



## **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 and twelve month periods ended December 31, 2007, and should be read in conjunction with our audited financial statements and notes thereto for the period ended December 31, 2007 (the “2007 Annual Statements”) as well as our audited financial statements and the notes thereto for the years ended December 31, 2006 (the “2006 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 2007 Annual Statements have been prepared in conformance with Canadian Generally Accepted Accounting Principles and the reporting currency is the Canadian Dollar.

The information contained within this report is current as of March 13, 2008 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 December 31, 2007, the Company held 35 mineral exploration licenses in Mongolia covering approximately 3,953 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.

On February 12, 2008, QGX announced that it has initiated a review of strategic alternatives to identify the most effective means for optimizing value from existing assets for shareholders. This review will be all encompassing in its evaluation of available options. There can be no assurance that the process will result in any specific strategic or financial transactions, and no timetable has been set for its completion. The Company does not plan to make future comments about the status of the review unless there are material developments.

## 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 2002. QGX began exploration in the early spring of 2005, and completed 348 drill holes on the property by the end of December 2006. 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.

Completion of three drilling programs during 2005-2006 formed the basis for a new NI 43-101 resource report, independently prepared by McElroy Bryan Geological Services Pty. Ltd. of Sydney, Australia, and announced on June 13, 2007. The updated June 2007 resource estimate is more than double the size of the previous 'measured and indicated' coal estimate of June 2006, summing to 252.9 MT. Later on August 7<sup>th</sup> QGX reported an additional 11 MT of inferred resources, together with the previously reported 252.9 MT measured and indicated resources.

| <b>Baruun Naran Project</b>                   |   |   |   |
|---|---|---|---|
| <b>NI 43-101 Compliant Resource Estimates</b> |   |   |   |
| <b>(tonnes x millions)</b>                    |   |   |   |
|   | <b>7-Jun-06<br/>First<br/>Resource<br/>Estimate</b> | <b>13-Jun-07<br/>Second<br/>Resource<br/>Estimate</b> | <b>7-Aug-07<br/>Updated<br/>Resource<br/>Estimate</b> |
| <b>Measured Resources</b>                     | 47.5  | 93.3  | 93.3  |
| <b>Indicated Resources</b>                    | 60.0  | 159.6   | 159.6   |
| <b>Measured and Indicated Total</b>           | 107.5   | 252.9   | 252.9   |
| <b>Inferred Resources</b>                     | 48.0  | 0.0   | 11.0  |

Mr. Bob Leach of A&B Mylec Pty Ltd ("Mylec"), located in Brisbane, Australia, has defined the coal quality for the coal seams across a number of parameters. Those announced results indicate coking coal fractions are present in each tested seam, and that with washing and blending, our recently announced pre-feasibility study indicates that two distinct coal products would most likely be produced from Baruun Naran:

1. A coking coal product (11% ash), and
2. A thermal coal product (20% ash).

Float-sink (sizing and washing) laboratory tests have been performed and indicate theoretical overall washing yields of 64.7%. These tests confirm that three washed products can be generated from a conventional wash process, however recent economic findings suggest favorable results from producing two products, one metallurgical grade and one thermal grade.

Other key areas of progress on the Baruun Naran project include:

- Completion of a social and environmental baseline study (“SEBS”) by AATA International, Inc. (Fort Collins, Colorado), in association with Ecotrade (Ulaanbaatar, Mongolia), which will form the basis of a subsequent social and environmental impact assessment (“SEIA”), to be initiated in 2008.
- Completion of a screening study by Nexant Inc, (San Francisco, California), 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. The screening study found the Baruun Naran coal resource to be a suitable feedstock for a CTL plant.
- Completion of a preliminary economic assessment by Minarco-MineConsult (Sydney, Australia), announced on July 19, 2007 which included an after-tax net present value (NPV) estimate for the project (discounted at 10%) of US\$481million.
- Completion of a pre-feasibility study by Minarco-MineConsult (Sydney, Australia), announced on January 12, 2008, which included an after-tax net present value (NPV) estimate for the project (discounted at 10%) of US\$499 million and a discounted cash flow - internal rate of return (DCF-IRR) of 33%. This latest economic study is discussed in greater detail in the Principal Property Updates section of this report.

**Golden Hills:** The Golden Hills property is located in northwestern Mongolia, 900 km west of Ulaanbaatar. QGX has completed the 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 in a location referred to as the Central Valley Zone (“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 typically 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 updated resource estimate.

| Resource Classification                                  | Cutoff Grade |            |                   | Grade       |             |             | Contained Metal        |                          |                    |
|--|--------------|------------|-------------------|-------------|-------------|-------------|------------------------|--------------------------|--------------------|
|  | Au<br>(g/t)  | Cu<br>(%)  | Tonnes<br>(000's) | Au<br>(g/t) | Ag<br>(g/t) | Cu<br>(%)   | Gold<br>(000's ounces) | Silver<br>(000's ounces) | Copper<br>(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 NI 43-101 compliant preliminary economic assessment ('PEA') for its 80% owned Golden Hills project, completed by Chlumsky, Armbrust & Meyer LLC ("CAM") of Denver, Colorado. Highlights of that independent report included:

- A positive PEA on a two-stage mine development plan with 15 year mine life, and
- A 27% DCF - 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.

| 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                                |
| Average Annual Revenues*                           | \$47 million                   | \$106 million                             |
| Average Annual Net Earnings                        | \$13.8 million                 | \$19.8 million                            |
| Capital Cost                                       | <u>Total Project</u>           |   |
| Development Capital                                | US\$146 million                |   |
| Sustaining Capital                                 | US\$18 million                 |   |
| NPV @ 10%  | US\$83 million                 |   |
| IRR  | 27%                            |   |
| *Revenues shown net of government royalties        |                                |   |
| *Revenues shown net of government royalties        |                                |   |

AMEC Americas Ltd (Vancouver) has provided positive metallurgical test results regarding the third phase of metallurgical studies related to the oxide at Golden Hills. These results include confirmation that agitated vat leaching, conventional crushing/grinding, and carbon-in-pulp treatment are all technically feasible processing methods for the oxide resource.

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 in 2006 covering approximately 2300 sq. km of the Golden Hills license block in western Mongolia. Ground follow-up of the identified airborne electromagnetic anomalies has been completed, and is discussed in greater detail in the Principal Property Updates section of this report.

### **Principal Property Updates for the Period October 1, 2007 to March 13, 2008**

**Baruun Naran:** On January 23, 2008, QGX announced the results of a NI 43-101 compliant pre-feasibility study (“PFS”) for the Baruun Naran project. Minarco-MineConsult of Sydney, Australia (“MMC”), independently prepared the PFS on QGX’s behalf. The PFS defines a conventional, truck-and-shovel, open-cut mining operation with coal processed on site using a wash plant to produce both a coking and a thermal coal product. The coal products are assumed to be delivered to markets by rail starting in 2011.

Project economics are strongly influenced by coking coal prices and volumes—72% of revenue is derived from coking coal product sales. Coking coal tonnages in the PFS are maximized by blending to an 11% ash product, which also yields a thermal coal product with a 20% ash specification.

The PFS concludes that the Project is financially robust with an estimated after-tax NPV (discounted at 10%) of US\$499 million and a DCF-IRR of 33%. Project highlights are summarized below.

## Project Production and Financial Highlights

| <b>Production</b>                                    |       |
|--|-------|
| Total Mineable Coal (ROM Mt)                         | 193   |
| Mine Life (production years)                         | 20    |
| ROM Production Rate (Mtpa)                           | 10.0  |
| Average Stripping Ratio (bcm/ROM mt)                 | 5.2:1 |
| <b>Average Annual Saleable Coal Production</b>       |       |
| Coking Coal (11% ash) (Mtpa)                         | 3.5   |
| Thermal Coal (20% ash) (Mtpa)                        | 2.4   |
| Total Average Annual Saleable Coal Production (Mtpa) | 5.9   |
| <b>Average Annual Revenues, and Profits</b>          |       |
| Average Annual Revenue (US\$ millions)*              | \$457 |
| Average Annual After-Tax Net Profit (US\$ millions)* | \$98  |
| <b>Financial Summary</b>                             |       |
| NPV @ 10% discount rate (US\$ millions)              | \$499 |
| DCF-IRR (%)  | 33%   |
| Payback (years)**                                    | 4.1   |

\* for periods with sales revenue; \*\* from start of mine construction; Mtpa = million metric tonnes per year; mt = metric tonne

**Golden Hills:** On August 22, 2007, QGX Ltd. announced that a drilling program and geotechnical studies have been initiated at the Central Valley Zone (“CVZ”) of Golden Hills, western Mongolia, as part of the requirements to convert the exploration license to a mining license. The drilling program consisted of five holes, a planned total of 750 meters, and two distinct objectives both of which were successfully met:

- hydrological drilling, to determine the hydrologic properties of the oxide zone, and
- geotechnical and rock mechanical test work to understand slope stability and to guide the design of the oxide gold-silver open pit, utilizing drill core from the water program.

An environmental baseline study was completed during the fourth quarter in support of conversion of license 3000X from an exploration license to a mining license along with a mining and milling progress design study, a preliminary feasibility study, and completion of a geological resource report.

On December 20, 2007, QGX announced that reserve estimates and supporting documents for the Golden Hills (Cu-Au-Ag) project, independently prepared by third-party Mongolian experts to a Mongolian government (non-NI 43-101) standard, were submitted to the Minerals Resource Council of the Mongolian government for registration. That reserve registration was received and the Company subsequently in January 2008 submitted a mining license application on the 3000X license, which is currently pending

On September 4, 2007, QGX Ltd. announced that exploration drilling was being conducted at the Copper Ridge massive sulphide prospect, located approximately 3 km from the Central Valley Zone (“CVZ”) copper-gold-silver massive sulphide deposit at

Golden Hills, western Mongolia. One diamond drill hole was completed (488 feet), and assays indicate intersection of six significant massive sulfide horizons, the widest being 7.15 metres in core length grading 0.74% copper, 2.5 g/t silver, and trace gold and zinc.

**Other Developments:** On August 15, 2007, QGX Ltd. announced the discovery at Khotgor, southern Mongolia, of a multiple-phase rhyolite-syenite-latitude porphyry intrusive centre with zoned alteration typically associated with molybdenum deposits. A recently completed induced polarization (IP) survey shows a classic “doughnut-shaped” chargeability response centered on the intrusive which forms a resistivity low. This is a classic geophysical response that is typically associated with porphyry deposits. QGX believes the chargeability high is reflecting a pyrite-rich fringe surrounding the hydrothermal system. QGX drilled 3 holes totaling 1307 metres in Q4 at the target site and sent the core to a geophysical lab in Canada for analysis. Results are expected in late March 2008

On December 13, 2007, QGX announced that independent metallurgical testing of tungsten-molybdenum sulfide ores has commenced for the Undur Tsagaan project in eastern Mongolia. The metallurgical study is being conducted by Process Research Associates Ltd. (“PRA”), Richmond, British Columbia.. The study will utilize a 200 kg composite sample derived from core with an average head grade of 0.129% WO<sub>3</sub> and 0.0179% Mo that QGX believes is representative of the deposit. Diagnostic test work will include grinding, gravity separation (centrifugal and table concentration), and flotation (rougher and cleaning). PRA anticipates the study will be completed in March 2008.

On December 20, 2007, QGX announced that reserve estimates and supporting documents for the Undur Tsagaan (W-Mo) project, independently prepared by third-party Mongolian experts to a Mongolian government (non-NI 43-101) standard, have been submitted to the Minerals Resource Council of the Mongolian government for registration. The Mongolia Minerals Law of 2006 states that a reserve must be registered with the government before an exploration license can be converted to a mining license. Subsequently, on February 29, 2008, QGX received a mining license on this property.

No other significant results were forthcoming from exploration programs on other properties in the period. Work and expenditure 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.

## Selected Annual Information

|                                 | 2007           | 2006          | 2005          |
|---------------------------------|----------------|---------------|---------------|
| Total Revenues                  | \$526,944      | \$1,036,086   | \$164,132     |
| Net Loss                        | (\$12,236,457) | (\$5,317,907) | (\$4,573,533) |
| Loss per common share           | (\$0.26)       | (\$0.12)      | (\$0.13)      |
| Loss per common share – diluted | (\$0.26)       | (\$0.12)      | (\$0.13)      |
| Total Assets                    | \$62,066,405   | \$67,783,141  | \$73,649,738  |
| Long Term Liabilities           | -              | -             | -             |
| Dividends                       | -              | -             | -             |

## 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 |             |             |             |
|--------------------------------|--------------------|-------------|-------------|-------------|
|                                | Dec. 31/07         | Sept. 30/07 | June 30/07  | Mar. 31/07  |
| Revenues                       | \$158,810          | \$97,818    | \$127,070   | \$143,246   |
| Net Income (loss)              | (7,094,008)        | (1,580,196) | (1,420,689) | (2,141,564) |
| Loss per share – basic         | (0.15)             | (0.03)      | (0.03)      | (0.05)      |
| Loss per share – fully diluted | (0.15)             | (0.03)      | (0.03)      | (0.05)      |
| Total Assets                   | 62,066,405         | 64,548,017  | 64,602,639  | 65,637,544  |

  

|                                | Dec. 31/06  | Sept. 30/06 | June 30/06  | Mar. 31/06 |
|--------------------------------|-------------|-------------|-------------|------------|
| Revenues                       | \$220,390   | \$197,713   | \$571,735   | \$46,248   |
| Net Income (loss)              | (1,062,716) | (2,145,347) | (1,244,737) | (865,107)  |
| Loss per share – basic         | (0.03)      | (0.04)      | (0.03)      | (0.02)     |
| Loss per share – fully diluted | (0.03)      | (0.04)      | (0.03)      | (0.02)     |
| Total Assets                   | 67,783,141  | 69,929,188  | 70,216,818  | 69,008,891 |

## 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. The Company's cash balance as at December 31, 2007 was \$7,578,216, and the interest income on those balances for the year was \$526,944.

Expenses for the year 2007 were \$12,763,401, \$6,409,408 higher than expenses (net of interest income) for 2006. Variance analysis on the full year results is as follows:

| <b>Full Year 2007 Variance vs. Prior Year</b> |                                     |   |
|---|-------------------------------------|---|
| <b>Item</b>                                   | <b>Variance Decrease/(Increase)</b> | <b>Explanation</b>  |
| Interest Income                               | \$ 509,142                          | Average cash balances were approximately \$15.0 million lower in 07 than in 06, generating lower interest income for the year.  |
| Write-down of Resource Properties             | \$ (5,700,866)                      | Property write-downs reflect lower lease acreage held by QGX at year end, and a total of 39 leases total, as opposed to 91 leases at YE 2006.   |
| Salaries and Benefits                         | \$ (467,429)                        | The 2007 amount reflects a management bonus payment (\$337k) in March ('06 Bonus) which was not similarly reflected in the FY 2006 statements ('05 Bonus).  |
| Stock-Based Compensation                      | \$ (147,863)                        | Options granted to certain Directors in 2007 received immediate vesting. The value of these options was fully expensed in Q4 2007. Similar stock-based compensation was not granted in 2006. This impact (\$350k) was offset by lower program costs for management, as portions became fully expensed (fully vested). |
| Professional Fees                             | \$ ( 47,329)                        | Higher legal fees related to tax planning work (\$77k) plus higher audit fees (\$5k) offset by lower consulting costs (\$32k).  |
| Foreign Exchange                              | \$ (49,093)                         | Larger US\$ currency devaluations generated more F/X loss in 2007, despite the fact that US\$ cash balances were lower. F/X losses in 2006 were generated from a fluctuating US\$ currency value acting on larger US\$ investment levels.   |
| Loss on Disposals                             | \$ ( 31,236)                        | Reflects non-cash losses on sale of several vehicles in Mongolian operations.   |
| Other Costs                                   | \$ (3,225)                          | Lower travel (\$4k) and lower office costs (\$7k) offset by higher investor relations (\$7k) and transfer agent cost (\$8k)   |
| Amortization Costs                            | \$ 8,197                            | Lower expense reflects the declining balance method utilized to depreciate assets.  |
| Bank Costs                                    | \$ 29,436                           | Banking costs were lower for 2007, due to lower management fees on lower cash balances.   |
|   | \$ (6,918,550)                      |   |

Fourth quarter 2007 expenses were higher than the comparable fourth quarter in 2006, by \$5,969,712. Principal expenditure variances for the quarter include:

- The substantial write-down of resource properties during 2007 occurred during Q4, reflecting a \$5,597,241 comparative increase to costs (non-cash), and most of the variance against Q4 2006;
- Foreign exchange losses in Q4 2007 (\$177,494) relative to foreign exchange gains in Q4 2006 (\$261,808) reflecting US dollar currency movements against US dollar cash holdings in the periods;

- Higher stock-based compensation in Q4 2007 (\$230,812) compared to Q4 2006, due to immediate expensing of options granted to directors in a prior '07 periods, and
- Offset by lower Q4 expenses for salaries, travel, professional fees and reversal of accruals taken against these cost categories in prior periods (\$297,643).

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 capitalized and recorded as an asset on the balance sheet under the heading "Resource Properties". These expenditures will be amortized over the estimated life of the properties if and when they reach production. Management continuously reviews the status of properties in the Company's mineral license portfolio, and if management believes that a license no longer holds sufficient mineral potential to retain in the portfolio, or if a license is dropped from the portfolio, the capitalized cost associated with that license is fully written off the balance sheet, and a write-off charge is taken to current period income. As a result, the resource properties asset line item on the Company's balance sheet reflects deferred costs entirely related to properties currently in the Company portfolio of exploration and mining licenses.

Certain restrictions will prevent tax deductions for some of the costs incurred on our resource properties. This probable loss of deductibility has been reflected as a future income tax liability on the balance sheet. The tax liability has been offset on the balance sheet by recording an increase to "Resource Properties", 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 recorded on the balance sheet in the year ending December 31, 2007 of \$2,112,957. Project detail for this capitalized amount is as follows:

- Baruun Naran project expenditure for the year was \$6,894,048. Project expenses include camp costs, staffing costs attributable to the project, consulting costs attributable to a pre-feasibility study, as well as a significant water drilling program. \$3,427,000 of the full year expenditure relates to the water program expense, which will continue for some number of additional quarters.
- Golden Hills project expenditure for the year was \$1,154,089. Project expenses include camp costs and staffing, consulting costs attributable to work supporting an application to convert the project's exploration license to a mining license, and water program costs. The mining license application was filed in December.
- Certain leases associated with the Golden Hills project were dropped during 2007, resulting in a write-down of \$1,594,378, and a net decrease to the project capitalization for the year of \$440,289.

- Undur Tsagaan project expenditure for the year was \$752,878. Project expenses include consulting costs for a Mongolian-standard economic scoping study, staffing costs, geologic consulting, and water drilling programs. This work supported a mining license application in December, which was granted in February of 2008.
- \$1,191,462 was capitalized against all other exploration projects (including Shuteen), reflecting staff costs, reconnaissance work, travel costs, supplies and other general operational expenses of the exploration team. This cost is ongoing.
- Total property write-downs for the year were \$7,036,052, including the write-down for the Golden Hills property mentioned above. These write-downs coupled with minor capital spending in Canada reduced our future income tax liability by \$843,468.

These write-downs of capitalized resource property assets is consistent with the Company's policy of concentrating expenditure on it's most prospective mineral leases, and on reducing from the portfolio those leases that management believes are less prospective for mineralization.

## **Liquidity and Capital Resources**

### **Working Capital**

QGX had working capital of \$5,465,985 at December 31, 2007, (December 31, 2006 – \$15,313,698) consisting primarily of cash and short-term investments. The decrease is due to expenditures on resource properties and general Company expenses, as incurred in the period, and discussed above.

The Company funded its operations in the year ended December 31, 2007 through the application of existing cash reserves, acquired through prior financings. Year end cash balances are insufficient to fund anticipated administrative costs and project development activities planned for the 12 months of 2008. Plans include the initiation of a full feasibility study on the Baruun Naran project in 2008, and the continuation of a water program begun in 2007. In recognition of these circumstances, the company continues to seek additional capital in order to fund these operations.

The Company's year end financial statements have been prepared on a going concern basis which assumes the realization of assets and liquidation of liabilities and commitments in the normal course of business. The ability of the company to continue as a going concern is dependent upon management's ability to raise capital and eventually to generate positive cash flows from mining operations. Management believes that they will be successful in these actions making the use of the going concern basis appropriate.

Based in part on the funding demands placed on the Company by its development projects, the Board and management are currently seeking and evaluating new capital sources and strategic alternatives for the Company. While the Company has been successful in the past at sourcing additional capital when required, this is always subject to market conditions and there can be no assurance that additional funds will be available at any given time.

## **2007 Private Placement Equity Financing**

In October 2007, the Company completed a private placement for 722,892 common shares of QGX at \$4.15 CDN per share, representing a cash investment of \$3 million.

## **Long-Term Liability**

The only long-term liability of the Company as of December 31, 2007 is for future income taxes. 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-asset and book-asset valuations 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.

The Company does not have any material contracts or commitments for expenses extending beyond twelve months. Ongoing lease costs and associated minimum work requirements in Mongolia, plus staffing costs can be considered long term in nature, but these expenses can be and are managed, based on current and anticipated funding levels.

The Company does not have any long term environmental liabilities included on the balance sheet. Environmental obligations for reclamation of disturbed areas are addressed on a continuous basis, as leases are explored and decisions made to abandon or plan further work. Local environmental regulations in Mongolia require surface disturbances from mineral exploration to be addressed on an annual basis. The Company has no production facilities, leaching facilities, or permanent maintenance facilities. The Company's estimate of outstanding environmental obligations on disturbed property is approximately \$70,000 at year end 2007. Exploration camp facilities are almost always temporary in nature, mobile, and are moved from site to site. Asset retirement obligations (ARO's) on permanent long-lived structures at the Company's two primary camp sites do not represent material exposures. The Company does include preliminary estimates of costs to conduct final environmental and ARO reclamation in its 43-101 standard preliminary economic assessments and pre-feasibility studies regarding project economic returns.

## **Capitalization**

There were 47,756,848 common shares outstanding at December 31, 2007.

The Company's fully diluted share count at December 31, 2007 was 51,531,848 shares. The potential dilution is related to 3,775,000 stock options held by officers, directors, employees and consultants, at exercise prices ranging from \$1.20 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.

### **Future Accounting Standards**

The Canadian Institute of Chartered Accountants ("CICA") issued the following accounting standards effective for the fiscal years beginning on or after October 1, 2007 and January 1, 2008. Sections 3862 "Financial Instruments-Disclosures", 1535 "Capital Disclosures", 3863 "Financial Instruments-Presentation" and 3031 "Inventories". The Company is currently evaluating the impact of these new handbook sections on the Company's financial statements and will adopt the sections commencing fiscal 2008.

In February 2008, the Canadian Accounting Standards Board confirmed that the use of International Financial Reporting Standards ("IFRS") will be required for Canadian Publicly accountable enterprises for years beginning on or after January 1, 2011. The Company is currently evaluating the impact of adopting IFRS accounting standards

### **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.

All property-related acquisition costs, exploration costs, and associated overhead expenditures are recorded as an asset on the balance sheet under the heading "Resource Properties". Resource properties, provided they are deductible for tax purposes at some future date, are recorded at cost.

A portion of the Company's current capitalized assets are not reasonably assured of their future tax deductibility, either in Mongolia or Canada. In accordance with Canadian Generally Accepted Accounting Principles (GAAP), the additional tax obligation associated with these non-deductible assets has been recognized immediately as a future tax liability. The Mongolian corporate income tax rate of 25% is the applicable rate in this tax liability calculation, and has been used to calculate both the future tax liability and the adjusted asset value. The calculation of tax liability has been applied as follows:

$$\text{Deferred tax liability} = (\text{Asset Value} \times 0.25) / (1 - 0.25)$$

All resource property assets, once capitalized are held on the balance sheet until one of two events occurs;

- If lease acreage is dropped from the exploration portfolio, or if management otherwise determines that the net carrying amount on a specific lease will not be recovered, the associated asset values and tax liability (if relevant) are immediately written off to income.
- If a property is put into production at some future date, both the capitalized asset value and the deferred tax liability will be amortized against earnings over the estimated life of the property.

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% - 77% in 2007 (78% - 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

All of QGX's operations involve mineral exploration and development and there is no guarantee that any such activity will result in commercial production of deposits. Mineral exploration and development involves substantial expenses and a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to adequately mitigate. Examples of these risks include, but are not limited to:

- **No Proven Commercial Resources.** There is no assurance that commercial quantities of ore will be discovered on any of QGX's exploration properties, or even if commercial quantities of ore are discovered, that a mineral property will be brought into commercial production. The Company has not completed a final feasibility study on its two advanced stage projects (Baruun Naran and Golden Hills), so cannot say that the possible project economics discussed in this MD&A have any commercial certainty.
- **Legal/Political Risk.** QGX's business in Mongolia may be harmed if the country fails to complete its transition from state socialism and a centrally planned economy to political democracy and a free market economy. Laws may be applied in an inconsistent, arbitrary and unfair manner. Legal remedies may be uncertain, delayed or unavailable, due to an undeveloped court system. Future amendments to Mongolian laws could weaken, shorten or curtail QGX's mineral exploration rights or adversely impact development economics.
- **Changing Government Regulations.** QGX's operations may be affected by government regulations, including those with respect to restrictions on production, price controls, export controls, income taxes, and expropriation of property, employment, land use, water use, environmental legislation and mine safety.
- **Lack of Infrastructure.** Mongolia is infrastructure-poor, and this affects mining businesses generally, and QGX's advanced stage projects in particular.
- **Lack of Qualified Staff.** Although the Company believes that it will be successful in attracting and retaining qualified personnel as it's business activity grows, there can be no assurance of such success.

- **Availability of Financing.** There can be no assurance that QGX will be capable of raising the additional financing that it needs to carry out its exploration and development objectives.
- **No Operating Mine History.** QGX has no history of developing or operating a mining project and there can be no assurance of its ability to operate such mining projects profitably.
- **Environmental Risks.** While the Company reclaims areas disturbed by exploration on a continuous basis, exploration activities could potentially create environmental exposures that would represent unforeseen expenses for the Company.

### **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 year ended December 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 December 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.

A change was made during the quarter ended September 30, 2007 to the accounting systems utilized in Mongolia. The Company replaced the general ledger system with another of very similar design, but which offered better access and performance in local currency. None of the consolidation systems, internal controls, or other processes were affected by the change. Management believes there have been no changes 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 December 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).