Hills property is located in northwestern Mongolia, 900 kilometers west of Ulaanbaatar. QGX has completed its earn-in requirements for an 80% interest in the initial license area comprising approximately 70 sq. km and has acquired a 100% interest in several surrounding licenses comprising approximately 6,000 sq. km. QGX discovered a copper-gold-silver volcanogenic massive sulphide ("VMS") deposit at Golden Hills in 2002, referred to as the Central Valley Zone (the "CVZ"). The CVZ deposit contains three distinct types of mineralization: 1) massive sulphide lenses containing copper (with byproduct gold and silver) occur at depths below the base of oxidation (approximately 70 m below the surface); 2) near-surface zones of gold and silver-bearing gossan that represent the oxidized up-dip portions of these sulphide zones, and 3) high-grade quartz-telluride veins containing gold and silver that occur along the margins of the massive sulphide and oxide bodies.

On February 28, 2005 QGX announced the completion of an independent, NI 43-101 compliant, mineral resource estimate for the CVZ. Chlumsky Armbrust & Meyer L.L.C. ("CAM") of Denver, Colorado, prepared the estimate in a report dated March 28, 2005. CAM later updated the resource estimate in a new NI 43-101 report dated October 17, 2005. The following table outlines the resource estimate.

Resource Classification	Cutoff Grade			Grade			Contained Metal		
	Au (g/t)	Cu (%)	Tonnes (000's)	Au (g/t)	Ag (g/t)	Cu (%)	Gold (000's ounces)	Silver (000's ounces)	Copper (mm lbs)
<b>Massive Sulphide</b>									
Measured	–	0.8	1,024	0.39	5.5	1.86	13	183	42
Indicated	–	0.8	9,140	0.39	5.3	1.70	114	1,567	343
<b>Total M+I</b>	–	<b>0.8</b>	<b>10,164</b>	<b>0.39</b>	<b>5.4</b>	<b>1.72</b>	<b>127</b>	<b>1,750</b>	<b>385</b>
Inferred	–	0.8	9,499	0.33	4.5	1.29	101	1,389	270
<b>Oxide (gossan)</b>									
Measured	1.0	–	474	3.10	19.0	–	47	290	–
Indicated	1.0	–	2,624	2.78	18.9	–	234	1,594	–
<b>Total M+I</b>	<b>1.0</b>	–	<b>3,098</b>	<b>2.83</b>	<b>18.9</b>	–	<b>281</b>	<b>1,884</b>	–
Inferred	1.0	–	1,752	2.72	19.5	–	153	1,098	–
<b>HGQT Veins</b>									
Inferred	3.0	–	696	19.63	35.0	–	439	783	–
<b>Contained Metal in Measured + Indicated Resources</b>							<b>409</b>	<b>3,634</b>	<b>385</b>
<b>Contained Metal in Inferred Resources</b>							<b>693</b>	<b>3,270</b>	<b>270</b>

On March 8, 2007 QGX announced the results of a preliminary economic assessment for the CVZ which is discussed in more detail in the Principal Property Updates section of this report.

## **Principal Property Updates for the Period January 1, 2007 to May 1, 2007**

**Baruun Naran:** Three drilling programs and one resource estimate were completed in 2006 at Baruun Naran.

- The first drilling program, completed in May 2006, formed the basis for the first (and current) NI 43-101 resource report filed on SEDAR in July 2006;
- The second 2006 drilling program, completed in September 2006, and was designed to increase our understanding of coal quality and to complete drilling in certain areas that would allow additional seams to be included in our initial resource estimate, and
- The third 2006 drilling program, completed in early December 2006, was intended to convert the known coal within the current area of interest (approximately 6.5 km long and 1.5 km wide) into the “indicated” and “measured” resource categories, forming the basis for a new NI-43-101 resource report.

McElroy Bryan Geological Services Pty. Ltd. of Sydney, Australia has been working with the results of the second and third drilling programs in Q1 2007, is expected to deliver results that will form the basis of a new “measured and indicated” NI 43-101 resource estimate in Q2 2007.

Mr. Bob Leach of A&B Mylec Pty Ltd (“Mylec”), located in Brisbane, Australia, has also been working with the results of the 2006 drilling programs in late 2006 and Q1 2007 to define coal quality across a number of parameters. We anticipate a detailed understanding of our coal-quality characteristics to be reported in Q2 2007, however an interim report was received and announced on February 21, 2007. Highlights included:

- Three distinct washed coal products can be produced from Baruun Naran; semi-soft to semi-hard coking coal (7-9% ash), secondary thermal coal (12-16% ash), and a tertiary thermal coal (20-25% ash);
- Coking coal fractions were present in each of the 6 seams tested, and
- Coal-quality distributions within seams vary, and will require blending to maintain desired ash specifications.

During 2006, AATA International, Inc. (Fort Collins, Colorado), in association with Ecotrade (Ulaanbaatar, Mongolia), completed a social and environmental baseline study (“SEBS”) for Baruun Naran. The work was compiled in January 2007 and the results announced on February 26, 2007. Highlights included:

- The study found no physical, chemical, biological or social characteristics that would present a fatal flaw to development of the property;
- The study provides the baseline database for the subsequent social and environmental impact assessment (“SEIA”), to be initiated later in 2007 as a necessary prerequisite to mining development at Baruun Naran, and
- The SEIA will be conducted to satisfy both Mongolian and International standards, including IFC Performance Standards and Equator Principles.

In addition to work on coal resources, quality, and environment, the Company retained Nexant Inc, (San Francisco, California), an engineering firm with majority ownership by The Bechtel Corporation, to conduct a screening study related to the production of petrochemical products (e.g., methanol, DME, and olefins) using standard coal-to-liquid (“CTL”) technologies, deployed in commercially operating plants today. The CTL plant concept is being evaluated as part of a review to maximize the value of the thermal coal

resource at Baruun Naran. Results of the Screening Study were announced on February 23, 2007. Highlights included:

- Baruun Naran coal is a suitable feedstock for a CTL plant, as run-of-mine product without washing the coal, thereby mitigating the need and capital for a washing plant;
- The Study envisions a CTL plant with a capacity of 1.78 million tonnes per annum (Mtpa) of methanol, ranking as one of Asia's largest coal-to-methanol plants. Development would consist of a phased approach with an initial start-up plant at one-third the size, and
- Coal tonnages required to support a large (1.78 M Mtpa) CTL plant are available at Baruun Naran for in excess of 30 years.

**Golden Hills:** QGX believes that the Central Valley Zone ("CVZ") is part of a larger VMS belt or district that has the potential to host several other Cu-Au-Ag deposits. To evaluate this mineral potential, QGX conducted an airborne geophysical survey covering approximately 2300 sq. km of the Golden Hills license block in western Mongolia. The results of the survey were announced on May 3, 2006. A final interpretation of the data by QGX's geophysical consultant is expected in Q2 2007. Ground follow-up of the identified airborne electromagnetic anomalies is planned for the 2007 field season.

The Company retained Chlumsky, Armbrust & Meyer LLC ("CAM") in Q4 of 2006 to conduct a NI 43-101 compliant Preliminary Economic Assessment ('PEA') for its 80% owned Golden Hills project. The results of that work were announced on March 8, 2007. Highlights included:

- A positive PEA on a two-stage mine development plan with 15 year mine life;
- A 27% IRR, based on long-term copper price of US\$1.50/lb, gold price of US\$529/oz, and silver price of US\$9.08/oz;
- Gold total cash cost in oxide phase of US\$149/oz (after silver credits), and
- Copper total cash cost in sulphide phase of US\$0.78/lb. (after gold-silver credits).

## Project Highlights for CVZ, Golden Hills, Mongolia

Highlights for Golden Hills Project		
Preliminary Economic Assessment Project Highlights	Oxide Phase Open Pit Years 1-4	Sulphide/Telluride Underground Years 5-15
Average Annual Production		
Copper		56.6 million Lbs.
Gold	79,900 oz	53,900 oz
Silver	521,000 oz	235,300 oz
Total Cash Cost*	US\$ 149/oz Au	US\$ 0.78/lb Cu
Average Annual Revenues	\$47 million	\$106 million
Average Annual Net Earnings	\$13.8 million	\$19.8 million
	<u>Total Project</u>	
Capital Cost		
Development Capital		US\$146 million
Sustaining Capital		US\$18 million
NPV @ 10% i		US\$83 million
IRR		27%
*Total cash costs defined as C(1) (Brook Hunt), net of by-product credits, reflect life-of-mine costs, and include TCRC's and transport costs, exclude royalties **Revenues shown net of government royalties		

Separately, the Company has received positive metallurgical test results from AMEC Americas Limited (Vancouver), regarding the third phase of metallurgical studies related to the oxide at Golden Hills. These results were announced February 23, 2007. Highlights include:

- Confirmation that agitated vat leaching is a technically feasible processing method for recovery of gold and silver from oxide;
- Conventional crushing/grinding circuits and carbon-in-pulp treatment are favourable, and
- The average sodium cyanide consumption for the Phase 3 tests with an 800g/t addition was 350g/t. This result is lower than previous results reported from Phase 1 and 2 tests, suggesting the potential for lower beneficiation costs.

### Other Properties

No significant results were forthcoming from exploration programs on other properties in the period. Work and spending on other properties has been reduced as the Company focuses on its advanced projects.

## Qualified Persons

David Anderson, Executive Chairman and John Thompson, Vice President-Project Development are the qualified persons under National Instrument 43-101 who have reviewed the technical information contained in this report.

## Amendments to the Mongolian Mining Laws

As reported previously, on May 12, 2006, the government of Mongolia introduced a Windfall Profit Tax Law, applicable to revenues from the sale of gold and copper concentrates (net of smelting & refining charges) produced in Mongolia. For more information on changes to the mining law in Mongolia, please refer to our discussion on this subject in our Annual Information Form, filed on SEDAR.

These tax and mining law changes clearly dampened investor sentiment towards mineral exploration companies with properties in Mongolia. However, we are starting to see some hopeful signs of change. A bill to modify the windfall profits tax was introduced by Parliament in the fall session and is awaiting a vote. Subsequent changes to the cabinet have been made that are considered to be pro-foreign investment. Further, several high ranking Mongolian government officials have been touring Canada, US, and Europe to promote mining investment. Finally, Rio Tinto and Ivanhoe Mines announced on April 10<sup>th</sup> 2007 that an agreement in principle on a draft investment agreement had been reached regarding the development of the large Oyu Tolgoi copper-gold project in southern Mongolia.

## Quarterly Disclosure – Eight Most Recently Completed Quarters

The following table sets forth certain unaudited financial information prepared by management of the Company.

	Three Months Ended			
	Mar. 31/07	Dec. 31/06	Sept. 30/06	June 30/06
Revenues	\$143,246	\$220,390	\$197,713	\$571,735
Net Income (loss)	(2,141,564)	(1,062,716)	(2,145,347)	(1,244,737)
Per share – basic	(0.05)	(0.03)	(0.04)	(0.03)
	Mar. 31/06	Dec. 31/05	Sept. 30/05	June 30/05
Revenues	\$46,248	\$76,080	\$40,680	\$24,980
Net Income (loss)	(865,107)	(1,499,904)	(1,769,054)	(726,065)
Per share – basic	(0.02)	(0.04)	(0.05)	(0.02)

## Results of Operations

### Revenues and Expenses

The Company is still in the pre-mining stage without any producing properties. Revenues were derived solely from interest income earned on cash balances. For the quarter ended March 31, 2007 interest income amounted to \$143,246 versus \$46,248 in the comparable period in 2006. Expenses (cash and non-cash) for the period totaled \$2,284,810 as compared to \$911,355 in the comparative period of 2006. The \$1,373,455 increase in 2007 reflects spending changes in the following areas:

- project write-downs of \$1,204,192;
- foreign exchange impacts of \$101,705;
- higher spending on office costs of \$41,603;
- increased spend on investor relations of \$48,451, and
- higher salaries of \$56,038.

These spending increases were partially offset by a \$88,990 decrease in stock-option expense.

The net result of the foregoing is that Company recorded a loss of \$2,141,564 (\$0.05 per common share) for the quarter as compared to \$865,107 loss (\$0.02 per common share) in the corresponding 3 month period of 2006. These negative earnings reflect the fact that the Company is incurring significant expenditures without generating revenues from operations. This is a common result for mineral exploration companies and we expect this trend to continue until we are able to generate meaningful operating revenues.

### Resource Expenditures

QGX is engaged in the acquisition, exploration, and development of resource properties. All acquisition, exploration, and related overhead expenditures are recorded as an asset on the balance sheet under the heading "Resource properties". These expenditures will be depleted over the estimated life of the properties if and when they reach production or will be written down by management when it is determined that the net carrying amount will not be recovered.

Certain restrictions are likely to prevent full tax deductions for some of the costs incurred on our resource properties. This has been reflected as a future income tax liability on the balance sheet. As described in note 3 and note 4 to the annual financial statements, the amount recorded as "Resource properties" has been increased to offset the future tax liability in accordance with Canadian Generally Accepted Accounting Principles.

All of the Company's properties are in the exploration stage and there can be no assurance that any will commence production in the future.

The Company recognized a net increase to resource properties in the quarter ending March 31, 2007 of \$47,218. This net increase is the result of the following:

- Total capitalized spending on exploration properties of \$1,374,430, with approximately \$557,000 attributable to the Baruun Naran project, and \$438,000 for the Golden Hills Project, related to camp and staffing cost, consultants, license costs and lab fees;

- A write-down of capitalized cost of \$1,204,192, related to the dropping of 29 non-strategic mineral licenses, and
- A further \$123,020 reduction in resource property assets reflecting a lower future tax liability, corresponding directly to the property asset write-down above.

This reduction in license holdings reflects management's belief that those licenses no longer hold sufficient mineral potential to retain in our portfolio, and therefore no longer warrant carrying their portion of deferred cost on the balance sheet.

## **Liquidity and Capital Resources**

### **Working Capital**

QGX showed working capital of \$13,220,177 at March 31, 2007, (December 31, 2006 – \$15,313,698) consisting primarily of cash and short-term investments. The decrease is due to resource expenditures incurred in the period, as discussed above. Management believes that the Company has sufficient cash to cover planned exploration expenditures and operating expenses, although the Company may seek to raise additional capital from time to time as market conditions warrant. There can be no assurance that additional funds will be available at any given time. Management will adjust its budgets accordingly to ensure that adequate working capital is maintained.

### **Long-Term Liability**

The only long-term liability the Company as at March 31, 2007 was for future income taxes (please refer to note 3 of the annual financial statements). This liability recognizes that higher tax may be paid at some future point, from potential income-generating operations, as a result of differences between tax and book asset valuations on certain assets held on the Company's balance sheet. This balance sheet liability will only be realized in the event that the project assets associated with it generate taxable income, either through operations or sale of the assets.

### **Capitalization**

There were 45,908,956 common shares outstanding at March 31, 2007.

The Company's fully diluted share count at March 31, 2007 was 50,013,956 shares. The potential dilution is related to 4,105,000 stock options held by officers, directors, employees and consultants, at exercise prices ranging from \$0.50 to \$3.25.

### **Change in Accounting Policies**

On January 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Sections 1530 "Comprehensive Income", 3251 "Equity" and 3855 "Financial instruments". The Company adopted these standards prospectively; accordingly comparative amounts for prior periods have not been restated. Recognition of these new guidelines had no effective impact on QGX's financials, based on the fact that the Company had no Comprehensive

Income, Equity restatements or Financial Instruments that required restatement to fair value as opposed to market valuation. There were no other changes to accounting policies since the Company's 2006 year end.

### **Restatement of Comparative Figures**

The Company identified certain restrictions that are likely to prevent it from realizing full tax deductions for some of the costs incurred while exploring its resource properties in Mongolia which have been previously deferred on the balance sheet. Accordingly the Company has recognized a liability for future income taxes in accordance with its related accounting policy, as described in Note 3 of the financial statements. As these costs were incurred in connection with acquisition of an asset, rather than in a business combination, the cost of this liability has been added to deferred resource property costs in accordance with Canadian Generally Accepted Accounting Principles. These costs were not treated as an expense in the statement of operations.

Management believes that these tax deduction restrictions were also in place as at December 31, 2005, and accordingly we have provided a restated comparative 2005 balance sheet in our consolidated financial statements for 2006. There was no impact on reported Statement of Earnings or cash flows in either 2006 or 2005.

### **Critical Accounting Estimates**

Critical accounting estimates used in the preparation of the Financial Statements include the Company's estimate of the recoverable value of its resource properties as well as the value of stock-based compensation. Both of these estimates could be significantly affected by factors that are out of the Company's control.

Resource properties, provided they are deductible for tax purposes at some future date, are recorded at cost. All acquisition, exploration, and related overhead expenditures are recorded as an asset on the balance sheet under the heading "Resource Properties". If certain of these capitalized assets are not reasonably assured of their future tax deductibility, the additional tax obligation will be recognized immediately as a future tax liability. These expenditures will be depleted over the estimated life of the properties if and when they reach production, or will be written down by management when it is determined that the net carrying amount will not be recovered.

The amount expensed for stock-based compensation was based on the application of a recognized option valuation formula, which is highly dependent on the expected volatility of the Company's shares. The Company used an expected volatility rate for its shares of 66% in 2007 (79% - 83% in 2006). This is an estimate based on past stock trading data and actual volatility may be significantly different in the future. While the estimate of stock-based compensation can have a material impact on the operating results reported by the Company, it is a non-cash charge and as such has no impact on the Company's financial condition.

## **Financial Instruments**

The Company has not entered into any specialized financial agreements to minimize its investment, currency, or commodity risks. There are no off-balance sheet arrangements. The principal financial instruments used by the Company are short-term, high-grade interest-bearing cash investments, acquired to enhance the returns on the Company's cash position. The Company considers these instruments to be low risk in nature. The fair value of these instruments approximates their carrying costs, unless otherwise noted on the financial statements.

## **Risks and Uncertainties**

Mineral exploration involves a high degree of risk. Few properties that are explored are ultimately developed into production. None of the Company's properties has a known body of commercial ore. Other risks facing the Company include: political stability in Mongolia; changes in legislation in Mongolia that could adversely affect exploration and mining rights as well as taxation and royalties; ability to attract and retain qualified personnel; availability of additional capital; costs and availability of materials and services relevant to the mining industry; title risks, and integrity of exploration results.

### **Disclosure Controls and Procedures (DC&P)**

Management is responsible for the information disclosed in this MD&A and has in place the appropriate information systems, procedures and controls to ensure that information used internally by management and disclosed externally is, in all material respects, complete and reliable.

As of the financial year ended December 31, 2006, an evaluation was carried out under the supervision of, and with the participation of, the Company's management, including the Chief Executive Officer and Chief Financial Officer, on both the design and effectiveness of the Company's disclosure controls and procedures. No changes were made during the quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's design or effectiveness of disclosure controls and procedures., as accepted and certified at year end 2006. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer conclude that current disclosure controls and procedures were effective as of March 31, 2007 to provide accurate and complete disclosure in public filings.

The Board of Directors assesses the integrity of the public financial disclosures through the oversight of the Audit Committee.

## **Internal Controls Over Financial Reporting Review – (ICFR)**

During 2006 the Company completed a detailed evaluation of the design effectiveness regarding controls over financial reporting, based on the framework established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The evaluation was conducted under the supervision of the Chief Executive Officer and the Chief Financial Officer, and identified a lack of segregation of duties and in-house expertise to deal with complex taxation, accounting and reporting duties, due to a limited number of employees dealing with financial matters. However, management has concluded that, considering the relatively small size of the company, employees involved, and the control procedures in place, including management and audit committee oversight:

- The risks associated with such lack of segregation are not significant enough to justify further measures, and
- Internal control over financial reporting has been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with issuer's GAAP.

No changes were made during the quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's design of internal controls over financial reporting., as accepted and certified at year end 2006.

Based on that evaluation, the Chief Executive Officer and Chief Financial Officer conclude that ICFR design was effective as of March 31, 2007.

## **Forward Looking Statements**

The above contains forward looking statements that are subject to a number of known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those anticipated in our forward looking statements. Shareholders and prospective investors should not place undue reliance on forward-looking information and should bear in mind the risks and uncertainties outlined above under "Risks and Uncertainties".

## **Additional Information**

Additional information relating to QGX can be found in the Financial Statements, as well as in the Company's Annual Information Form, which are filed on SEDAR at [www.sedar.com](http://www.sedar.com).