

# **Migao Corporation**

## **Management Discussion and Analysis**

**First Quarter, Fiscal 2008  
Ended December 31, 2007**

Prepared by Management  
(Unaudited)

February 11, 2008

The following is Management's Discussion and Analysis ("MD&A") of the financial condition of Migao Corporation (the "Company" or "Migao") and the financial performance for the three months ended December 31, 2007. This discussion and analysis should be read in conjunction with the unaudited Interim Consolidated Financial Statements and related notes as at and for the period ended December 31, 2007 and the audited Consolidated Financial Statements and related notes as at and for the period ended September 30, 2007. Reference should also be made to the Company's filings with Canadian securities regulatory authorities which are available at [www.sedar.com](http://www.sedar.com).

All amounts are in Canadian dollars unless otherwise noted and prepared in accordance with Canadian Generally Accepted Accounting Policies.

At December 31, 2007, the Company had 37,380,518 common shares outstanding. At February 11, 2008, the Company has 37,444,130 common shares outstanding.

### **Forward-Looking Information**

The statements made in this MD&A that are not historical facts contain forward-looking information that involves risk and uncertainties. All statements, other than statements of historical facts, which address Migao's expectations, should be considered forward-looking statements. Such statements are based on management's exercise of business judgment as well as assumptions made by and information currently available to management. When used in this document, the words "may", "will", "anticipate", "believe", "estimate", "expect", "intend" and words of similar import, are intended to identify any forward-looking statements. You should not place undue reliance on these forward-looking statements. These statements reflect our current view of future events and are subject to certain risks and uncertainties as contained in the Company's filings with Canadian securities regulatory authorities. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, our actual results could differ materially from those anticipated in these forward-looking statements to reflect events or circumstances after the date hereof, or to reflect the occurrence of any unanticipated events. Although we believe that our expectations are based on reasonable assumptions, we can give no assurance that our expectations will materialize. The forward-looking statements made in this MD&A describe our expectations as at February 11, 2008.

For a description of material factors that could cause our actual results to differ materially from the forward-looking statements in this MD&A, please see the Risk Factors section on page 12.

## **Overview**

Migao, through its wholly owned subsidiaries (referred herewith as “Sichuan Migao”, “Guangdong Migao”, “Liaoning Migao”, “Shanghai Migao”, “Changchun Migao” and “Tianjin Migao”), owns land and/or operates fertilizer production plants in various strategic locations in the People’s Republic of China (“PRC”) for the production and sales of specialty potash fertilizer (potassium nitrate and potassium sulphate), along with their by-products, to the Chinese domestic agricultural market. These fertilizers provide China’s economic crop (i.e. tobacco, fruit and vegetable) growers added opportunities for improving crop quality and increasing crop yield in an environmentally responsible manner, and contributing to the overall agricultural development of China.

China has few potash reserves and all are concentrated in the northwest where transportation costs to the economically developed eastern and southern coastal regions are prohibitive. Because of this shortage, the development of nitrogenous and phosphorous fertilizers in China has been rapid but the development of potash fertilizer has been slow, causing a usage imbalance. Migao is positioned to capitalize on the value added chemical fertilizer market in China.

In addition to measures based on Canadian generally accepted accounting principles (“GAAP”) in this MD&A, we use terms such as earnings before interest, taxes, depreciation and amortization (“EBITDA”) and EBITDA margin. EBITDA and EBITDA margin are not defined by GAAP, and our use of such terms or measurement of such items may vary from that of other companies. In this MD&A, we describe certain ‘income’ and ‘expense’ items that are unusual or non-recurring. These terms are not defined by GAAP. Our usage of these terms may vary from the usage adopted by other companies. We provide this detail so that readers have a better understanding of the significant events and transactions that have had an impact on our results.

## Consolidated Results of Operations

### *Consolidated Financial Performance*

<i>in thousands of Canadian dollars except per share and percentages data</i>	<i>Q1 2008</i>	<i>Q1 2007</i>	<i>% change</i>	<i>Q4 2007</i>	<i>% change</i>
<b>Gross revenue</b>	<b>24,680</b>	21,731	14%	25,496	(3%)
<b>Gross profit</b>	<b>5,840</b>	4,674	25%	4,246	38%
<b>Gross profit (% of revenue)</b>	<b>24%</b>	22%	9%	17%	41%
<b>Selected operating expenses:</b>					
<b>Selling</b>	<b>1,175</b>	980	20%	765	54%
<b>General and administrative</b>	<b>801</b>	746	7%	581	38%
<b>Stock-based compensation</b>	<b>227</b>	251	(10%)	226	-
<b>Professional</b>	<b>108</b>	211	(49%)	261	(59%)
<b>Finance costs</b>	<b>81</b>	-	NA	288	(72%)
<b>Pre-operating costs</b>	<b>17</b>	-	NA	368	(95%)
<b>Other income</b>	<b>41</b>	51	(20%)	72	(43%)
<b>Income taxes</b>	<b>371</b>	128	190%	(462)	(180%)
<b>Income taxes (% of revenue)</b>	<b>1.5%</b>	1%	50%	(2%)	(175%)
<b>Effective tax rate (% of income before taxes)</b>	<b>11%</b>	5%	120%	(25%)	(144%)
<b>Net income</b>	<b>3,100</b>	2,409	29%	2,292	35%
<b>Net income (% of revenue)</b>	<b>13%</b>	11%	18%	9%	44%
<b>EBITDA</b>	<b>3,991</b>	3,087	29%	2,214	80%
<b>EBITDA (% of revenue)</b>	<b>16%</b>	14%	14%	9%	78%
<b>Earnings per share (in \$):</b>					
<b>Basic</b>	<b>0.08</b>	0.08	-	0.06	33%
<b>Diluted</b>	<b>0.08</b>	0.08	-	0.06	33%

### *Quarterly Results*

<i>in thousands of Canadian dollars except per share and percentage data</i>	<i>Fiscal 2008</i>	<i>Fiscal 2007</i>				<i>Fiscal 2006</i>		
	<i>Q1</i>	<i>Q4</i>	<i>Q3</i>	<i>Q2</i>	<i>Q1</i>	<i>Q4</i>	<i>Q3</i>	<i>Q2</i>
<b>Sales</b>	<b>24,680</b>	25,496	26,865	27,712	21,731	15,434	15,426	15,100
<b>Gross profit</b>	<b>5,840</b>	4,246	6,339	6,281	4,674	3,626	3,113	4,310
<b>Gross profit (% of revenue)</b>	<b>24%</b>	17%	24%	23%	22%	23%	20%	29%
<b>Selected operating expenses:</b>								
<b>Selling</b>	<b>1,175</b>	765	950	1,335	980	592	193	771
<b>General and administrative</b>	<b>801</b>	581	968	1,018	746	694	545	367
<b>Stock-based compensation</b>	<b>227</b>	226	186	245	251	251	119	-
<b>Professional</b>	<b>108</b>	261	321	179	211	156	124	69
<b>Finance costs</b>	<b>81</b>	288	-	-	-	-	-	-
<b>Pre-operating costs</b>	<b>17</b>	368	-	-	-	-	-	-
<b>Other income</b>	<b>41</b>	72	44	35	51	10	36	2
<b>Income taxes</b>	<b>371</b>	(462)	791	200	128	112	161	157
<b>Income taxes (% of revenue)</b>	<b>1.5%</b>	(2%)	3%	1%	1%	1%	1%	1%
<b>Effective tax rate (% of income before taxes)</b>	<b>11%</b>	(25%)	20%	6%	5%	5%	7%	5%
<b>Net income</b>	<b>3,100</b>	2,292	3,167	3,338	2,409	1,956	2,006	2,949
<b>Net income (% of revenue)</b>	<b>13%</b>	9%	12%	12%	11%	13%	13%	20%
<b>EBITDA</b>	<b>3,991</b>	2,214	4,530	4,250	3,087	2,592	2,439	3,319
<b>EBITDA (% of revenue)</b>	<b>16%</b>	9%	17%	15%	14%	17%	16%	22%
<b>Earnings per share (in \$):</b>								
<b>Basic</b>	<b>0.08</b>	0.06	0.09	0.10	0.08	0.08	0.08	NA
<b>Diluted</b>	<b>0.08</b>	0.06	0.08	0.10	0.08	0.08	0.08	NA

**Revenues**

Revenues for the quarter ended December 31, 2007 increased by \$3.0 million (or 14%) and decreased by \$0.8 million (or 3%) compared with the same period last year and the previous quarter, respectively. The significant increases over the same period last year are mainly due to the expanded production capacity in both Sichuan and Guangdong facilities. The slight decrease in revenue compared to the previous quarter is due to differences in average foreign exchange rates between the two periods. Revenue in fact increased by RMB 2.6 million compared with the previous quarter with similar capacity. The run rate for the core products was at 260,000 tonnes as of December 31, 2007, compared with 200,000 tonnes as of September 30, 2007.

The following is a summary of the Company's facilities and production capacities as of December 31, 2007.

	<b>Core Product</b>	<b>Annual Capacity (tonnes)</b>	<b>By-Product</b>	<b>Annual Capacity (tonnes)</b>	<b>Production Commencement</b>
<b>Sichuan</b>					
- Phase I	Potassium Nitrate	20,000	Ammonium Chloride	11,200	December 2003
- Phase II	Potassium Nitrate	20,000	Ammonium Chloride	11,200	September 2004
- Phase III (Stage I)	Potassium Nitrate	20,000	Ammonium Chloride	11,200	November 2006
- Phase III (Stage II)	Potassium Nitrate	20,000	Ammonium Chloride	11,200	November 2007
<b>Guangdong</b>					
- Phase I	Potassium Sulphate	40,000	Hydrochloric Acid	48,000	December 2004
- Phase II (Stage I)	Potassium Sulphate	40,000	Hydrochloric Acid	48,000	November 2006
- Phase II (Stage II)	Potassium Sulphate	20,000	Hydrochloric Acid	24,000	January 2007
<b>Liaoning</b>					
- Phase I	Potassium Sulphate	40,000	Hydrochloric Acid	48,000	December 2005
<b>Changchun</b>					
- Phase I	Potassium Sulphate	40,000	Hydrochloric Acid	48,000	December 2007
<b>Total</b>		260,000		260,800	

*Note: "Annual Capacity" denotes the design capacities of the facilities. Actual production has exceeded design capacities by 5 to 10 percent annually.*

The Company continues to see strong demand for its core products: potassium nitrate and potassium sulphate, as well as its by-products: ammonium chloride and hydrochloric acid.

Migao earns all of its revenues in Chinese Renminbi. Accordingly, reported revenues will fluctuate with changes in the exchange rate to Canadian dollars. The average exchange rate for the quarter ended December 31, 2007 was \$0.1321 to 1 Chinese Renminbi. The average exchange rate for the quarter ended December 31, 2006 was \$0.1449 to 1 Chinese Renminbi. The average exchange rate for the previous quarter ended September 30, 2007 was \$0.1382 to 1 Chinese Renminbi.

***Geographic Revenues***

The Company earns virtually all of its revenues in the PRC, with only minor export sales. At the moment, there is no plan to expand into exporting products on a large scale, as the Chinese demand is far from satiated.

***Gross Profit***

Gross profit for the quarter ended December 31, 2007 increased by \$1.2 million (or 25%) and \$1.6 million (or 38%) compared with the same period last year and the previous quarter, respectively. The significant increases are mainly due to the expanded production capacity in Sichuan and Guangdong facilities during the year and increased selling prices of finished goods. Gross margin as a percentage of sales for the quarter ended December 31, 2007 increased slightly by 2% to 24% (from 22%) compared to the same period last year and increased by 7% (from 17%) compared with the previous quarter ended September 30, 2007. The increase in gross margin compared to the previous quarter is mainly due to increased selling prices of products.

***Selling Expenditures***

Selling expenditures for the quarter ended December 31, 2007 increased by \$0.2 million (or 20%) and \$0.4 million (or 54%) compared with the same period last year and the previous quarter, respectively. Selling expenditures as a percentage of sales for the quarter ended December 31, 2007 increased by 0.3% (from 4.5%) and 1.8% (from 3.0%) to 4.8% compared with the same period last year and the previous quarter, respectively.

Selling expenditures also include transportation and related costs incurred for delivery of goods to customers and depreciation on capital assets used by the sales department.

***General and Administrative Expenditures***

General and administrative expenditures for the quarter ended December 31, 2007 increased by \$0.06 million (or 7%) and \$0.2 million (or 38%) compared with the same period last year and the previous quarter, respectively. General and administrative expenditures as a percentage of sales for the quarter ended December 31, 2007 decreased by 0.2% (from 3.4%) and increased by 0.9% (from 2.3%) to 3.2% compared with the same period last year and the previous quarter, respectively.

General and administrative expenditures include production, finance, human resources and management staff as well as facilities expenses, supplies and equipment depreciation. These costs are, for the most part, fixed and therefore fluctuate to a much lesser extent in relation to revenues.

***Professional and Consulting Expenditures***

Professional and consulting expenditures for the quarter ended December 31, 2007 decreased by \$0.1 million (or 49%) and \$0.2 million (or 59%) compared with the same period last year and the previous quarter, respectively. Professional and consulting expenditures as a percentage of sales for the quarter ended December 31, 2007 decreased by 0.6% (from 1.0%) to 0.4% both compared with the same period last year and the previous quarter, respectively.

Professional and consulting expenditures mainly include corporate level legal, accounting, auditing, consulting and directors' fees.

### ***Earnings***

Net earnings for the quarter ended December 31, 2007 increased by \$0.7 million (or 29%) and \$0.8 million (or 35%) compared with the same period last year and the previous quarter, respectively. Net earnings as a percentage of sales for the quarter ended December 31, 2007 increased by 2.0% (from 11%) and 4.0% (from 9%) to 13% compared with the same period last year and the previous quarter. The significant increase in net earnings compared to the previous quarter is mainly due to increased selling prices of products.

### ***Expansion Projects***

#### Sichuan Migao

Stage two of the Phase III potassium nitrate project, which is to add an additional 20,000 tonnes of potassium nitrate capacity, was completed in early October and production begun on October 26, 2007. Both the production schedule and the construction costs were in line with company expectations. The expanded production capacity brings the total capacity of the Sichuan Migao facility to 80,000 tonnes of potassium nitrate. All of the production from the 80,000 tonne potassium nitrate facility has been sold into the spring of 2008.

#### Shanghai Migao

A potassium sulphate facility, with 40,000 tonnes of initial capacity, is under construction in the city of Shanghai and is scheduled to be completed by the summer this year.

#### Changchun Migao

On February 27, 2007, the Company announced that a potassium sulphate facility, with 40,000 tonnes of initial capacity, will be constructed in the city of Changchun, province of Jilin and was originally scheduled to be completed by the early part of the calendar year 2008. The facility was completed on October 18, 2007. Full production from the newly opened facility was scheduled to be phased in over an eight week period. The first 20,000 tonnes of production begun on November 21, 2007, and the second 20,000 tonnes came online on December 21, 2007. Therefore, full scale production from the 40,000 tonne expansion is ahead of schedule.

## **Liquidity and Capital Resources**

(in thousands of Canadian dollars except for ratios)      **December 31, 2007**      **September 30, 2007**

	<b>December 31, 2007</b>	<b>September 30, 2007</b>
<b>Current Ratio</b>	2.09 : 1	3.03 : 1
<b>Cash</b>	21,144	17,453
<b>Working Capital</b>	39,584	36,669
<b>Total Assets</b>	124,870	100,027
<b>Total Debt</b>	36,430	18,031
<b>Total Equity</b>	88,440	81,995
<b>Debt to Equity Ratio</b>	0.41 : 1	0.22 : 1

### ***Cash Position***

Cash and cash equivalents totalled \$21.1 million as of December 31, 2007, representing an increase of \$3.7 million compared with the balance as of September 30, 2007. The increase for the quarter ended December 31, 2007 is a result of \$5.3 million from operations, \$1.4 million of cash flow from proceeds from exercise of options and warrants, offset by \$3.0 million invested in capital assets mainly for the construction of Sichuan, Shanghai and Changchun Migao.

Migao has approximately \$4.8 million of land use rights payable. These payables may come due in the second quarter of fiscal 2008.

The Company believes that its current cash position is sufficient to meet the ongoing needs of the business. However, the Company may choose to access capital markets and/or bank financing for funding of future expansion and other opportunities.

### ***Working Capital***

Working capital was \$39.6 million as of December 31, 2007, representing an increase of \$2.9 million compared with September 30, 2007. This increase is primarily attributable to \$3.7 million increase in cash and cash equivalents, \$1.4 million increase in accounts receivable, \$13.9 million increase in prepayments, deposits and other receivables, \$2.7 million increase in inventory, offsets by \$0.7 million decrease in net income taxes receivable, \$3.7 million increase in accounts payable and accrued liabilities, and \$14.5 million increase in customer deposits.

### ***Plant and Equipment, Construction in Progress, Land Use Rights***

Plant and equipment net of accumulated depreciation and amortization was \$28.1 million at December 31, 2007 compared with \$20.5 million as of September 30, 2007. This increase is due to the completion of the stage two of the Sichuan Migao and Changchun Migao expansion projects.

Construction in progress was \$1.6 million at December 31, 2007 compared with \$6.0 million as of September 30, 2007. The decrease is due to the accounting reclassifications due to the completion of the phase III, stage two of the Sichuan Migao and Changchun Migao expansion projects.

Land use rights net of accumulated amortization was \$18.7 million at December 31, 2007 compared with \$18.4 million as of September 30, 2007. The slight increase is due to unrealized foreign exchange gains on Land use rights experienced during the quarter.

#### ***Contractual Obligation Summary***

- Purchase commitments for raw materials and supplies in the amount of \$24.9 million (RMB 184 million) exist as of December 31, 2007. They were entered into in the normal course of business.
- Commitments on capital expenditures in the amount of \$2.9 million (RMB 21 million) exist as of December 31, 2007. They were entered into in the normal course of business.

#### ***Disclosure Controls and Procedures and Internal Control over Financial Reporting***

Management has evaluated the effectiveness of the Company's disclosure controls and procedures as at September 30, 2007 and has concluded, based on its evaluation, that these controls and procedures provide reasonable assurance that material information relating to the Company is made known to management and reported as required.

Management is also responsible for the design of internal controls over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Management has engaged external consultants to evaluate the design of the Company's internal controls and procedures over financial reporting as at September 30, 2007, and believes the design to be sufficient and appropriate to provide such reasonable assurance.

The consultants have made recommendations for improvement in certain aspects of the Company's system of internal controls, and management intends to formalize approval and review processes by using checklists and initialing source documents, reconciliations and other accounting worksheets on a more consistent basis. The Company has begun the process of hiring additional qualified personnel to assist in the implementation of the above items, and subsequent to the quarter end hired an additional designated accountant at the corporate head office.

In addition, the Company maintains a lean financial department in which finance staff are cross trained to handle non compatible functions in case of emergency, illness, staff turnover or other situations. This cross training could result in a lack of segregation of duties. Management mitigates this risk by being aware of whenever incompatible functions are performed and providing additional review and oversight.

Despite management's best efforts, there can be no assurance that the risk of material statement in this situation can be reduced.

It should be noted that while the officers of the Company, as certified in the Company's Annual Filings and as required under Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, have evaluated the effectiveness of these disclosure controls and procedures for the year ended September 30, 2007 and have concluded that they are being maintained as designed, they do not expect that the disclosure controls and procedures or internal controls over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can only provide reasonable, not absolute, assurance that the objectives of the control system are met.

### **Capital Structure**

The Company is authorized to issue an unlimited number of common shares and unlimited number of preference shares, each common share providing the holder with one vote. As of February 11, 2008, there were:

- 37,444,130 common shares outstanding.
- 1,165,000 stock options outstanding, with exercise prices of between \$2.85 to \$9.93, and weighted average remaining life of 3.38 years. 228,333 of these stock options are exercisable as of February 11, 2008.
- 2,200,943 warrants outstanding, with exercise price of \$3.70, exercisable before May 18, 2008.
- 2,621,000 warrants outstanding, with exercise price of \$5.30, exercisable before February 22, 2009.
- 3,000 agent compensation options outstanding, with exercise price of \$2.85 per compensation unit. Each compensation unit consists of one common share of the Company and one-half warrant. Each whole warrant entitles the agent to purchase one common share at \$3.70 before May 18, 2008.
- 225,938 agent compensation options outstanding, with exercise price of \$4.15 per compensation unit. Each compensation unit consists of one common share of the Company and one-half warrant. Each whole warrant entitles the agent to purchase one common share at \$5.30 before February 22, 2009.

### **Off-Balance Sheet Arrangement**

The Company does not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations or financial condition of Migao including, without limitation, such considerations as liquidity and capital resources that have not previously been discussed.

## **Transactions with Related Parties**

As of December 31, 2007, amount due to Liaoning Yongcheng Economic and Trade Development Co. Ltd. (“LYEDC”) was \$23,738. LYEDC is controlled by an officer and director of the Company. The amounts are non-interest bearing and due on demand.

## **Proposed Transactions**

Migao is not a party to any proposed transaction that may have an effect on the financial condition, results of operations or cash flows or proposed asset or business acquisition or disposition.

## **Critical Accounting Policies**

This MD&A should be read in conjunction with the Company’s unaudited Consolidated Financial Statements for the three month period ended December 31, 2007 and notes thereto. Those Consolidated Financial Statements outline the accounting principles and policies used to prepare our financial statements. The critical accounting policies of the Company are outlined in our Fiscal 2007 MD&A and remain substantially unchanged. Accounting policies are critical if they rely on a substantial amount of judgment in their application or if they result from a choice between accounting alternatives and that choice has a material impact on reported results or financial position.

### ***Accounting policy changes including initial adoption***

Effective October 1, 2007, the Company implemented the new CICA accounting Section 3862 (Financial Instruments – Disclosures) and Section 3863 (Financial Instruments – Presentation). These standards provide additional guidance on disclosing risks related to recognized financial instruments and how those risks are managed. The company also implemented Section 1535 (Capital Disclosures), which provides guidance for disclosing information about an entity’s capital and how it manages its capital.

These new accounting policy changes have been implemented prospectively and the adoption of these standards did not have a significant impact on the Company’s consolidated financial statements.

## **Financial Instruments and Other Instruments**

Migao is not a party to any financial instrument, as the term is defined in National Instrument 51-102F1, paragraph 1.14.

**Risk Factors**

The Company is exposed to a variety of risks in the normal course of operations. In the Annual Information Form of the Company dated January 15, 2008, it provided a detailed review of the risks that could affect its financial condition, results of operations or business and that could cause actual results to differ materially from those expressed in our forward-looking statements. In management's opinion, there has been no material change in the nature or magnitude of the risks faced by the Company.