

# **Migao Corporation**

**(Formerly "Fox Mountain Explorations Ltd.")**

**Interim Consolidated Financial Statements  
Third Quarter  
Ended June 30, 2006**

# **Migao Corporation**

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*Third Quarter ended June 30, 2006*  
*(Unaudited)*

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# Migao Corporation

## Interim Consolidated Balance Sheets

(in Canadian dollars)

	June 30, 2006 (Unaudited)	September 30, 2005 (Audited)
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 8,240,476	\$ 2,455,571
Accounts receivable	13,378,763	3,747,496
Prepayments, deposits and other receivables (note 2)	7,044,354	3,004,872
Inventory (note 3)	3,779,932	2,434,816
	32,443,525	11,642,755
<b>Plant and equipment (note 5)</b>	13,245,868	8,758,541
<b>Construction in progress</b>	2,235,428	2,664,321
<b>Land use rights (note 6)</b>	5,487,905	4,893,638
	\$ 53,412,726	\$ 27,959,255
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (note 6)	\$ 3,785,532	\$ 4,970,922
Customer deposits	1,189,467	467,513
Due to related parties (note 4)	3,941,221	261,864
Income tax payable	160,624	-
	9,076,844	5,700,299
<b>Due to related parties (note 4)</b>	-	15,676,613
	9,076,844	21,376,912
<b>Shareholders' equity</b>		
Share capital (note 7)	28,804,006	1,538
Contributed surplus (note 7)	2,705,091	-
Cumulative translation adjustment	(537,621)	(142,388)
Retained earnings (note 9)	13,364,406	6,723,193
	44,335,882	6,582,343
<b>Commitment (note 11)</b>		
<b>Subsequent events (note 12)</b>		
	\$ 53,412,726	\$ 27,959,255

The accompanying notes are an integral part of these consolidated financial statements.

Approved on behalf of the Board of Directors

Signed by "Keith Attoe"

Director

Signed by "Michael W. Manley"

Director

## Migao Corporation

### Interim Consolidated Statements of Operations and Retained Earnings

Third Quarter ended June 30, 2006

(in Canadian dollars)

	For the three months ended		For the nine months ended	
	June 30, 2006 (unaudited)	June 30, 2005 (unaudited)	June 30, 2006 (unaudited)	June 30, 2005 (unaudited)
<b>Revenues</b>	\$ 15,426,319	\$ 6,846,816	\$ 42,915,105	\$ 21,184,757
<b>Cost of goods sold</b>	12,313,381	6,326,927	32,790,647	18,839,812
<b>Gross profit</b>	3,112,938	519,889	10,124,458	2,344,945
<b>Operating expenses</b>				
Selling expenses	193,102	230,612	1,426,741	532,004
General and administrative	545,108	343,904	1,190,045	694,938
Professional and consulting	124,000	-	343,823	-
Pre-operating costs	-	-	125,288	54,997
Stock-based compensation	119,805	-	119,805	-
	982,015	574,516	3,205,702	1,281,939
<b>Income (loss) from operations</b>	2,130,923	(54,627)	6,918,756	1,063,006
Other income	36,257	1,037	40,711	5,707
<b>Income (loss) before income taxes</b>	2,167,180	(53,590)	6,959,467	1,068,713
Provision for income taxes	161,315	-	318,254	-
<b>Net income (loss) for the period</b>	2,005,865	(53,590)	6,641,213	1,068,713
<b>Retained earnings, beginning of period</b>	11,358,541	1,161,694	6,723,193	39,391
<b>Retained earnings, end of period</b>	\$ 13,364,406	\$ 1,108,104	\$ 13,364,406	\$ 1,108,104
<b>Income per share: (note 8)</b>				
Basic	\$ 0.08	-	\$ 0.31	-
Diluted	\$ 0.08	-	\$ 0.31	-
<b>Weighted average number of common shares outstanding: (note 8)</b>				
Basic	24,186,216	-	21,662,072	-
Diluted	24,260,457	-	21,686,819	-

The accompanying notes are an integral part of these consolidated financial statements.

## Migao Corporation

### Interim Consolidated Statements of Cash Flows

Third Quarter ended June 30, 2006

(in Canadian dollars)

	<u>For the three months ended</u>		<u>For the nine months ended</u>	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Cash flow from operating activities</b>				
Cash receipts from customers	\$ 9,612,269	\$ 13,660,199	\$ 33,912,847	\$ 33,281,247
Cash paid to suppliers and employees	(18,329,304)	(13,427,625)	(41,034,254)	(34,930,785)
Income taxes paid	(159,364)	-	(159,364)	-
Interest paid	(41,190)	-	(41,190)	-
Interest received	15,539	-	19,993	2,332
	(8,902,050)	232,574	(7,301,968)	(1,647,206)
<b>Cash flow from investing activities</b>				
Purchase of plant and equipment	(166,908)	(827,169)	(600,682)	(3,035,110)
Construction in process	(1,314,605)	-	(4,099,527)	(339,859)
Payments for land use rights	(222,400)	-	(1,519,384)	-
	(1,703,913)	(827,169)	(6,219,593)	(3,374,969)
<b>Cash flow from financing activities</b>				
Payment of bank loan	(1,456,000)	-	-	-
Advances from related parties, net	1,494,386	899,350	3,129,194	5,107,640
Issuance of common shares, net	16,125,726	-	16,156,726	-
Advances from director	-	-	20,546	-
	16,164,112	899,350	19,306,466	5,107,640
<b>Increase in cash and cash equivalent</b>	<b>5,558,149</b>	<b>304,755</b>	<b>5,784,905</b>	<b>85,465</b>
<b>Cash and cash equivalent, beginning of period</b>	<b>2,682,327</b>	<b>1,386,389</b>	<b>2,455,571</b>	<b>1,605,679</b>
<b>Cash and cash equivalent, end of period</b>	<b>\$ 8,240,476</b>	<b>\$ 1,691,144</b>	<b>\$ 8,240,476</b>	<b>\$ 1,691,144</b>

The accompanying notes are an integral part of these consolidated financial statements.

# Migao Corporation

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## Notes to Interim Consolidated Financial Statements

Third Quarter ended June 30, 2006

(in Canadian dollars)

(Unaudited)

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### 1. Nature of Operations and Basis of Presentation

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#### The Company

The consolidated financial statements of Migao Corporation (“the Company” or “Migao”) as of June 30, 2006 reflect the reverse takeover by H.K. Migao Industry Limited (“HK Migao”) of Fox Mountain Explorations Ltd. (“Fox Mountain”), a natural resource exploration company incorporated on December 29, 1997 under the laws of the province of Ontario. The reverse takeover by HK Migao of Fox Mountain was approved by the shareholders of each company and was completed on May 18, 2006 at which time the Company was renamed Migao Corporation.

HK Migao holds 100% of Sichuan Migao Chemical Fertilizer Industry Co. Ltd. (“Sichuan”), Guangdong Migao Chemical Co. Ltd. (“Guangdong”), and Liaoning Migao Chemical Co. Ltd. (“Liaoning”) (collectively, the “Subsidiaries”).

#### Reverse Takeover Transactions

Effective May 18, 2006, the Company issued 20,400,000 common shares to the shareholders of HK Migao to complete the acquisition of 100% of the issued and outstanding shares of HK Migao. As a result of this acquisition, the former shareholders of HK Migao controlled 98% of the issued and outstanding share capital of the Company immediately after the acquisition, constituting a reverse takeover, with HK Migao being the acquiring company.

The acquisition of the shares of HK Migao has been accounted for as a reverse takeover transaction in accordance with guidance provided in Emerging Issues Committed Abstract No. 10. As Fox Mountain did not qualify as a business for accounting purposes, the transaction has been accounted for as an issuance of shares by HK Migao for the net monetary assets of Fox Mountain, accompanied by a recapitalization of the Company.

The net monetary assets of the Company received were as follows:

Total assets acquired	\$	NIL
Less current liabilities		<u>1,100</u>
Net assets acquired	\$	<u>(1,100)</u>

Further to the reverse takeover transaction, these consolidated financial statements for the nine month period ended June 30, 2006 reflect the assets, liabilities and results of operations of HK Migao, the legal subsidiary, prior to the reverse takeover and the consolidated assets, liabilities and results of operations of the Company and HK Migao subsequent to the reverse takeover. The consolidated financial statements are issued under the name of the legal parent (the Company) but are deemed to be a continuation of the legal subsidiary (HK Migao). The comparative balance sheet as at September 30, 2005 and the comparative results of operations and cash flows for the nine months period ended June 30, 2005 are those of HK Migao.

The following supplementary information summarizes the results of operations and deficit of Fox Mountain for the period preceding the reverse takeover transaction:

## Migao Corporation

### Notes to Interim Consolidated Financial Statements

Third Quarter ended June 30, 2006

(in Canadian dollars)

(Unaudited)

## 1. Nature of Operations and Basis of Presentation - continued

### Reverse Takeover Transactions - continued

	October 1, 2005 to May 17, 2006
Expenses:	
General and administrative	\$ <u>25,658</u>
Loss for the period	25,658
Deficit – beginning of period	<u>413,915</u>
Deficit – end of period	<u>\$ 439,573</u>

### Nature of Operation

The Company, through its wholly owned Subsidiaries, is a manufacturer of specialty potash-based fertilizers, produced at its three facilities in the People's Republic of China ("PRC").

### Basis of Presentation

These unaudited interim consolidated financial statements (the "financial statements") have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") and include the accounts of the Company and its subsidiaries in the PRC. These interim financial statements have been prepared by the management of the Company using the same accounting policies and methods as the most recently audited financial statements of HK Migao. These financial statements do not contain all disclosures required by Canadian GAAP for annual financial statements, and accordingly, the financial statements should be read in conjunction with the audited financial statements of HK Migao for the nine months ended September 30, 2005. Interim results are not necessarily indicative of the results expected for the fiscal year. Certain comparative figures have been reclassified to conform to the current period's presentation.

## 2. Prepayments, Deposits, and Other Receivables

	June 30, 2006 (Unaudited)	September 30, 2005 (Audited)
Prepayments for raw materials	\$ 4,278,414	\$ 1,331,253
Prepayments for construction costs	1,859,944	975,871
Prepayment for transportation services	161,522	159,195
Deposits for the supply of utilities	136,329	115,040
VAT receivable	441,817	379,513
Other receivables and deposits	166,328	44,000
	<u>\$ 7,044,354</u>	<u>\$ 3,004,872</u>

## Migao Corporation

### Notes to Interim Consolidated Financial Statements

Third Quarter ended June 30, 2006

(in Canadian dollars)

(Unaudited)

### 3. Inventory

	June 30, 2006 (Unaudited)	September 30, 2005 (Audited)
Raw materials	\$ 3,396,226	\$ 1,852,097
Finished goods	322,627	520,448
Packing materials	61,079	62,271
	<b>\$ 3,779,932</b>	<b>\$ 2,434,816</b>

### 4. Related Party Balances and Related Party Transactions

At the end of the periods, the Company had related party balances as follows:

	June 30, 2006 (Unaudited)	September 30, 2005 (Audited)
Amount due to:		
Liaoning Yongcheng Economic and Trade Development Co. Ltd. ("LYEDC")	\$ 3,941,221	\$ 12,130,546
Russia Liumix Chemical Co. Ltd. ("Liumix")	-	3,807,931
	<b>3,941,221</b>	<b>15,938,477</b>
Less: current portion (i)	<b>3,941,221</b>	<b>261,864</b>
Long-term portion (ii)	<b>\$ NIL</b>	<b>\$ 15,676,613</b>

Prior to the incorporation of HK Migao in August 2005, the Subsidiaries were 75% owned by LYEDC and 25% owned by Liumix. LYEDC and the Company are ultimately controlled by the same shareholder.

- (i) Expenses paid by LYEDC, on behalf of the Company in the amount of \$680,480 are included in the current portion of due to related party. The balance of \$3,204,989 represents advances from LYEDC to the subsidiaries for operating purposes, and \$55,752 represents interest payable on the long-term portion of the advances, up to the date of conversion to equity on June 7, 2006 (Note 4(ii)). These amounts are non-interest bearing and due on demand.
- (ii) Advances to the subsidiaries from LYEDC for operating purposes in the amount of \$6,278,482 represent the long-term portion. On October 18, 2005, the maturity dates on these advances was extended to be due on January 1, 2009 and bear interest at 2% per annum commencing on January 1, 2006. Two notes payable on the transfer of the subsidiaries' ownerships to the Company by the former owners, LYEDC and Liumix, in the amounts of \$5,365,653 and \$3,800,022 respectively, were transferred to Migao International Holding Limited, a company majority owned by the shareholder of LYEDC.

## Migao Corporation

### Notes to Interim Consolidated Financial Statements

Third Quarter ended June 30, 2006

(in Canadian dollars)

(Unaudited)

#### 4. Related Party Balances and Related Party Transactions – continued

(ii) - continued

On June 7, 2006, the long-term debt in the amount of \$6,278,482 was converted into 1,846,612 common shares of the Company at \$3.40 per share, the closing trading price on June 7, 2006. The value of the debt was converted into Canadian dollars from its denominated currency of Chinese Renminbi using the exchange rate on June 7, 2006.

Office rent in the amount of \$7,500 was paid during the quarter ended June 30, 2006 to a company controlled by certain directors of the Company.

#### 5. Plant and Equipment

			June 30, 2006 (Unaudited)
	Cost	Accumulated Amortization	Net Book Value
Buildings and improvements	\$ 6,681,080	\$ 366,826	\$ 6,314,254
Machinery and equipment	7,435,896	1,037,397	6,398,499
Vehicles	472,379	149,207	323,172
Office equipment	264,488	54,545	209,943
	<b>\$ 14,853,843</b>	<b>\$ 1,607,975</b>	<b>\$ 13,245,868</b>
			September 30, 2005 (Audited)
	Cost	Accumulated Amortization	Net Book Value
Buildings and improvements	\$ 3,316,393	\$ 197,096	\$ 3,119,297
Machinery and equipment	5,791,583	628,833	5,162,750
Vehicles	434,704	105,515	329,189
Office equipment	174,230	26,925	147,305
	<b>\$ 9,716,910</b>	<b>\$ 958,369</b>	<b>\$ 8,758,541</b>

Amortization expense for the nine months period ended June 30, 2006 was \$641,901 (June 30, 2005 - \$335,117).

## Migao Corporation

### Notes to Interim Consolidated Financial Statements

Third Quarter ended June 30, 2006

(in Canadian dollars)

(Unaudited)

## 6. Land Use Rights

	<b>June 30, 2006 (Unaudited)</b>	September 30, 2005 (Audited)
Land use rights	\$ 5,511,321	\$ 4,913,167
Less: accumulated amortization	23,416	19,529
	<b>\$ 5,487,905</b>	<b>\$ 4,893,638</b>

As of June 30, 2006, the Company had seven land leases from the Chinese government with a term of fifty years each.

Amortization expense for the nine months period ended June 30, 2006 was \$4,617 (June 30, 2005 - \$5,303) and is included in general and administrative expenses.

As of June 30, 2006, the Company had not acquired the land use right certificates for five of the land leases and approximately \$1.4 million has been accrued as the balance due on the issuance of the certificates. It is common practice in the PRC that the land use right certificates are only issued when the government has serviced the land ready for construction.

Under the PRC law, land use rights can be revoked and the tenants can be forced to vacate at any time when re-development of the land is in the public interest.

## 7. Share Capital

(a) **Authorized:**

Unlimited common shares without par value; and

Unlimited preference shares without par value.

(b) (i) **Issued common shares of HK Migao pre RTO**

	<b>Number of Shares</b>	<b>Amount</b>
Balance – September 30, 2005	10,000	\$ 1,538
Conversion of long-term debt	10,400	9,165,675
<b>Balance - May 17, 2006</b>	<b>20,400</b>	<b>\$ 9,167,213</b>

## Migao Corporation

### Notes to Interim Consolidated Financial Statements

Third Quarter ended June 30, 2006

(in Canadian dollars)

(Unaudited)

## 7. Share Capital - continued

(b) (ii) Issued common shares	Number of Shares	Amount
Share capital is comprised of the number of issued and outstanding common shares of Fox Mountain and the stated capital of HK Migao	8,540,000	\$ 9,167,213
Consolidation of common share 1 for 17 basis	(8,037,691)	-
Issued to acquire HK Migao	20,400,000	-
Issued pursuant to a private placement at \$2.85 per share (i)	6,363,000	18,134,550
Share issuance costs	-	(2,190,952)
Private placement warrants (i)	-	(2,099,790)
Underwriters' compensation options (ii)	-	(485,497)
Issued on conversion of long-term debt (iii)	1,846,612	6,278,482
<b>Balance - June 30, 2006</b>	<b>29,111,921</b>	<b>\$ 28,804,006</b>

Reverse takeover accounting causes the amount represented by Share Capital to relate to the legal subsidiary, HK Migao, while the number of shares relates to the legal parent.

(i) On May 18, 2006 (the "closing date"), the Company completed a private placement of 6,363,000 units priced at \$2.85 per unit with each unit consisting of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to acquire one common share on payment of \$3.70 per common share within two years from the closing date. The fair value of the warrants issued with the private placement was estimated using the Black-Scholes option pricing model on the closing date of the private placement to be \$0.66 per warrant. Assumptions used to determine the value of the warrants were: dividend yield 0%; risk-free interest rate 4%; expected volatility 66%; and expected life 2 years.

(ii) In addition to the agency fee paid in cash, the Company granted compensation options entitling the agents to acquire 445,410 units at price of \$2.85 per unit until two years from the closing date. Each agent compensation unit comprises of one common shares and one-half warrant. Each whole warrant entitles the agent to acquire one common share on payment of \$3.70 per common share within two years from the closing date. The fair value of the compensation options granted with the private placement was estimated using the Black-Scholes option pricing model on the closing date of the private placement to be \$1.09 per option. Assumptions used to determine the value of the compensation options were: dividend yield 0%; risk-free interest rate 4%; expected volatility 66%; and expected life 2 years.

(iii) On June 7, 2006, 1,846,612 common shares of the Company were issued at \$3.40 per share upon the conversion of the long-term debt in the amount of \$6,278,482 owing to LYEDC, related by common control.

## Migao Corporation

### Notes to Interim Consolidated Financial Statements

Third Quarter ended June 30, 2006

(in Canadian dollars)

(Unaudited)

## 7. Share Capital - continued

### (c) Contributed surplus

	<b>Amount</b>
Balance – September 30, 2005	\$ -
Conversion of note payable in HK Migao	9,164,099
Elimination on consolidation	(9,164,099)
Stock-based compensation expense	119,805
Compensation options to brokers	485,497
Warrants issuance on private placement	2,099,790
<b>Balance - June 30, 2006</b>	<b>\$ 2,705,091</b>

On November 10, 2005, a note payable in the amount of \$9,165,675 to Migao International Holding Limited, was converted into a total of 10,400 common shares of HK Migao. The contributed surplus represents the difference between the par value of the shares and value of the note payable owed to Migao International Holding Limited before the conversion.

### (d) Stock options

Under the Company's stock option plan, the Company may grant stock options to directors, senior officers, employees and advisors and is authorized to issue up to 10% of the issued and outstanding shares of the Company. The board of directors or such other persons designated by the board administers the plan and determines the vesting and terms of each award.

The following table summarizes the activity of the Company's stock option plan.

	<b>Shares</b>	<b>Weighted average exercise price</b>
Outstanding – March 31, 2006	-	\$ -
Granted during the period	1,165,000	2.85
<b>Outstanding - June 30, 2006</b>	<b>1,165,000</b>	<b>\$ 2.85</b>

The following table summarizes the weighted average information about the outstanding stock options.

<b>Exercise price (\$)</b>	<b>Number outstanding</b>	<b>Weighted average remaining contractual life (years)</b>	<b>Number exercisable</b>
2.85	1,165,000	4.88	NIL

During the period, 1,165,000 compensation options were issued to the employees and directors of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$2.85 per common share. These options have vesting periods of up to three years and an exercise period of up to five years, expiring on May 18, 2011. The fair value of the options issued was estimated using the Black-Scholes option pricing model on the date of issue to be \$1.40 per option.

## Migao Corporation

### Notes to Interim Consolidated Financial Statements

Third Quarter ended June 30, 2006

(in Canadian dollars)

(Unaudited)

## 7. Share Capital - continued

### (d) Stock options - continued

Assumptions used to determine the value of the warrants were: dividend yield 0%; risk-free interest rate 4%; expected volatility 66%; and expected life 5 years. Stock-based compensation expense for the three months period ended June 30, 2006 was \$119,805 (June 30, 2005 – NIL).

### (e) Warrants

	Number of Warrants	Weighted average exercise price
Outstanding – March 31, 2006	-	\$ -
Issued on private placement financing	3,181,500	3.70
<b>Outstanding - June 30, 2006</b>	<b>3,181,500</b>	<b>\$ 3.70</b>

## 8. Income per Share

HK Migao was not incorporated until August 2005 and the statements of operations and retained earnings for the three and nine months ended June 30, 2005 are prepared on a combined basis of the Subsidiaries which were incorporated without share capital. The income per share and weighted average number of common shares outstanding amounts for the period ended June 30, 2005 are therefore not presented.

## 9. Retained Earnings

Under the laws of the PRC, all wholly owned foreign investment entities have to set aside a portion of their net income each year as a general reserve fund until the fund has reached 50% of the entity's paid in capital. The Company is also required to set aside a portion of net income as an expansion fund. These funds are allowed to be distributed to shareholders at the time of winding up. The fund accumulated by the Company as at June 30, 2006 was \$439,943 (RMB 3,153,714).

## 10. Segmented Information

The Company has one operating segment, being the production and sale of specialty potash-based fertilizer, along with their associated by-products. All of Company's assets and operations are located in the PRC.

## 11. Commitment

Purchase contracts exist for raw material acquisition in the amount of US\$2.02 million as of June 30, 2006, to be fulfilled within six months following the period-end. These contracts are entered into in the normal course of business.

## **Migao Corporation**

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### **Notes to Interim Consolidated Financial Statements**

*Third Quarter ended June 30, 2006*

*(in Canadian dollars)*

*(Unaudited)*

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## **12. Subsequent Events**

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Subsequent to the period end, the following transactions were completed:

- a) On July 24, 2006, the Company obtained two of its five outstanding land use right certificates from the government, both expiring on July 20, 2055.
- b) A purchase contract of raw material in amount of approximately US\$2 million was signed in July, 2006 to secure supply.
- c) On July 10, 2006, the Company took out a short-term bank loan in the amount of \$1,395,000 (RMB 10 million) for working capital and general corporate purposes. It is due on January 10, 2007, bears interest at 6.786% per annum, and is secured by certain land use rights.
- d) On August 7, 2006, the Company took out a short-term bank loan in the amount of \$2,790,000 (RMB 20 million) for working capital and general corporate purposes. It is due on August 6, 2007, bears interest at 5.85% per annum, and is secured by certain properties and land use rights.