

# First Metals Inc.

## MANAGEMENT DISCUSSION & ANALYSIS (MD&A) FOR THE SIX MONTHS ENDED JUNE 30, 2008

### MANAGEMENT'S DISCUSSION AND ANALYSIS

The MD&A is written as of July 29, 2008 and should be read in conjunction with the Corporation's interim unaudited financial statements for the six months ended June 30, 2008 and related notes thereto, which have been prepared in accordance with Canadian generally accepted accounting principles. In addition, the following should be read in conjunction with the 2007 audited financial statements, the related Management's Discussion and Analysis and the 2007 Annual Information Form, as well as other information relating to the Corporation which is available on the Corporation's website ([www.firstmetalsinc.com](http://www.firstmetalsinc.com)) and filed on the SEDAR website ([www.sedar.com](http://www.sedar.com)).

### HIGHLIGHTS

- On April 28, 2008, the Corporation announced that it achieved commercial production as of March 1, 2008 at the Fabie Bay Mine.
- For the three months ended June 30, 2008, net earnings of \$3,515,579 (\$0.08 per share) were generated from the shipment of 4,820,065 lbs of Copper and 76 ounces of Gold and 3,600 ounces of Silver. On a year to date basis, for the six months ended June 30, 2008, net earnings of \$5,290,411 (\$0.13 per share) were earned from the sale of 6,816,037 lbs of Copper and 119 ounces of Gold and 6,554 ounces of Silver.
- During the period from November until March 1, 2008, the Corporation was in the pre-operating stage and as a result, revenues were deferred and offset against mine development costs. During the fourth quarter of 2007, net revenues of \$3,993,060 were deferred and during the first two months of 2008, prior to achieving commercial production, additional net revenues of \$2,132,650 were deferred.
- During the second quarter of 2008, the Corporation received an additional \$1,323,346 as a result of final settlements for production during the pre-operating period. In total, net pre-operating revenues of \$7,449,056 have been received.
- Since shipments of ore started, the Corporation has produced 10,607,404 pounds of payable Copper which, when combined with 196 ounces of Gold and 9,756 ounces of payable Silver, has resulted in estimated gross metal values of U.S. \$40,742,000.
- Now that commercial production has been achieved at Fabie, the organization is focusing its efforts towards the successful development of the Magusi site.

### CORPORATE OVERVIEW AND OVERALL PERFORMANCE

The Corporation was incorporated on February 23, 2006 with the mission of rapidly becoming a profitable producer of base metals and associated products. It currently has three projects at

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various stages of advancement. During the six-month period under review, the Fabie Bay project achieved Commercial Production on March 1, 2008.

#### SUMMARIZED FINANCIAL RESULTS

	2008		2007				2006		
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Production									
Tonnes Mined	111,967	83,318	31,521						
Tonnes Milled	105,552	86,447	27,387						
Payable Copper (000's lbs)	4,820	4,449	1,338	-	-	-	-	-	-
Gold (ozs)	76	92	29	-	-	-	-	-	-
Silver (ozs)	3,600	5,539	617	-	-	-	-	-	-
Estimated Value of Metal Shipments U.S. (000's)	\$ 18,437	\$ 17,166	\$ 5,139	-	-	-	-	-	-
Estimated realizable copper prices, net of royalty, treatment & refining charges (Cdn \$ /lb)	3.47	\$ 3.40	\$ 3.29	-	-	-	-	-	-
Royalty, treatment & refining charges (Cdn \$/lb)	0.45	\$ 0.56	\$ 0.48						
Total cash cost (Cdn \$/lb) <sup>1</sup>	2.46	\$ 2.04	\$ 1.75	-	-	-	-	-	-
Net revenues from metal sales (000's) <sup>2</sup>	\$ 16,706	\$ 6,772	-	-	-	-	-	-	-
Other revenues (000's)	61	104	\$ 60	\$ 64	\$ 11	\$ 14	\$ 53	\$ 33	\$ 9
	<u>16,767</u>	<u>6,876</u>	<u>60</u>	<u>64</u>	<u>11</u>	<u>14</u>	<u>53</u>	<u>33</u>	<u>9</u>
Net earnings (loss) (000's)	\$ 3,516	\$ 1,775	\$ (968)	\$ (687)	\$ (739)	\$ (592)	\$ (1,383)	\$ (352)	\$ (112)
Earnings per share									
Basic	\$ 0.08	\$ 0.05	\$ (0.03)	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.05)	\$ (0.02)	\$ (0.01)
Diluted	\$ 0.08	\$ 0.05	\$ (0.03)	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.05)	\$ (0.02)	\$ (0.01)
Cash flow from operating activities (000's)	\$ 3,545	\$ 954	\$ (7,942)	\$ 3,928	\$ (152)	\$ 495	\$ (1,594)	\$ 147	\$ (72)
Total assets (000's)	\$ 65,573	\$ 55,165	\$ 49,139	\$ 40,382	\$ 34,807	\$ 13,882	\$ 12,681	\$ 12,726	\$ 3,850
Total liabilities (000's)	\$ 41,146	\$ 38,883	\$ 34,790	\$ 28,597	\$ 22,581	\$ 4,800	\$ 3,078	\$ 988	\$ 1,147
Shareholder's equity (000's)	\$ 24,427	\$ 16,281	\$ 14,349	\$ 11,785	\$ 12,225	\$ 9,083	\$ 9,604	\$ 11,737	\$ 2,704

#### Notes

1. Refer to discussion on non-GAAP measures

2. Month of March only. During the pre-operating period revenues have been offset against the Mine Development Costs

Shipments of Ore from Fabie Bay began in November 2007 and Commercial Production was achieved on March 1, 2008. As a result, the revenues and net earnings during the periods Q2 - 2006 through Q4 - 2007 represent the results of operation for a development stage organization. They are impacted by the level of mine development in the period.

The results for Q1 - 2008 reflect the pre-operating activities until March 1, 2008 at which time, the Corporation determined that commercial production had been achieved as it had achieved 60% of the design capacity over a thirty day period.

#### NON-GAAP MEASURES – TOTAL CASH COSTS PER POUND OF COPPER CALCULATION

First Metals has included in this document, certain non-GAAP performance measures, including total cash costs of copper on a produced/sold basis which is consistent with the sales contract with Xstrata Copper Canada Limited. These non-GAAP measures do not have any standardized meaning prescribed by GAAP, nor are they necessarily comparable with similar measures presented by other companies. Cash costs are presented as they represent an industry standard

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method of comparing certain costs on a per unit basis. The Corporation believes that certain investors use this information to evaluate the Corporation's performance. The data is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP. The Corporation recognizes that there are limitations within these numbers due to the assumptions inherent in estimating copper production which can take up to three months to finalize.

To date, the operations at the mine are going well. While production from the mine has met mill capacity, the mill has been plagued by a series of mechanical breakdowns and stoppages that reduced the daily average through put during the second quarter from the average design capacity of 1,500 tpd to just under 1,200 tpd. Staff and contracted mill maintenance specialists have been reviewing operating and preventative maintenance practices and have made a number of changes with a view to achieving higher throughput on a sustained basis. The milling costs are essentially fixed costs and therefore impact the total cash costs per pound as well as the net earnings.

During the three months ended June 30, 2008, the Corporation's total cash operating costs (exclusive of financing costs and income and capital taxes) was \$2.46/lb. which compares with the year-to-date average for the six month period of \$2.34/lb. Management believes that these costs can be lowered to under \$2.00/lb once mill design throughput is achieved.

### **RESULTS OF OPERATIONS AND OPERATIONAL REVIEW- THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007.**

During the first two months of 2008, the Corporation was in the pre-operating stage, until commercial production was achieved effective March 1, 2008. Net revenues were capitalized and offset against mine development costs.

During the three month period ended June 30, 2008, approximately 105,551 dry metric tonnes, (approximately 1,160 tonnes per day) with an average head grade of 2.53% copper were processed. Copper recovery in the quarter averaged 91.36% and the concentrate grade averaged 20.2% copper.

On a year to date basis during the six month period ended June 30, 2008, approximately 191,999 dry metric tonnes (approximately 1,055 tonnes per day), with an average head grade of 2.57% copper were processed. Copper recovery during the six months averaged 90.72% and the concentrate grade averaged 20.2% copper.

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#### Revenues by Metal

	Three Months ended June		Six Months ended June	
	2008	2007	2008	2007
Copper	\$ 18,678,391	-	\$ 26,306,026	-
Gold	96,684	-	121,281	-
Silver	114,125	-	129,713	-
	18,889,200	-	26,557,020	-
Treatment, refining charges	(1,782,263)	-	( 2,525,087)	-
Net metal royalty	(401,107)	-	( 554,463)	-
Net revenue	<b>\$ 16,705,830</b>	-	<b>\$ 23,477,470</b>	-

#### Sales by Payable Metal

	Three Months ended June		Six Months ended June	
	2008	2007	2008	2007
Copper (lbs)	4,820,065	-	6,816,037	-
Gold (ounces)	75	-	119	-
Silver (ounces)	3,600	-	6,554	-
	-	-	-	-

#### Sales by Payable Metal Deferred during Pre-Operating Period

	Three Months ended June		Six Months ended June	
	2008	2007	2008	2007
Copper (lbs)	-	-	2,453,225	-
Gold (ounces)	-	-	48	-
Silver (ounces)	-	-	2,585	-
	-	-	-	-

#### Average Metal Prices & Foreign exchange rates

	Three Months ended June		Six Months ended June	
	2008	2007	2008	2007
Copper (US\$/lbs)	3.80	-	3.81	-
Gold (US\$/ounces)	893.95	-	895.95	-
Silver (US\$/ounces)	16.17	-	17.17	-
US\$/CDN\$ exchange rate	1.007	-	1.006	-

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### **Net Revenues**

Treatment and refining charges represent contractual payments made to Xstrata for smelting and refining the concentrate which is sold under contract.

Net royalty expenses represent net metal return payments to Globex based on 2% of the estimated metal content of the ore which is extracted from the Fabie Bay property.

### **Operating Costs**

During the three month period ended June 30, 2008, the total operating costs increased from nil to \$12,636,153 as there was no commercial production during the comparable period. For the same reason, the total operating costs for the six month period were compared to nil in the previous year.

Mining and development costs represent the ongoing mining and development costs at the Fabie Bay property following the achievement of commercial production on March 1, 2008.

The milling and ore transportation costs represent the third party payments to an outside contractor which transports the Fabie Ore to a storage facility at Xstrata Copper Canada Limited ("Xstrata"). There were no comparable costs in the first quarter of 2007 as the Corporation was in the pre-operating stage. Under the contractual arrangement with Xstrata, the Corporation pays for the operating costs plus a profit margin. A significant portion of the costs are fixed and as a result of maintenance shutdowns, during the second quarter of 2008, the costs were higher than expected on a per unit basis. Since there was no production in 2007, no comparable costs were incurred.

Under the Corporation's accounting policy, no amortization is recorded until the assets are substantially complete and ready for use. Amortization, based on the estimated useful lives of the assets, is provided on a straight-line basis for furniture and fixtures, computer and telecommunication equipment and mining equipment under capital leases, mining infrastructure and mill refurbishment costs are being amortized on a unit of production basis. During the pre-operating period, depreciation and amortization was deferred. Since there was no production in the comparable period in 2007, no depreciation and amortization was recorded in the comparable period.

### **Other Expenses**

During the three month period ended June 30, 2008, other expenses increased from \$750,753 in the comparable period in 2007 to \$1,557,553 mainly as a result of treating interest as a period expense rather than capitalizing it during the development stage and pre-operating period.

For the first six months of 2008, other expenses increased from \$1,356,797 in the comparable period in 2007 to \$2,359,149 mainly due to the interest expense being treated as a period expense.

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#### Other Income

Other income mainly represents income which has accrued on restricted funds. During the three months ended June 30, 2008, the other income increased from \$11,406 to \$60,824 as the funds were only received part way through the previous period.

During the six months ended June 30, 2008, other income increased from \$25,896 to \$164,728 because the funds were received after May 4, 2007.

#### Income and Mining Tax Recovery

Income and mining tax recovery in the second quarter of 2008 was \$942,631 compared to nil in the same period in 2007 as the Corporation was in the development stage in the previous year. The recovery represents management's current estimate of taxable income for the year and its tax planning strategies which will result in the utilization of prior year loss carry forwards which were not previously recognized.

For the first six months of 2008, the income and mining tax recovery of \$892,457 compares to nil in the previous year as the Corporation did not generate income from operations during the development stage.

#### SUMMARY OF QUARTERLY FINANCIAL INFORMATION

All amounts are in Canadian Dollars and the Financial Statements are prepared in accordance with Canadian GAAP. The following table sets forth selected quarterly financial information for each of the last eight quarters. .

Quarter ending	Revenue \$	Net earnings (loss) \$	Net earnings (loss) per share <sup>(Note a)</sup> \$
June 30, 2008	16,705,830	3,515,579	0.08
March 31, 2008	6,771,640	1,774,832	0.05
Dec. 31, 2007	60,356	(968,319)	(0.03)
Sept. 30, 2007	63,941	(686,918)	(0.02)
June 30, 2007	11,405	(739,347)	(0.02)
March 31, 2007	14,491	(591,554)	(0.02)
Dec. 31, 2006	53,160	(1,383,342)	(0.05)
Sept. 30, 2006	33,358	(352,127)	(0.02)

#### Notes:

- Prior to March 31, 2008, the loss per share data is basic and diluted as the exercise of warrants and options would be anti-dilutive and therefore the loss per share is based on the weighted average number of shares outstanding during the period. In the quarter-end March 31, 2008, the basic and fully diluted shares were the same, as the exercise prices of the options and warrants were greater than the average of the stock price. In the quarter-end June 30, 2008, the basic and fully-diluted earnings per share produce the same results.

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Since the Corporation was in the pre-operating stage prior to the achievement of commercial production on March 1, 2008, prior to that date, the revenues represent only interest income earned on excess funds.

The net revenues from the shipments of materials during the fourth quarter of 2007 of \$3,993,000 and the net pre-operating revenues of \$2,132,650 in the first quarter of 2008 have been offset against the pre-production and Mine Development Costs. During the second quarter of 2008, the Corporation received an additional \$1,323,346 as a result of final settlements for production during the pre-operating period. In total, net pre-operating revenues of \$7,449,056 have been received.

The increase in the loss in the quarter ended December 31, 2006 of \$1,383,342 compared to the loss of \$352,127 in the quarter ended September 30, 2006 was a result of increased professional fees and an increase in the stock-based compensation recognized in the quarter.

The reduction in the loss in the quarter ended March 31, 2007 of \$591,554 compared to the loss of \$1,383,342 in the quarter ended December 31, 2007 was a result of reduced stock-based compensation recognized in the quarter.

The increase in the loss in the quarter ended June 30, 2007 of \$739,347 compared to the loss of \$591,554 in the quarter ended March 31, 2007 was a result of increased administrative costs as staff joined the organization and an increase in the stock-based compensation applicable to the addition of officers and recognition of directors' contributions.

The reduction in the loss in the quarter September 30, 2007 of \$686,918 compared to the loss of \$739,347 in the quarter ended June 30, 2007 was mainly a result of increased interest income on funds released from escrow as well as reduced stock-based compensation recognized in the quarter.

The increase in the loss in the quarter ended December 31, 2007 of \$968,319 compared to the loss of \$686,918 in the quarter ended September 30, 2007 was mainly a result of increased administrative costs and legal fees incurred in the release of funds held in escrow.

### **Development of Mining Properties**

On April 26, 2006, the Corporation acquired the Fabie Bay, Magusi River and Duprat mining claims and certain additional neighbouring claims from Globex Mining Enterprises Inc. ("Globex") for cash consideration of \$1,000,000 and additional commitments related to the issuance of shares for no additional consideration, the future payment of a 2% net metal return once commercial production was achieved and the future payment of a 10% net profit interest on any earnings from the mining claims after the recoupment of \$10,000,000 of capital.

During the twenty-four months since the Corporation was established, it successfully developed the Fabie Bay property and put it into commercial production.

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### **Major developments during the nine month period ended December 31, 2006**

In this period, the Corporation completed the Initial Public Offering of the Corporation's shares (the "IPO") to raise the funds necessary to commence initial preparations of the site, equipment sourcing, hydro installation and other steps towards ultimately putting the Fabie Bay project into production. Equipment leases were negotiated, equipment was purchased and development expenditures were undertaken.

A Certificate of Authorization for the de-watering of the existing open pit and underground at Fabie Bay was obtained. Dewatering of the ramp to the 50 meter level was started. Active exploration of the Fabie Bay and Magusi River properties was undertaken.

### **Major developments during the three month period ended March 31, 2007**

In this period, the Corporation concentrated on developing surface infrastructure, construction, including the electrical power line, surface electrical distribution, garage, crusher, ventilation & heating systems and site office buildings.

The dewatering of the open pit on the Fabie Bay property was completed, giving access to the underground mineralization. Underground dewatering continued to provide access via the ramp down to the 150 metre level.

A close drill pattern was implemented across the top of the deposit in the open pit in preparation for blasting and to estimate more precisely the resources of the Fabie Pit. More than 400 drill holes totalling 4,516 meters were drilled.

### **Major developments during the three month period from April 1, 2007 to June 30, 2007**

The Corporation continued its development activities on Fabie Bay. Dewatering of the underground workings was substantially completed. Underground ventilation and electrical power distribution were re-established. Development, in preparation for underground mining, was initiated. Installation of the 31-km Hydro Quebec power line to Fabie, as well as the 5000 kVA on-site electrical power distribution station, was completed.

Production drilling was undertaken on the open pit portion of the Fabie Bay deposit within the limits of the historical deposit outline. A total of 400 vertical holes were completed on a 2.7 meter by 2.7 meter pattern to a depth of 10 meters. Each of the production holes was sampled and assay results indicated that, in certain areas, the zone extended slightly beyond the previously assumed historical limits.

A 3,500-meter diamond drilling program designed to confirm historical information and better define the deposit at depth was undertaken. In addition, a 10,000-meter diamond drill program on the Magusi River property was initiated and an airborne geophysical survey was completed.

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A custom milling, smelting, sales and mill refurbishment contract for Fabie ore production was completed with Xstrata Copper. Refurbishment of the Horne mill was initiated.

Key mining equipment was delivered and significant progress was made on the construction and installation of essential surface infrastructure including primary mine ventilation, compressed air plant, crushing, office/dry complex, drill core handling/storage, site security and a maintenance shop.

Key mining personnel were hired and focused on completing surface and underground pre-production activities.

### **Major developments during the three month period from July 1, 2007 to September 30, 2007**

In this period, a 3,500-meter diamond drilling program on the Fabie Bay property, designed to confirm historical results and better define the deposit at depth, continued. In addition, a 10,000-meter diamond drill program on the Magusi River property continued. Core logging, assaying, data analysis and interpretation were on-going.

Refurbishment of the Xstrata Copper Horne mill continued.

Additional production holes and the sinking cut were drilled in the open pit portion of the Fabie Bay copper deposit. These holes were intended to determine the exact deposit limits and to prepare the bench for blasting. Each of the additional production holes was sampled and, together with the holes drilled in the previous quarter, updated resource tonnage and grades were prepared using a 1% copper cut-off grade. The result was a measured mineral resource of 99,800 tonnes at a diluted grade of 2.25% copper.

Surface infrastructure was completed during the quarter including the site office complex, security gatehouse and primary ventilation systems. The surface crusher was successfully tested and commissioned. All of the required mobile equipment units needed for underground development and production were acquired.

In addition, construction of the warehouse facility, installation of the mine air heating and primary compressor plants, as well as equipping of the maintenance garage, were all initiated and scheduled for completion early in the fourth quarter. Upgrading of the site access road to semi-trailer haulage standards commenced and was completed in the following quarter. Construction of the 'Megadome' ore storage and transfer facility, located near the entrance of the Xstrata Copper Horne smelter complex, was substantially completed.

The total workforce was increased to 60 to accommodate the increasing pace of underground pre-production development and stope preparation.

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#### **Major developments during the three-month period from October 1, 2007 to December 31, 2007**

In this period, the 10,000-meter diamond drill program on the Magusi River property was completed. Core logging, assaying, data analysis and interpretation of this initial program were all on-going at the end of the quarter. Planning and design of a follow-up 20,000-meter diamond drilling program was completed and drilling was initiated in the first week of January 2008.

All key site surface infrastructures were completed and operational as of the end of the quarter. Upgrading of the 31-km site access road to semi-trailer haulage standards was completed. Construction of the 'Megadome' ore storage and transfer facility, located near the entrance of the Xstrata Copper Horne smelter complex, was also completed.

Blasting of the open pit portion of the Fabie Bay copper deposit was initiated on November 1, 2007. A total of 33,154 tonnes of open pit and underground development material was transported to the 'Megadome' ore storage facility. Of this, 28,513 tonnes were transferred to the Xstrata Copper Canada Horne mill for processing during the fourth quarter.

Refurbishment of the Xstrata Copper Canada Horne mill circuit, dedicated to Fabie Bay was completed during the period. Circuit commissioning was initiated November 22, 2007 and, to the end of the year, a total of 27,522 tonnes were milled at an average head grade of 2.82% copper. Copper recovery for the period averaged 87.5%. Metallurgical results continued to improve as circuit dynamics were better understood. During the fourth quarter of 2007, 3,676 tonnes of copper concentrate were delivered and processed at the Xstrata Horne smelter based on final weights and assays; the production was 1,337,865 lbs of copper, 29 troy ounces of Gold and 619 troy ounces of Silver.

At that time, all of the personnel required for operations were in place. In spite of the current mining labour shortage, First Metals has been successful in attracting highly experienced and qualified individuals for all positions.

#### **Major developments during the three month period from January 1, 2008 to March 31, 2008**

##### **Fabie Bay**

On April 28, 2008, the Corporation announced that it achieved commercial production as of March 1, 2008 at the Fabie Bay Mine. During the month of March, 44,500 tonnes of copper ore, grading 2.56% Cu were mined and trucked from the Fabie Bay Mine near Rouyn-Noranda, Quebec.

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### **Major developments during the three month period from April 1, 2008 to June 30, 2008.**

#### **Fabie Bay**

Details of the Fabie Bay Operation are outlined earlier in this MD&A.

#### **Magusi Property**

During the quarter, the in-fill diamond drill program totalling approximately 20,000 metres from surface to the 350 metre level on a 20 by 20 metre pattern was undertaken. The program was designed to provide additional information on the structure of the Copper and Zinc lenses to allow for mine planning.

The Corporation announced on January 23, 2008 that it had made application to the Quebec Ministry of Sustainable Development, Environment and Parks and Ministry of Natural Resources and Wildlife to extract a 50,000 tonne bulk sample from the Magusi River Project. The permit was issued to the Corporation on March 13, 2008.

Golder & Associates were engaged to prepare a detailed crown pillar and rock mechanics study.

SGS/Lakefield were engaged to undertake metallurgical testing which will be used in the evaluation and planning.

Detailed planning, engineering and procurement activities related to the infrastructure needed to begin the ramp development were significantly advanced during the second quarter of 2008.

In addition, Scott Wilson Roscoe Postle Associates were engaged to prepare a preliminary scoping study which will include development requirements, mining methods, production/development schedules and capital/operating costs.

The Magusi Block Model is also being updated and the Corporation is targeting to produce a Resource Calculation by the end of August 2008.

#### **FINANCING ACTIVITIES**

On May 4, 2007, First Metals Inc. issued \$20,000,000 in Senior Secured Notes with interest payable at 14% (the "Notes"). Each \$1,000 Note, which has a term of 5 years and 1 day, was offered at a purchase price of 98% of the principal amount thereof and is callable by the Corporation at any time following 24 months from the closing. Interest is paid quarterly. The Notes contain fixed and floating charges over all of the Corporation's assets.

In addition, for each \$1,000 in principal amount of Notes issued, the purchasers received, for no additional consideration, share purchase warrants to acquire a total of one hundred common shares of the Corporation at an exercise price of \$1.35 per share expiring 5 years and 1 day from

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July 30, 2007, the date the Escrow Release Conditions were achieved. In aggregate, 2 million share purchase warrants were issued. A Collateral Agent has been appointed and a lien over all of the property and assets of the Corporation has been established.

The proceeds from the sale of the Notes have been used to complete underground development at the Fabie Bay Copper Mine near Rouyn-Noranda, Québec, refurbishment of the Horne Mill pursuant to the terms of the agreement between the Corporation and Xstrata Copper as well as to meet general working capital needs.

The Notes restrict the indebtedness of the Corporation including Capital leases and guaranteed indebtedness based on outstanding amounts when the Notes were issued. These requirements are monitored on an ongoing basis and at June 30, 2008, the Corporation was in compliance.

### **LIQUIDITY AND CAPITAL RESOURCES**

#### **Senior Secured Notes**

The completion of the \$20,000,000 Senior Secured Notes financing, referred to above was designed to meet the Corporation's financial requirements for completing the Fabie Bay project. Originally, the bulk of these restricted funds were held in escrow awaiting the completion of the two conditions for their release: (1) the receipt of the mining permit and (2) the definitive Custom Milling agreement with Xstrata. Subsequent to June 30 2007, all of the conditions outlined above were satisfied for release of this escrow.

From the release, \$5.6M was placed in escrow to satisfy the Corporation's obligations for funding the mill refurbishment program at the Horne Mill and the remaining \$9.5M, net of fees and commissions, became available to the Corporation to complete the development program at the Fabie site. Prior to the release from escrow, the funds were already accounted for as cash of the Corporation, but with restrictions, as the cash was earmarked for the mill refurbishment.

The Corporation's cash and cash equivalents at June 30, 2008 was \$4,607,360 and an additional \$6,180,564 was held as restricted cash, in escrow to fund the refurbishment of the Horne Mill. This escrow has been committed to refurbishment work undertaken and will be paid to Xstrata Copper in 2008. Further details are provided in Note 4 to the interim financial statements.

#### **Flow-through Financing**

On December 21, 2007, the Corporation completed a flow-through financing consisting of 2,799,996 units priced at \$1.10/unit resulting in gross proceeds of \$3,080,000. A unit consisted of a flow-through share and a half warrant, with a whole warrant entitling the holder to purchase a common share at \$1.75 in the first year and \$2.00 in the subsequent year. The share issue costs totalled \$170,653. These funds have been used to fund the 20,000 meter drilling program which has been established for the Magusi Property.

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### Short-term Investments

The term deposits increased from \$1,127,437 at December 31, 2007 to \$4,367,070 at June 30, 2008. The increase mainly reflects the impact of the \$5,290,411 net earnings for the period along with the net pre-operating revenues of \$7,449,056 during the period. These sources of funds were offset by investments in working capital, repayment of capital lease obligations and the investment in mineral interests and property, plant and equipment.

Commercial Production having been achieved, the operations are now generating significant monthly cash flow.

Operationally, the Corporation is developing the Magusi polymetallic deposit, which may require substantial capital investments.

The Corporation is not aware of any trends, demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result in, its liquidity either materially increasing or decreasing at present or in the foreseeable future.

Currently the Corporation does not have any loans or indebtedness beyond the Senior Secured Notes, Obligations under Capital Leases and normal trade payables. The Senior Secured Notes restrict the Corporation from incurring additional indebtedness without Noteholder approval. Under these arrangements, Liens and Capital Lease Obligations created after the closing date are limited to \$3,000,000 outstanding at any one time. Management monitors this restriction on an ongoing basis and is in compliance with the restriction.

### Working Capital

Under the terms of the Custom Milling Agreement with Xstrata, forty-five days after the end of the production period, the Corporation receives an estimated provisional payment for 90% of the metal content based on average prices in the previous month. A final payment, based on actual weights and assay and the average of the London Metal Exchange prices three months after production, is received when all of the appropriate information is available generally estimated to be ninety-five days after the provisional payments. During the first six months of 2008, the final payments for the months of November through March 2008 have averaged 116 days. As a result, once commercial production was achieved, the Corporation must finance receivables equivalent to sixty-six days of production.

At June 30, 2008, the Corporation had amounts and settlements receivable from Xstrata of \$16,534,959 (December 31, 2007 - \$5,553,972) which represented a \$10,980,987 increase. The receivables represent the full value of the metal shipments for the months of May and June (\$13,361,685 including related taxes) along with final payments which follow the receipt of appropriate weights and assays for the shipments for the months of February, March and April which total \$3,173,274.

At June 30, 2008, the working capital was \$12,463,390 which represented a \$10,783,540 increase from \$1,679,850 at December 31, 2007. The working capital includes cash of \$6,180,564 held in

# First Metals Inc.

## MANAGEMENT DISCUSSION & ANALYSIS (MD&A) FOR THE SIX MONTHS ENDED JUNE 30, 2008

escrow to fund the mill refurbishment and provide for the accrued mill refurbishment costs of \$6,896,395. During the next quarter, the Corporation will incur exploration and development expenses on the Magusi property; however, the Corporation will receive significant revenues from the processing of ore from Fabie Bay.

### Operating Activities

Cash generated from operating activities was \$3,545,003 for the quarter ended June 30, 2008 compared to a usage of \$152,009 in the comparable period ended June 30, 2007. The increase is mainly a result of the net income of \$3,515,579 for the period which has been adjusted for items not affecting cash and by the changes in non-cash working capital.

Cash generated from operating activities for the six month period ended June 30, 2008 was \$3,498,795 compared to \$342,877 in the comparable period ended June 30, 2007. The increase is mainly a result of the net income of \$5,290,411 for the period which has been adjusted for items not affecting cash and by the changes in non-cash working capital.

### Financing Activities

During the second quarter of 2008, the Corporation received \$55,000 for shares which were issued under the stock option plan. During the comparable period in 2007, the Corporation received \$1,883,492 from the issue of common share and warrants for cash as well as \$1,718,262 from warrants. In addition during this comparable period in 2007, the Corporation completed the Senior Secured Notes financing which resulted in the receipt of \$16,090,340 which was initially held in escrow. During this period, the Corporation also made the final payment of \$250,000 required under the purchase agreement with Globex as Commercial Production had been achieved at the beginning of March 2008.

During the six month period ended June 30, 2008, the financing activities were limited to the \$55,000 of receipts from the issue of shares under the stock option plan, the \$250,000 final payment to Globex and payments of \$1,431,328 on capital lease obligations. In the comparable period in 2007, the Corporation raised \$16,090,340 from the Senior Secured Notes financing along with \$1,883,492 from the issue of common share and warrants for cash and \$1,718,262 from warrants.

### Investing Activities

During the second quarter of 2008, \$662,837 was invested in Mineral Interests and Property, plant and equipment compared to \$2,970,613 in the previous year. The lower level of expenditures reflects the completion of major activities on the Fabie Deposit.

On a year to date basis, \$729,080 has been invested in Mineral Interests and Equipment in 2008 as compared to \$5,907,972 in the first six months of 2007 during the development phase for the Fabie Bay property.

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### Net Cash Flow

During the second quarter of 2008, cash and cash equivalents increased by \$1,776,396 compared to \$875,864 in the corresponding period in 2007. The increase reflects the impact of initial revenues from the shipment of ore to the Horne Mill.

On a year to date basis for the first six months of 2008, cash and cash equivalents increased by \$1,049,694 as a result of the achievement of commercial production as compared to a reduction in cash and cash equivalents of \$2,189,109 while Fabie Bay development activities were underway in the first six months of 2007.

### Capital Resources

All of the major equipment required to produce from the Fabie Mine has been acquired. The Corporation is currently exploring the Magusi deposit and some additional equipment will be required to develop this deposit at the same time that production continues from the Fabie Mine.

The equipment which may be needed later in the 2008 fiscal period will be met either through a limited number of Capital Leases or cash flow from the Fabie Mine. At this time, it is premature for the Corporation to estimate the requirements until the exploration activities currently underway are further advanced.

### Contractual Commitments

As at June 30, 2008, the Corporation had the following commitments:

	<u>Less than 1 year \$</u>	<u>1 to 3 years \$</u>	<u>Greater than 3 years \$</u>	<u>Total \$</u>
Capital Leases	2,125,662	909,152	232,944	3,267,758
Drilling program	121,000			121,000
Milling Processing Deposit	675,000			675,000
Equipment leases	406,417	865,700		1,272,117
Magusi development	2,000,000	-		2,000,000
Office space	44,487	44,487		88,973
Mine Closure reclamation	155,000	67,000		222,000
	<u>5,527,566</u>	<u>1,886,339</u>	<u>232,944</u>	<u>7,646,848</u>

### KEY ECONOMIC TRENDS

The financial performance of the Corporation will be directly affected by the activities conducted on the Fabie Bay and Magusi River projects in conjunction with their development for commercial production of copper, zinc, gold and silver. It is anticipated that the development

# **First Metals Inc.**

## **MANAGEMENT DISCUSSION & ANALYSIS (MD&A)**

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funding required for the Magusi project will be supplied by cash flow from the Fabie Bay project now that it has reached commercial production.

The financial performance of the Corporation is closely linked to the prices obtained for the copper, zinc, gold and silver produced by the Corporation. To date, copper prices have continued to be at levels that are significantly higher than estimated production costs and significantly higher than the prices which prevailed when the property was acquired and initial commitments made towards going into production.

### **RISKS AND UNCERTAINTIES**

The Corporation's operations and results are subject to a number of risks at any given time. The Risks relating to the business conducted by the Corporation include (i) start-up and continued production at the Horne Mill, (ii) development and operating risks at the Fabie Bay Mine, (iii) exploration risks, (iv) environmental risks and hazards (v) uninsurable risks, (vi) market factors and volatility of commodity prices, (vii) exchange rate fluctuations, (viii) share price fluctuations and volatility, (ix) management influence and control, (x) loss of mining claims, (xi) ability to arrange additional financing if required and (xii) changes in regulatory requirements.

Exploration for mineral resources involves a high degree of risk. The cost of conducting programs may be substantial and the likelihood of success is difficult to assess. For a more complete discussion of these risks and others, reference should be made to the December 31, 2007 Management Discussion and Analysis and the IPO prospectus.

Production of mineral resources also involves a high degree of risk. Working underground exposes workers to risks, particularly during development. Working with heavy equipment and explosives are also inherently risky.

Under the current contract with Xstrata, it has agreed to process all of the ore from the Fabie Bay deposit. At the present time, the Corporation is exploring options for processing the ore from the Magusi property including the Custom Milling by Xstrata. Production from Magusi is dependent upon securing a milling source.

The Corporation's Custom Milling agreement with Xstrata mitigates much of the environmental risk associated with tailings as the ownership of the facility generating the tailings, and thus the prime responsibility remains with Xstrata.

### **Copper Prices**

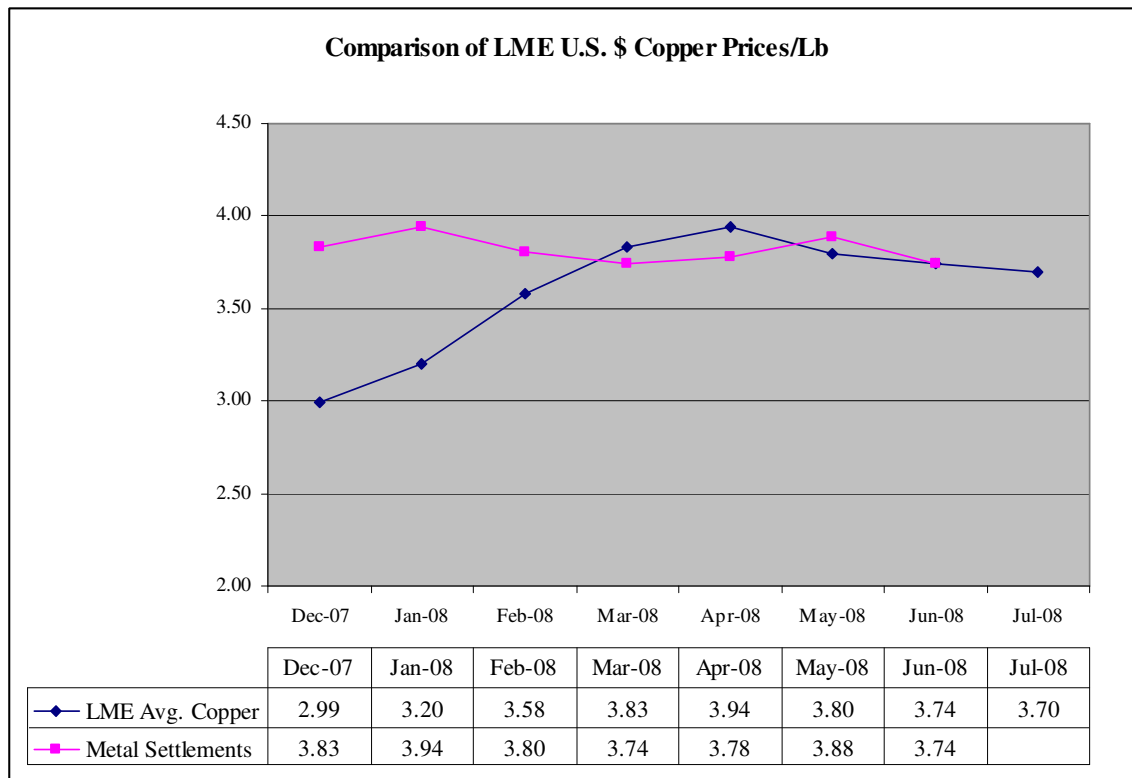
During the last nine months, Copper prices have ranged between U.S. \$2.80/lb and U.S. \$3.95/lb. First Metals began shipping material in November 2007 and received a provisional payment for the November and December production on January 15, 2008. These provisional payments were based on an average copper price of U.S. \$2.98/lb. The final settlements are based on the average pricing during the third month following production. Accordingly, the final payment for November production was based on the average London Metal Exchange (LME) prices for

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February (U.S. \$3.57/lb) and correspondingly the December production was based on the average LME pricing for March 2008 (U.S. \$3.82/lb.).

The chart below outlines the average LME Prices in US dollars per pound of Copper which have averaged U.S \$3.60 during the first seven months of 2008. In addition to the LME prices, the graph also displays the settlement prices which the Corporation has received as final settlements for the December 2007 through March 2008 shipments which are based on the average of the LME prices in the third month following production (Average settlement pricing for six month period – U.S. \$3.82).



The net revenue which is received by First Metals reflects smelting, refining, and treatment charges as well as a deduction for net metal royalties.

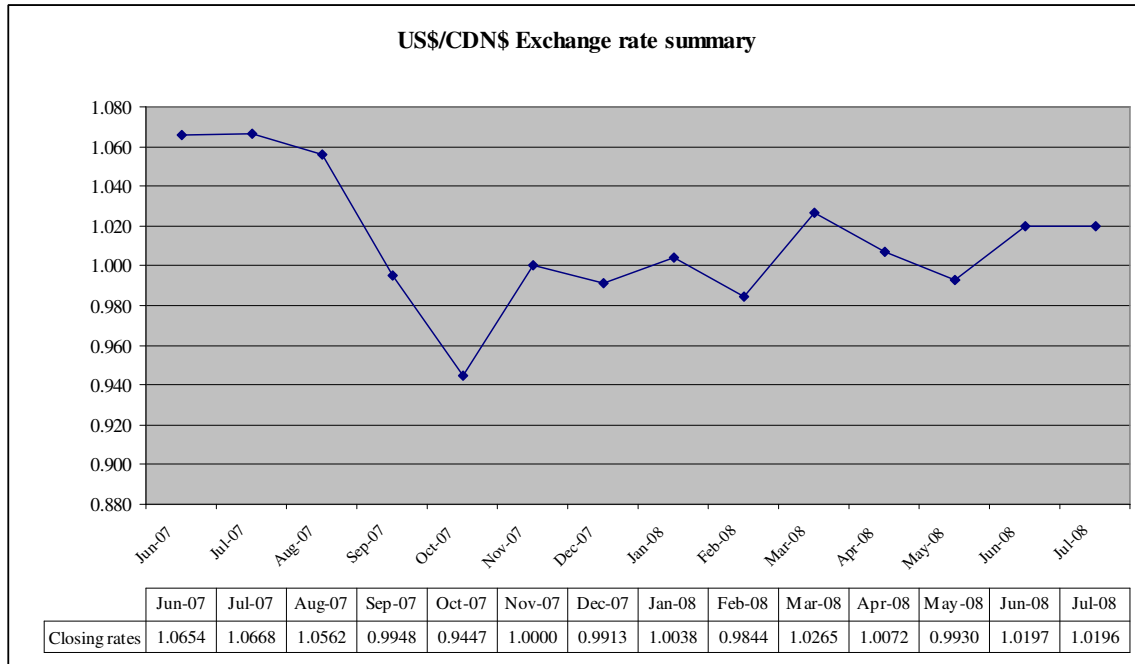
Despite the concerns regarding the demand for Copper in the United States, management is aware that significant demand for copper currently exists in international markets.

# First Metals Inc.

## MANAGEMENT DISCUSSION & ANALYSIS (MD&A) FOR THE SIX MONTHS ENDED JUNE 30, 2008

### Exchange rates

The Corporation reports its financial results in Canadian dollars. The majority of its costs are incurred in Canadian dollars, while its metal sales are completely realized in U.S. dollars.



For the first six months of 2007, the Canadian dollar averaged C\$1.14/U.S.\$. During the third quarter the Canadian dollar continued to appreciate and averaged C\$1.04/U.S.\$. During the fourth quarter of 2007, the Canadian dollar remained strong against the U.S. dollar and finished the year at C\$ 1.011/U.S.\$.

During January, February and March 2008, the Canadian dollar remained strong against the U.S. dollar, fluctuating in a range generally within 2 ½ cents of parity and averaged approximately ½ cent discount to the U.S. dollar. During April, May and June 2008, the Canadian dollar remained strong against the U.S. dollar.

As an initial policy direction, Management has adopted a policy of converting U.S. dollar receipts as received. It is exploring strategies to mitigate the impact on the operations of changes in both foreign exchange and commodity prices.

### CHANGES IN ACCOUNTING POLICIES

#### Adoption of Accounting Changes

On January 1, 2008, the Corporation adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook Sections Section 1535, Capital Disclosures; Section 3862, Financial

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## **MANAGEMENT DISCUSSION & ANALYSIS (MD&A)**

### **FOR THE SIX MONTHS ENDED JUNE 30, 2008**

Instruments – Disclosures; Section 3863, Financial Instruments – Presentation; and Section 1400, Financial Statement Presentation. In accordance with the transitional provisions, prior periods have not been restated. The principal changes resulting from these new standards are described below:

Section 1535, Capital disclosures, establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard, the Corporation is required to disclose quantitative and qualitative information about its objectives, policies and procedures for managing capital.

Section 3031, Inventories, provides guidance on the determination of costs and the subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Section 3862, Financial instruments – disclosures, requires entities to disclose quantitative and qualitative information that enable users to evaluate (a) the significance of financial instruments for the Corporation's financial performance, and (b) the nature and extent of risks arising from financial instruments to which the Corporation is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks.

Section 3863, Financial Instruments – Presentation establishes the standards for the classification of financial instruments as liabilities or equity and the classification of related gains, income, and/or losses in the statement of operations. The adoption of these standards did not result in any changes to the Corporation's financial statements.

Section 1400, General Standards of Financial Statement Presentation was amended to include guidance related to management's responsibility to assess the ability of the entity to continue as a going concern. Management is required to make an assessment of an entity's ability to continue as a going concern and taking into account all available information about the future, which is at least, but not limited to twelve months from the balance sheet date.

#### **Future Adoption of Accounting Changes**

The Corporation has begun to plan for the adoption of the International Financial and Reporting Standards (IFRS) which will be required in 2011. At this time, it is premature to outline, the impacts to the Corporation.

#### **International Financial Reporting Standards (IFRS)**

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011 and will be applicable to the Company commencing with its fiscal year beginning April 1, 2011. The

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## **MANAGEMENT DISCUSSION & ANALYSIS (MD&A)**

### **FOR THE SIX MONTHS ENDED JUNE 30, 2008**

transition date of April 1, 2011 for the Corporation will require the restatement for comparative purposes of amounts reported by the Corporation for the year ended March 31, 2011. While the Corporation has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

#### **RELATED PARTY TRANSACTIONS**

During the second quarter, the Corporation continued to receive Management and Financial services from four Insiders of the Corporation. The management service agreements were designed during the development stage to provide the Corporation: with strategic direction, overall financing strategies, financial planning and reporting, operations planning, mine development strategies and investor relations and marketing strategies. All of these agreements expired in June 2008 and certain of these management services are continuing to be provided on a month to month basis.

Under the terms of the service agreements, these Insiders are entitled to monthly fees ranging from \$6,000 to \$11,600 per month, including car and home office allowances. The individual fees have been mutually agreed to and reflect the individual's level of service and do not exceed market comparable rates for such services.

During the second quarter of 2008, a total of \$70,000 (2007 - \$78,750) was paid under these arrangements. On a year to date basis, for the first six months of 2008, \$145,000 (2007 - \$157,500) was paid for the management services. The total is lower in the current year as one of the Insiders passed away late in 2007.

These transactions are measured at the exchange amount, which approximates the fair value as agreed between management and the related parties except to the extent that the Related Parties may have willingly given value greater than received in order to benefit the Corporation.

#### **CONTROLS AND PROCEDURES**

##### **Disclosure Controls and Procedures (DCP)**

First Metal's management, with the participation of its Chief Executive Officer and Chief Financial Officer has evaluated the design and effectiveness of the Corporation's disclosure controls and procedures as defined in the rules of the Canadian Securities Administrators as of June 30, 2008. Based on that evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective as of June 30, 2008.

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

The Corporation's management, with the participation of the Chief Executive Officer and Chief Financial Officer, are responsible for establishing and maintaining adequate internal controls over financial reporting. Under the supervision of the Chief Financial Officer, the Corporation's

# First Metals Inc.

## MANAGEMENT DISCUSSION & ANALYSIS (MD&A)

### FOR THE SIX MONTHS ENDED JUNE 30, 2008

internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with generally accepted accounting principles (“GAAP”). The Corporation’s controls include policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflects the transactions and dispositions of the assets of the Corporation;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of the Corporation’s management and directors, and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Corporation’s assets that could have a material effect on the annual financial statements or interim financial statements.

The Corporation’s management, including its Chief Executive Officer and Chief Financial Officer, believe that any disclosures and procedures or internal controls over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the controls system are met. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Corporation have been prevented or detected.

On an ongoing basis, the Corporation reviews the effectiveness of all aspects of the organization including the DCP’s and ICFR. In the period under review, there have been no changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Corporation’s internal control over financial reporting.

The Corporation’s management, including its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Corporation’s internal controls over financial reporting and management has concluded that the internal controls over financial reporting were effective as of June 30, 2008.

#### **OUTSTANDING SHARE DATA**

The Corporation’s authorized share capital is an unlimited number of common shares without par value. As at June 30, 2008, there were 42,851,198 outstanding common shares and 4,143,785 stock options outstanding. The weighted-average remaining contractual life of outstanding options was approximately 1.87 years and a total of 3,187,535 options were exercisable at a weighted average exercise price of \$1.08

# First Metals Inc.

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### FOR THE SIX MONTHS ENDED JUNE 30, 2008

At June 30, 2008, the Corporation has share purchase warrants outstanding entitling the holders to acquire common shares as follows:

Description	Number of warrants	Exercise price (Average)	Expiry date
Issued pursuant to IPO	2,988,050	\$ 1.25	September 1, 2008
Issued with Senior Secured Notes	2,000,000	\$ 1.35	July 31, 2012
Issued with 2007 Flow-through offering	1,399,838	\$ 1.75 - \$2.00	December 21, 2009
	<b>6,387,888</b>	<b>\$ 1.02</b>	

#### FURTHER INFORMATION

Additional disclosures concerning the Corporation's general and administrative expenses and Mineral Interests are provided in the interim financial statements available through both the SEDAR website ([www.sedar.com](http://www.sedar.com)) and on the Corporation's own website ([www.firstmetalsinc.com](http://www.firstmetalsinc.com)).

#### OUTLOOK

The Corporation looks forward to the continued production and the achievement of positive cash flow from operations. Additional resources are being applied to advancing the development of the Magusi deposit towards commercial production. Studies are ongoing to determine the economic viability and the mining methods and associated costs for achieving this goal.

#### FORWARD LOOKING STATEMENTS

Certain of the statements made and information contained herein are "forward-looking information" within the mean of the Ontario Securities Act. Forward-looking statements are subject to a variety of risks and uncertainties which could cause actual events or results to differ from those reflected in the forward-looking statements, including, without limitations, risk and uncertainties relating to the future prices of copper, zinc or other metal prices and foreign currency fluctuations; risks inherent in mining including environmental hazards, industrial accidents, unusual or unexpected geological formations; risks associated with the estimation of mineral resources and reserves and the geology, grade and continuity of mineral deposits; the possibility that future exploration, development or mining results will not be consistent with the Corporation's expectations; operating and capital costs, the potential for and effects of labour disputes or other unanticipated difficulties with or shortages of labour, inability to obtain necessary governmental permits; and other risks and uncertainties, including those described under Risk Factors Relating to the Corporation's Business as outlined in the Corporations' Initial Public Offering ("IPO") available on the SEDAR website ([www.sedar.com](http://www.sedar.com)).

# **First Metals Inc.**

## **MANAGEMENT DISCUSSION & ANALYSIS (MD&A)**

### **FOR THE SIX MONTHS ENDED JUNE 30, 2008**

Often, but not always, forward-looking statements can be identified by the use of words such as “plans”, “expects”, “is expected”, “budget”, “scheduled”, “estimates”, “forecasts”, “intends”, “anticipates”, or “believes” or variations (including negative variations) of such words and phrases, or statements that certain actions, events or results “may”, “could”, “would”, “might” or “will” be taken, occur or be achieved.

Forward-looking statements in this MD&A describe the Corporation’s expectations as of July 25, 2008 and the Corporation disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or results or otherwise.

There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements.

Accordingly, readers should not place undue reliance on forward-looking statements.