

Migao Corporation

Consolidated Financial Statements
September 30, 2007 and 2006

Migao Corporation

Table of Contents

September 30, 2007 and 2006

	Page
Auditor's Report	1
Consolidated Financial Statements	
Balance Sheets	2
Statements of Operations and Retained Earnings	3
Statements of Comprehensive Income	4
Statements of Cash Flows	5
Notes to Financial Statements	6 - 25

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Auditors' Report

To the Shareholders of
Migao Corporation

We have audited the consolidated balance sheets of Migao Corporation as at September 30, 2007 and 2006 and the consolidated statements of operations and retained earnings, comprehensive income and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Signed: *"Moore Stephens Cooper Molyneux LLP"*

**Chartered Accountants
Licensed Public Accountants**

Toronto, Ontario
November 9, 2007

Migao Corporation

Consolidated Balance Sheets

September 30, 2007 and 2006

(in Canadian dollars)

	2007	2006
Assets		
Current assets		
Cash and cash equivalents	\$ 17,452,952	\$ 16,315,835
Accounts receivable	6,372,852	4,435,769
Prepayments, deposits and other receivables (note 3)	10,613,761	4,891,382
Inventory (note 4)	19,101,408	3,947,193
Income taxes receivable (note 6)	1,159,283	-
	54,700,256	29,590,179
Plant and equipment (note 6)	20,517,788	13,464,499
Construction in progress	5,971,902	6,203,587
Land use rights (note 7)	18,366,905	7,828,983
Future income tax assets, net (note 12)	470,000	-
	\$ 100,026,851	\$ 57,087,248
Liabilities		
Current liabilities		
Bank indebtedness (note 8)	\$ 4,578,150	\$ 1,410,000
Accounts payable and accrued liabilities (note 7)	9,957,740	5,213,106
Customer deposits	3,450,214	2,965,101
Due to related party (note 5)	45,387	530,672
Income taxes payable	-	109,308
	18,031,491	10,228,187
Shareholders' equity		
Share capital (note 9)	54,013,269	28,729,591
Contributed surplus (note 9)	8,550,992	2,955,592
Retained earnings (note 10)	26,527,076	15,320,755
Accumulated other comprehensive income (loss) (note 11)	(7,095,977)	(146,877)
	81,995,360	46,859,061
Commitments (note 15)		
Subsequent event (note 18)		
	\$ 100,026,851	\$ 57,087,248

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

Approved on behalf of the Board of Directors

Signed by "Guocai Liu" _____

Director

Signed by "Michael Manley" _____

Director

Migao Corporation

Consolidated Statements of Operations and Retained Earnings

For the years ended September 30, 2007 and 2006

(in Canadian dollars)

	2007	2006
Revenues	\$ 101,803,592	\$ 58,349,473
Cost of goods sold (note 6)	80,263,341	44,599,078
Gross profit	21,540,251	13,750,395
Operating expenses		
Selling	4,030,261	2,019,132
General and administrative (note 6 and 7)	3,312,954	1,883,841
Professional and consulting	972,028	499,651
Stock-based compensation	908,258	370,305
Pre-operating costs	367,804	-
Finance costs	287,577	-
	9,878,882	4,772,929
Income from operations	11,661,369	8,977,466
Other income	202,229	50,246
Income before income taxes	11,863,598	9,027,712
Provision for income taxes (note 12)	657,277	430,150
Net income for the period	11,206,321	8,597,562
Retained earnings, beginning of period	15,320,755	6,723,193
Retained earnings, end of period	\$ 26,527,076	\$ 15,320,755
Income per share: (note 13)		
Basic	\$ 0.33	\$ 0.37
Diluted	\$ 0.32	\$ 0.37
Weighted average number of common shares outstanding: (note 13)		
Basic	33,479,987	23,539,842
Diluted	35,074,923	23,555,094

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

Migao Corporation

Consolidated Statements of Comprehensive Income

For the years ended September 30, 2007 and 2006

(in Canadian dollars)

	2007	2006
Net income	\$ 11,206,321	\$ 8,597,562
Other comprehensive income (loss), net of tax:		
Unrealized losses on translating financial statements of self-sustaining foreign operations	(6,949,100)	(4,489)
Comprehensive income	\$ 4,257,221	\$ 8,593,073

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

Migao Corporation

Consolidated Statements of Cash Flows

For the years ended September 30, 2007 and 2006
(in Canadian dollars)

	2007	2006
Cash flows from operating activities		
Cash receipts from customers	\$ 99,042,119	\$ 60,158,788
Cash paid to suppliers and employees	(108,443,338)	(51,454,033)
Income taxes paid	(489,421)	(320,842)
Interest paid	(273,977)	(55,813)
Interest received	126,527	50,246
	(10,038,090)	8,378,346
Cash flows from investing activities		
Purchase of plant and equipment	(12,386,635)	(5,580,367)
Construction in process	(145,159)	(3,539,266)
Payments for land use rights	(8,926,672)	(2,946,440)
	(21,458,466)	(12,066,073)
Cash flows from financing activities		
Proceeds from bank loan	3,168,150	1,410,000
Advances from (repayment to) related parties, net	(505,297)	268,808
Issuance of common shares, net	22,993,040	15,869,183
Proceeds from exercise of underwriters' compensation options	1,565,256	-
Proceeds from exercise of warrants	5,127,524	-
Proceeds from exercise of stock options	285,000	-
	32,633,673	17,547,991
Increase in cash and cash equivalents	1,137,117	13,860,264
Cash and cash equivalents, beginning of year	16,315,835	2,455,571
Cash and cash equivalents, end of year	\$ 17,452,952	\$ 16,315,835
Cash and cash equivalents consist of:		
Cash on hand	\$ 14,398,901	\$ 12,112,572
Term deposit	40,000	40,000
Bank notes	3,014,051	4,163,263
	\$ 17,452,952	\$ 16,315,835

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

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

1. Nature of Operations

Nature of Operations

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

The Company

Migao holds 100% of the issued and outstanding capital of H.K. Migao Industry Limited ("HK Migao"), which in turns holds 100% of the issued and outstanding capital of Sichuan Migao Chemical Fertilizer Industry Co., Ltd. ("Sichuan Migao"), Guangdong Migao Chemical Co., Ltd. ("Guangdong Migao"), Liaoning Migao Chemical Co., Ltd. ("Liaoning Migao"), Migao Chemical Industry (Shanghai) Co., Ltd. ("Shanghai Migao") and Migao Chemical (Changchun) Co., Ltd. ("Changchun Migao") (collectively, the "Subsidiaries").

2. Significant Accounting Policies

Basis of presentation

These 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.

Cash equivalents

For the purpose of the consolidated statements of cash flows, the Company considers cash equivalents to be cash and highly liquid investments with original maturities of three months or less.

Inventory

Raw materials are valued at the lower of cost and replacement cost. Finished goods are valued at the lower of cost and net realizable value. The cost of finished goods comprises direct materials and, where applicable, direct labor costs and overhead costs. Cost is determined using the weighted-average method. Net realizable value represents the anticipated selling price less all further costs for distribution.

Plant and equipment

Plant and equipment are recorded at cost. Amortization is provided over the expected useful lives of the plant and equipment with a 10% residual value using the following methods and annual rates:

Building and improvements	-	20 years straight line
Machinery and equipment	-	10 years straight line
Vehicles	-	5 years straight line
Office equipment	-	5 years straight line

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

2. Significant Accounting Policies - continued

Construction in progress

Construction in progress represents properties under construction and is stated at cost. Construction in progress is not amortized until such time as the assets are completed and put into operational use.

Land use rights

Land use rights are recorded at cost and are amortized over 50 to 70 years, which are the terms of the land use rights set by the Chinese government.

Impairment of long-lived assets

Long-lived assets held for use are reviewed for impairment when events or changes in circumstances indicate that their carrying value may not be recoverable. When the carrying value is not recoverable from future cash flows on an undiscounted basis and the carrying value exceeds the assets' fair value, an impairment loss is recorded for the excess of carrying value over fair value.

Income taxes

The Company uses the liability method of accounting for income taxes. Under this method, income tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on income tax assets and liabilities is reflected in operations in the period in which the change occurs. Valuation allowances are established when necessary to reduce future tax assets to the amount expected to be realized.

Income per share

Basic income per share is computed using the weighted average number of common shares outstanding during the year. Diluted income per share is computed giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares using the treasury stock method, except when their effect would be anti-dilutive. The treasury stock method assumes that proceeds received from the exercise of stock options and warrants are used to repurchase common shares at the prevailing market rate.

Revenue recognition

Revenue is recognized when goods are shipped and all significant risks and rewards of ownership passed to the customer with collection of revenue reasonably assured. Payments received in advance for orders that do not yet qualify for recognition under the Company's policies are recorded as customer deposits.

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

2. Significant Accounting Policies - continued

Pre-operating costs

All expenditures incurred prior to the commencement of commercial operations are expensed.

Foreign exchange

The Company's functional currency is the Canadian dollar and the Subsidiaries' functional currency is the Chinese Renminbi ("RMB"). The accounts of the Subsidiaries are translated into Canadian dollars using the current rate method. Under this method, assets and liabilities are translated at the year end rate of exchange. Revenues and expenses are translated into Canadian dollars at the average rate of exchange for the period. Exchange gains and losses from foreign currency translations are recorded in shareholders' equity as other comprehensive income.

Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recent Canadian accounting pronouncements

Inventories

In June 2007, the Canadian Institute of Chartered Accountants ("CICA") released new Handbook Section 3031, "Inventories", replacing Section 3030, effective for annual and interim periods for fiscal years beginning on or after January 1, 2008. This Section provides guidance on the determination of cost and its 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.

The Company is currently evaluating the impact of this new handbook section on the consolidated financial statements and will adopt the sections commencing fiscal 2008.

Financial Instruments – Disclosures and Presentation

In December 2006, the CICA released new Handbook Section 3862, "Financial Instruments - Disclosures", and Section 3863, "Financial Instruments - Presentation", replacing Section 3861, effective for annual and interim periods for fiscal years beginning on or after October 1, 2007.

Section 3862 is to require entities to provide disclosures in their financial statements that enable users to evaluate:

- (a) the significance of financial instruments for the entity's financial position and performance; and
- (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks.

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

2. Significant Accounting Policies - continued

Recent Canadian accounting pronouncements - continued

Financial Instruments – Disclosures and Presentation - continued

Section 3863 is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. This Section establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset.

The Company is currently evaluating the impact of these new handbook sections on the consolidated financial statements and will adopt the sections commencing fiscal 2008.

Accounting policy changes including initial adoption

Effective October 1, 2006, the Company implemented the new CICA accounting sections: 3855 (Financial Instruments – Recognition and Measurement), 3861 (Financial Instruments – Disclosure and Presentation), 3865 (Hedges), and 1530 (Comprehensive Income). These new accounting policy changes have been implemented prospectively with no restatement of comparative financial statements, except as noted below.

Comprehensive income includes net income and other comprehensive income. It is defined as the change in equity (net assets) of a company during the period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during the period except those resulting from investments by owners and distributions to owners. The only item included in other comprehensive income is the foreign currency translation of self-sustaining foreign operations. As a result, the previously recorded currency translation account on the consolidated balance sheets' shareholders' equity section has been eliminated and included as "accumulative other comprehensive income" in shareholders' equity. Furthermore, the gain (or loss) from translating the Company's self-sustaining foreign operations is now recorded as other comprehensive income. Prior years financial statements have been restated to reflect this change. The Company's earnings per share presented on the consolidated statements of income is based upon its net income and not comprehensive income.

The adoption of sections 3855, 3861 and 3865 had no impact on the Company's financial statements.

3. Prepayments, Deposits, and Other Receivables

	2007	2006
Prepayments for raw materials	\$ 7,478,368	\$ 2,689,982
Prepayments for construction costs	903,810	1,416,103
Prepayment for transportation services	22,968	1,390
Deposits for the supply of utilities	150,965	252,816
VAT receivable	582,526	347,177
Other receivables and deposits	1,475,124	183,914
	\$ 10,613,761	\$ 4,891,382

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

4. Inventory

	2007	2006
Raw materials	\$ 13,930,933	\$ 3,670,084
Finished goods	1,075,089	213,129
Packing materials	89,818	63,980
Goods in transit	4,005,568	-
	\$ 19,101,408	\$ 3,947,193

5. Related Party Balances

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

	2007	2006
Amount due to:		
Liaoning Yongcheng Economic and Trade Development Co. Ltd. ("LYEDC")	\$ 45,387	\$ 530,672

Migao and LYEDC are related due to common control. The amounts are non-interest bearing and due on demand. Payments in the amount of \$485,285 were made to LYEDC in paying off the balance owing.

6. Plant and Equipment

	2007		
	Cost	Accumulated Amortization	Net Book Value
Buildings and improvements	\$ 10,684,094	\$ 701,107	\$ 9,982,987
Machinery and equipment	11,984,245	2,180,777	9,803,468
Vehicles	793,580	288,699	504,881
Office equipment	337,561	111,109	226,452
	\$ 23,799,480	\$ 3,281,692	\$ 20,517,788
	2006		
	Cost	Accumulated Amortization	Net Book Value
Buildings and improvements	\$ 6,708,599	\$ 352,976	\$ 6,355,623
Machinery and equipment	7,812,532	1,202,871	6,609,661
Vehicles	477,459	184,680	292,779
Office equipment	273,120	66,684	206,436
	\$ 15,271,710	\$ 1,807,211	\$ 13,464,499

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

6. Plant and Equipment - continued

Amortization expense for the year ended September 30, 2007 was \$1,719,825 (September 30, 2006 - \$841,137) and is included in cost of goods sold and general and administrative expense.

On June 11, 2007, Guangdong Migao was approved by the local tax authority for tax credits totalling \$1,383,394 (RMB 10,424,975) on purchases of domestic equipment during calendar year 2006. Sichuan Migao was also approved for tax credits of \$369,797 (RMB 2,786,714) and value-added tax refund of \$210,962 (RMB 1,589,770). These credits and value-added tax refund were recorded to reduce the cost of equipment and the tax credits will be applied against profit taxes levied to Guangdong Migao and Sichuan Migao.

7. Land Use Rights

	2007	2006
Land use rights	\$ 18,596,769	\$ 7,859,142
Less: accumulated amortization	229,864	30,159
	\$ 18,366,905	\$ 7,828,983

As of September 30, 2007, the Company had sixteen land leases from the Chinese government with terms of fifty to seventy years.

Amortization expense for the year ended September 30, 2007 was \$223,816 (September 30, 2006 - \$11,177) and is included in general and administrative expense.

As of September 30, 2007, the Company had not obtained the land use right certificates for eight of the land leases and approximately \$4.7 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.

8. Bank Indebtedness

At September 30, 2007, the Company has short-term bank loans outstanding totaling \$4,578,150 (RMB 34.5 million) (September 30, 2006 - \$1,410,000 or RMB 10 million) for working capital purposes.

<u>Amount</u>	<u>Due Date</u>	<u>Interest per annum</u>	<u>Secured by</u>
\$ 663,500	February 20, 2008	6.7095%	certain land use rights
\$ 663,500	April 16, 2008	6.7095%	certain land use rights
\$ 1,327,000	May 29, 2008	6.57%	certain land use rights
\$ 1,924,150	August 20, 2008	6.9084%	certain land use rights and buildings

Total carrying value of security was \$4,149,062 (RMB 31,266,483). Total interest paid during the year amounted to \$273,977 (2006 - \$55,813).

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

9. Share Capital

(a) **Authorized:**

Unlimited common shares without par value.

(b) **Issued common shares**

	Number of Shares	Amount
Balance – September 30, 2005	-	\$ -
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	-	(2,265,367)
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
Balance - September 30, 2006	29,111,921	\$ 28,729,591
Issued on exercise of underwriters' compensation options (iv)	53,449	152,330
Fair value of underwriters' compensation options (iv)		58,259
Fair value of warrants issued (iv)		(24,854)
Issued on exercise of underwriters' compensation options (v)	10,000	28,500
Fair value of underwriters' compensation options (v)	-	10,900
Fair value of warrants issued (v)	-	(12,900)
Issued on exercise of underwriters' compensation options (vi)	90,000	256,500
Fair value of underwriters' compensation options (vi)		98,100
Fair value of warrants issued (vi)		(58,950)
Issued on exercise of underwriters' compensation options (vii)	12,271	34,972
Fair value of underwriters' compensation options (vii)		13,375
Fair value of warrants issued (vii)		(8,283)
Exercise of warrants (viii)	1,063,941	3,936,582
Fair value of warrants exercised (viii)	-	702,201
Issued pursuant to a private placement at \$4.15 per share (ix)	6,025,000	25,003,750
Share issuance costs (ix)	-	(2,010,710)
Fair value of warrants issued on private placement (ix)	-	(5,512,875)
Fair value of underwriters' compensation options issued (ix)	-	(704,925)
Sub-total	36,366,582	\$ 50,691,563

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

9. Share Capital - continued

(b) Issued common shares - continued	Number of Shares	Amount
Balance forward	36,366,582	\$ 50,691,563
Issued on exercise of underwriters' compensation options (x)	75,312	312,545
Fair value of underwriters' compensation options (x)		176,230
Fair value of warrants issued (x)		(77,571)
Issued on exercise of underwriters' compensation options (xi)	178,164	507,767
Fair value of underwriters' compensation options (xi)		194,199
Fair value of warrants issued (xi)		(128,278)
Issued on exercise of underwriters' compensation options (xii)	88,164	251,267
Fair value of underwriters' compensation options (xii)		96,099
Fair value of warrants issued (xii)		(62,156)
Issued on exercise of underwriters' compensation options (xiii)	5,000	14,250
Fair value of underwriters' compensation options (xiii)		5,450
Fair value of warrants issued (xiii)		(3,400)
Issued on exercise of underwriters' compensation options (xiv)	2,500	7,125
Fair value of underwriters' compensation options (xiv)		2,725
Fair value of warrants issued (xiv)		(1,700)
Exercise of warrants (xv)	224,706	1,190,942
Fair value of warrants exercised (xv)	-	411,212
Issued on exercise of stock options (xvi)	100,000	285,000
Fair value of stock options exercised (xvi)	-	140,000
Balance - September 30, 2007	37,040,428	\$ 54,013,269

(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 of 2 years.

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

9. Share Capital - continued

(b) Issued common shares - continued

(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 two years from the closing date. Each agent compensation unit is comprised of one common share and one-half of one common share purchase 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 of 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.

(iv) Each of the 53,449 underwriters' compensation options exercised consisted of 1 common share and ½ common share purchase warrant. The fair value of options were estimated using the Black-Scholes option pricing model to be \$1.09 per option. The warrants issued on the exercise of these options are valued at \$0.93 per warrant with the following assumptions: dividend yield 0%; risk-free interest rate 4.08%; expected volatility 66%; and expected life of 1.6 years.

(v) Each of the 10,000 underwriters' compensation options exercised consisted of 1 common share and ½ common share purchase warrant. The fair value of options were estimated using the Black-Scholes option pricing model to be \$1.09 per option. The warrants issued on the exercise of these options are valued at \$2.58 per warrant with the following assumptions: dividend yield 0%; risk-free interest rate 4.10%; expected volatility 106%; and expected life of 1.3 years.

(vi) Each of the 90,000 underwriters' compensation options exercised consisted of 1 common share and ½ common share purchase warrant. The fair value of options were estimated using the Black-Scholes option pricing model to be \$1.09 per option. The warrants issued on the exercise of these options are valued at \$1.31 per warrant with the following assumptions: dividend yield 0%; risk-free interest rate 4.18%; expected volatility 108%; and expected life of 1.1 years.

(vii) Each of the 12,271 underwriters' compensation options exercised consisted of 1 common share and ½ common share purchase warrant. The fair value of options were estimated using the Black-Scholes option pricing model to be \$1.09 per option. The warrants issued on the exercise of these options are valued at \$1.35 per warrant with the following assumptions: dividend yield 0%; risk-free interest rate 4.69%; expected volatility 108%; and expected life of 0.92 years.

(viii) During the year ended September 30, 2007, 1,063,941 of the common share purchase warrants issued in relation to the private placement financing on May 18, 2006 were exercised at \$3.70 per share. The warrants were valued at \$0.66 per warrant using the following assumptions: dividend yield 0%; risk-free interest rate 4%; expected volatility 66%; and expected life of 2 years.

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

9. Share Capital - continued

(b) Issued common shares - continued

(ix) On February 22, 2007 (the “closing date”), the Company completed a private placement of 6,025,000 units priced at \$4.15 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 \$5.30 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 \$1.83 per warrant. Assumptions used to determine the value of the warrants were: dividend yield 0%; risk-free interest rate 4.11%; expected volatility 106%; and expected life of 2 years. In addition to the agency fee of \$1,750,263 paid in cash, the Company granted compensation options entitling the agents to acquire 301,250 compensation units at price of \$4.15 per unit within two years from the closing date. Each compensation unit comprises of one common share and one-half warrant. Each whole warrant entitles the agent to acquire one common share on payment of \$5.30 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 \$2.34 per option. Assumptions used to determine the value of the compensation options were: dividend yield 0%; risk-free interest rate 4.11%; expected volatility 106%; and expected life of 2 years.

(x) Each of the 75,312 underwriters’ compensation options exercised consisted of 1 common share and ½ common share purchase warrant. The fair value of options were estimated using the Black-Scholes option pricing model to be \$2.34 per option. The warrants issued on the exercise of these options are valued at \$2.06 per warrant with the following assumptions: dividend yield 0%; risk-free interest rate 4.71%; expected volatility 110%; and expected life of 1.6 years.

(xi) Each of the 178,164 underwriters’ compensation options exercised consisted of 1 common share and ½ common share purchase warrant. The fair value of options were estimated using the Black-Scholes option pricing model to be \$1.09 per option. The warrants issued on the exercise of these options are valued at \$1.44 per warrant with the following assumptions: dividend yield 0%; risk-free interest rate 4.68%; expected volatility 110%; and expected life of 0.85 years.

(xii) Each of the 88,164 underwriters’ compensation options exercised consisted of 1 common share and ½ common share purchase warrant. The fair value of options were estimated using the Black-Scholes option pricing model to be \$1.09 per option. The warrants issued on the exercise of these options are valued at \$1.41 per warrant with the following assumptions: dividend yield 0%; risk-free interest rate 4.68%; expected volatility 110%; and expected life of 0.83 years.

(xiii) Each of the 5,000 underwriters’ compensation options exercised consisted of 1 common share and ½ common share purchase warrant. The fair value of options were estimated using the Black-Scholes option pricing model to be \$1.09 per option. The warrants issued on the exercise of these options are valued at \$1.36 per warrant with the following assumptions: dividend yield 0%; risk-free interest rate 4.68%; expected volatility 110%; and expected life of 0.82 years.

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

9. Share Capital - continued

(b) Issued common shares - continued

(xiv) Each of the 2,500 underwriters' compensation options exercised consisted of 1 common share and ½ common share purchase warrant. The fair value of options were estimated using the Black-Scholes option pricing model to be \$1.09 per option. The warrants issued on the exercise of these options are valued at \$1.36 per warrant with the following assumptions: dividend yield 0%; risk-free interest rate 4.27%; expected volatility 110%; and expected life of 0.68 years.

(xv) During the year ended September 30, 2007, 224,706 of the common share purchase warrants issued in relation to the private placement financing on February 22, 2007 were exercised at \$5.30 per share. The warrants were valued at \$1.83 per warrant using the following assumptions: dividend yield 0%; risk-free interest rate 4.11%; expected volatility 106%; and expected life of 2 years.

(xvi) During the year ended September 30, 2007, 100,000 of the common share purchase options issued to the employees and directors of the Company were exercised by a former director of the Company at a price of \$2.85 per common share. The stock options were valued at \$1.40 per stock option using the following assumptions: dividend yield 0%; risk-free interest rate 4%; expected volatility 66%; and expected life of 5 years.

(c) Contributed surplus

	Amount
Balance – September 30, 2005	\$ -
Conversion of note payable in HK Migao	9,164,099
Elimination on consolidation	(9,164,099)
Stock-based compensation expense	370,305
Compensation options to brokers	485,497
Warrants issuance on private placement	2,099,790
Balance - September 30, 2006	\$ 2,955,592
Fair value of exercised underwriters' compensation options	(655,337)
Fair value of warrants issued on the exercise of underwriters' compensation options	378,092
Stock-based compensation expense	908,258
Fair value of warrants exercised	(1,113,413)
Fair value of private placement warrants	5,512,875
Fair value of underwriters' compensation options	704,925
Fair value of stock options exercised	(140,000)
Balance - September 30, 2007	\$ 8,550,992

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

9. Share Capital - continued

(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 options to acquire 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 Black-Scholes option valuation model, used by the Company to determine fair values, was developed for use in estimating the fair value of freely traded options. This model requires the input of highly subjective assumptions including future stock price volatility and expected time until exercise. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing model does not necessarily provide a reliable single measure of the fair value of the Company's stock options granted during the year.

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

	Options	Weighted average exercise price
Outstanding – September 30, 2005	-	\$ -
Granted during the year	1,165,000	2.85
Outstanding - September 30, 2006	1,165,000	\$ 2.85
Granted during the year	120,000	8.08
Exercised during the year	(100,000)	2.85
Outstanding – September 30, 2007	1,185,000	\$ 3.38

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

As of September 30, 2007

Exercise price	Number outstanding	Weighted average remaining contractual life (years)	Number exercisable
\$2.85	1,065,000	3.63	288,333
\$7.69	60,000	4.75	NIL
\$8.46	60,000	4.75	NIL
\$3.38	1,185,000	3.75	288,333

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

9. Share Capital - continued

(d) Stock options - continued

During the year ended September 30, 2006, 1,165,000 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. Assumptions used to determine the value of the options were: dividend yield 0%; risk-free interest rate 4%; expected volatility 66%; and expected life of 5 years. Stock-based compensation expense on these options for the year ended September 30, 2007 was \$791,849 (September 30, 2006 - \$370,305).

During the year ended September 30, 2007, 60,000 options were issued to a director of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$7.69 per common share. These options have vesting periods of up to three years and an exercise period of up to five years, expiring on June 27, 2012. The fair value of the options issued was estimated using the Black-Scholes option pricing model on the date of issue to be \$6.14 per option. Assumptions used to determine the value of the options were: dividend yield 0%; risk-free interest rate 4.5%; expected volatility 108%; and expected life of 5 years. Stock-based compensation expense on these options for the year ended September 30, 2007 was \$58,579 (2006 – NIL).

During the year ended September 30, 2007, 60,000 options were issued to employees of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$8.46 per common share. These options have vesting periods of up to three years and an exercise period of up to five years, expiring on June 27, 2012. The fair value of the options issued was estimated using the Black-Scholes option pricing model on the date of issue to be \$6.06 per option. Assumptions used to determine the value of the options were: dividend yield 0%; risk-free interest rate 4.5%; expected volatility 108%; and expected life of 5 years. Stock-based compensation expense on these options for the year ended September 30, 2007 was \$57,830 (2006 – NIL).

(e) Warrants

As at September 30, 2007 and 2006, the following share purchase warrants were outstanding:

September 30, 2006	Issued	Exercised	Expired	September 30, 2007	Exercise Price	Expiry Date
3,181,500	219,774	1,063,941	-	2,337,333	\$ 3.70	May 18, 2008
-	3,050,156	224,706	-	2,825,450	\$ 5.30	February 22, 2009
3,181,500	3,269,930	1,288,647	-	5,162,783		

September 30, 2005	Issued	Exercised	Expired	September 30, 2006	Exercise Price	Expiry Date
-	3,181,500	-	-	3,181,500	\$ 3.70	May 18, 2008

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

9. Share Capital - continued

(f) Underwriters' Compensation Options

As at September 30, 2007 and 2006, the following underwriters' compensation options were outstanding:

September 30, 2006 (outstanding and exercisable)	Issued	Exercised	Expired	September 30, 2007 (outstanding and exercisable)	Exercise Price	Weighted average remaining contractual life (years)
445,410	-	439,548	-	5,862	\$ 2.85	0.63
-	301,250	75,312	-	225,938	\$ 4.15	1.40
445,410	301,250	514,860	-	231,800	\$ 4.12	1.38

September 30, 2005 (outstanding and exercisable)	Issued	Exercised	Expired	September 30, 2006 (outstanding and exercisable)	Exercise Price	Weighted average remaining contractual life (years)
-	445,410	-	-	445,410	\$ 2.85	1.55

10. 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 September 30, 2007 was \$2,283,903 (RMB 17,211,024; September 30, 2006 – \$444,674 or RMB 3,153,714).

11. Accumulated Other Comprehensive Income

Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations:

	2007	2006
Balance – beginning of year	\$ (146,877)	\$ (142,388)
Unrealized foreign currency translation losses during the period	(6,949,100)	(4,489)
Balance – end of year	\$ (7,095,977)	\$ (146,877)

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

12. Income Tax

The components of income before income taxes are as follows:

	2007	2006
Pre-tax income (loss) from operations:		
Canada	\$ (2,708,938)	\$ (936,662)
Foreign - China	14,572,536	9,964,374
	\$ 11,863,598	\$ 9,027,712

The provision for income taxes consists of the following:

	2007	2006
Income taxes for operations:		
Current		
Foreign - China	\$ 1,127,277	\$ 430,150
Future		
Foreign - China	(470,000)	-
	\$ 657,277	\$ 430,150

The subsidiaries are governed by the Income Tax Laws of the PRC concerning Foreign Investment Enterprises and various local income tax laws. Pursuant to the relevant laws and regulations in the PRC, the subsidiaries are subject to income tax at an effective rate of 18% to 28% on income as reported in their statutory financial statements. The subsidiaries are entitled to a full exemption from PRC income tax for two years starting from their first profitable year and a 50% exemption from PRC income tax for three years starting two years after the first profitable year.

Each subsidiary maintains a December 31st year end for tax purposes. Sichuan received a full exemption from tax for the years ended December 31, 2004 and 2005 having incurred a loss in its first year of operations being December 31, 2003. Sichuan also received a 50% exemption from tax for the year ended December 31, 2006. Guangdong received a full exemption from tax for the years ended December 31, 2005 and 2006 having incurred a loss in its first year of operations being December 31, 2004. Liaoning received a full exemption from tax for the year ending December 31, 2006 and is expected to receive a full exemption from tax for the year ending December 31, 2007 having incurred a loss in the first year of operations being December 31, 2005. Shanghai and Changchun are expected to receive full exemptions from tax for the years ending December 31, 2008 and 2009. As a result of their operating results, the Subsidiaries will be eligible for the 50% exemption from tax as follows: Sichuan for the years ending December 31, 2007 and 2008; Guangdong for the years ending December 31, 2007 through 2009; Liaoning for the years ending December 31, 2008 through 2010; and Shanghai Changchun for the years ending December 31, 2010 through 2012.

The Company (legal parent) is governed by the Income Tax Act of Canada. It is not anticipated to incur income taxes as no operational revenue is to be generated.

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

12. Income Tax - continued

Income tax expense varies from the amount by applying the combined Canadian federal and provincial tax rate of 36.12% (2006 – 36.12%) to income before income taxes as follows:

	2007	2006
Pre-tax income from continuing operations:	\$ 11,863,598	\$ 9,027,712
Income taxes at combined Canadian tax rate	\$ 4,285,132	\$ 3,260,810
Increase (decrease) in income taxes resulting from:		
Lower tax rates on earnings of foreign subsidiaries	(3,955,918)	(3,168,982)
Non-deductible expenses	328,063	133,754
Change in valuation allowance	-	204,568
	\$ 657,277	\$ 430,150

A summary of the future income tax assets is as follows:

	2007	2006
Future income tax assets:		
Plant and equipment and land use rights	\$ 380,000	\$ -
Other timing differences	90,000	-
Loss carryforwards	1,043,000	403,099
	1,513,000	403,099
Less: Valuation allowance	1,043,000	403,099
Total future income tax assets	470,000	-
Future income tax liabilities:	-	-
Net future income tax assets	\$ 470,000	\$ -

The Company has established the above valuation allowances as of September 30, 2007 due to the uncertainty of future realization of future income tax assets. At September 30, 2007, the Company has approximately \$4,003,000 of non-capital loss carry-forward in Canada. The utilization of the loss is uncertain therefore a valuation allowance has been applied and no future income tax asset is set up for these losses. These losses expire as follows:

2027	\$ 1,116,000
2028	<u>2,887,000</u>
Total	<u>\$ 4,003,000</u>

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

13. Earnings per Share

The following table sets forth the computation of basic and diluted earnings per common share for the years ended September 30:

	2007	2006
Numerator:		
Income attributable to common shareholders – basic and diluted	\$ 11,206,321	\$ 8,597,562
Denominator:		
Weighted-average common shares outstanding - basic	33,479,987	23,539,842
Effect of dilutive securities:		
Warrants	1,008,144	-
Stock options	544,374	-
Underwriters' compensation options	42,418	15,252
Weighted-average common shares outstanding - diluted	35,074,923	23,555,094
Basic earnings per common share	\$ 0.33	\$ 0.37
Diluted earnings per common share	\$ 0.32	\$ 0.37

For the year ended September 30, 2007, approximately 120,000 potentially dilutive stock options were excluded from the computation of weighted-average number of diluted common shares outstanding, as the applicable exercise prices were greater than the average market price of the Company's common shares for the year.

For the year ended September 30, 2006, approximately 3,181,500 potentially dilutive warrants were excluded from the computation of weighted-average number of diluted common shares outstanding, as the applicable exercise prices were greater than the average market price of the Company's common shares for the year.

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

14. 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.

Geographical information:

2007	Canada	China	Total
		(000's)	
Sales from operations	\$ NIL	\$ 101,804	\$ 101,804
Net income (loss)	\$ (2,709)	\$ 13,915	\$ 11,206
Total assets	\$ 242	\$ 99,785	\$ 100,027
Plant and equipment, land use rights and construction in progress	\$ NIL	\$ 44,857	\$ 44,857

2006	Canada	China	Total
		(000's)	
Sales from operations	\$ NIL	\$ 58,349	\$ 58,349
Net income (loss)	\$ (936)	\$ 9,964	\$ 8,598
Total assets	\$ 75	\$ 57,012	\$ 57,087
Plant and equipment, land use rights and construction in progress	\$ NIL	\$ 27,497	\$ 27,497

15. Commitments

Purchase commitments for raw materials and supplies in the amount of \$2.4 million (RMB 18 million) exist as of September 30, 2007 (September 30, 2006 - \$611,667 or RMB 4.3 million). These contracts are entered into in the normal course of business.

Commitments on capital expenditures in the amount of \$3.9 million (RMB 29 million) exist as of September 30, 2007 (September 30, 2006 - \$3,004,343 or RMB 21.3 million). These contracts are entered into in the normal course of business.

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

15. Commitments - continued

The Company signed an office lease on August 14, 2006. The term of the lease is five years from October 1, 2006. The lease obligations are reflected in the following table on a fiscal year basis.

2008	\$	70,194
2009		71,163
2010		72,132
2011		<u>73,101</u>
Total	\$	<u>286,590</u>

16. Financial Instruments

Fair value

The carrying amount of accounts receivable, other receivables, bank indebtedness, accounts payable and accrued liabilities approximates their fair value because of the short-term maturities of these items. The fair value of the amount due to related parties are not readily determinable due to the related party nature of the advances.

Credit risk

Under PRC business custom, the Company is required to pay deposits on most of their purchases and demands deposits on most of their sales other than those with the government, who is one of the significant customers of the Company. Consequently, exposure to credit risk is limited accordingly.

Currency risk

The Company is exposed to currency risk as the Company's business is carried out in RMB and the Company maintains RMB denominated bank accounts but uses Canadian dollars as its reporting currency. Unfavorable changes in the exchange rate between RMB and Canadian dollars may result in a material effect on the cumulative translation adjustment recorded as a charge in shareholders' equity. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

In addition, the RMB is not a freely convertible currency. The Company's subsidiaries are allowed to pay outstanding current account obligations in foreign currency but must present the proper documentation to a designated foreign exchange bank. There is not certainty that all future local currency can be repatriated.

Commodity price risk

The Company uses various commodity raw materials in the manufacture of chemical fertilizer. Commodity prices are subject to volatile price changes resulting from a variety of factors including international economic trends, global and regional demand, interest rates, global and regional consumption patterns. Accordingly, the Company is exposed to market risk from fluctuating market prices of certain raw materials. In addition, the Company is also exposed to market price risk on other inputs such as electricity and natural gas. The Company is currently not involved in any arrangement to mitigate the risk.

Migao Corporation

Notes to Consolidated Financial Statements

September 30, 2007 and 2006

(in Canadian dollars)

17. Economic Dependence

During 2007, two customers individually comprised 56% and 6% of revenue and two suppliers individually accounted for 37% and 16% of total purchases. At September 30, 2007, three customers individually represented 19%, 18% and 18% of total accounts receivable and two suppliers represented 36% and 19% of total accounts payable.

During 2006, two customers individually comprised 48% and 10% of revenue and two suppliers individually accounted for 41% and 19% of total purchases. At September 30, 2006, two customers individually represented 46% and 15% of total accounts receivable and one supplier represented 57% of total accounts payable.

18. Subsequent Event

Subsequent to September 30, 2007 and as of December 3, 2007, 235,590 warrants were exercised for gross proceeds of \$1,126,403.