

# **Migao Corporation**

**Interim Consolidated Financial Statements  
Third Quarter, Fiscal 2008  
Ended June 30, 2008  
(Unaudited)**

# Migao Corporation

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*For the three and nine months ended June 30, 2008 and 2007*

*(Unaudited)*

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# Migao Corporation

## Interim Consolidated Balance Sheets

(in thousands of Canadian dollars)

	June 30, 2008 (Unaudited)	September 30, 2007 (Audited)
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 22,592	\$ 17,453
Accounts receivable	20,389	6,373
Prepayments, deposits and other receivables (note 2)	39,009	10,614
Inventory (note 3)	43,019	19,101
Income taxes receivable	575	1,159
	125,584	54,700
<b>Plant and equipment (note 5)</b>	<b>31,794</b>	<b>20,518</b>
<b>Construction in progress</b>	<b>5,884</b>	<b>5,972</b>
<b>Land use rights (note 6)</b>	<b>19,409</b>	<b>18,367</b>
<b>Future income tax assets</b>	<b>470</b>	<b>470</b>
	\$ 183,141	\$ 100,027
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank loans (note 7)	\$ 10,328	\$ 4,578
Accounts payable and accrued liabilities (note 6)	15,809	9,958
Customer deposits	6,310	3,451
Due to related party (note 4)	24	45
Income taxes payable	1,033	-
	33,504	18,032
<b>Shareholders' equity</b>		
Share capital (note 8)	94,687	54,013
Contributed surplus (note 8)	7,201	8,551
Retained earnings (note 9)	40,959	26,527
Accumulated other comprehensive income (loss) (note 10)	6,790	(7,096)
	149,637	81,995
<b>Commitments (note 12)</b>		
<b>Subsequent events (note 15)</b>		
	\$ 183,141	\$ 100,027

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

Approved on behalf of the Board of Directors

Signed by "Guocai Liu" \_\_\_\_\_

Director

Signed by "Michael Manley" \_\_\_\_\_

Director

## Migao Corporation

### Interim Consolidated Statements of Operations and Retained Earnings

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

	For the three months ended		For the nine months ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
<b>Revenues</b>	\$ 49,681	\$ 26,865	\$ 108,866	\$ 76,308
<b>Cost of goods sold (note 5)</b>	37,361	20,526	82,452	59,015
<b>Gross profit</b>	12,320	6,339	26,414	17,293
<b>Operating expenses</b>				
General and administrative (notes 5 and 6)	1,367	968	3,383	2,732
Selling	2,185	950	4,595	3,265
Professional and consulting	418	321	790	711
Stock-based compensation (note 8)	804	186	1,295	682
Finance costs	84	-	252	-
Pre-operating costs	250	-	367	-
	5,108	2,425	10,682	7,390
<b>Income from operations</b>	7,212	3,914	15,732	9,903
Other income	131	44	208	130
Gain on sale of non-operating subsidiary (note 1)	99	-	99	-
<b>Income before income taxes</b>	7,442	3,958	16,039	10,033
Provision for income taxes - current	675	791	1,607	1,119
<b>Net income for the period</b>	6,767	3,167	14,432	8,914
<b>Retained earnings,</b>				
beginning of period	34,192	21,068	26,527	15,321
<b>Retained earnings,</b>				
end of period	\$ 40,959	\$ 24,235	\$ 40,959	\$ 24,235
<b>Income per share:</b>				
Basic	\$ 0.16	\$ 0.09	\$ 0.37	\$ 0.28
Diluted	\$ 0.15	\$ 0.08	\$ 0.34	\$ 0.27
<b>Weighted average number of common shares outstanding:</b>				
Basic	42,650,696	36,019,784	39,356,093	32,334,403
Diluted	44,703,286	38,399,026	42,214,482	33,292,664

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

## Migao Corporation

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### Interim Consolidated Statements of Comprehensive Income

(in thousands of Canadian dollars)

(Unaudited)

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	<u>For the three months ended</u>		<u>For the nine months ended</u>	
	<b>June 30, 2008</b>	June 30, 2007	<b>June 30, 2008</b>	June 30, 2007
<b>Net income for the period</b>	\$ <b>6,767</b>	\$ 3,167	\$ <b>14,432</b>	\$ 8,914
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations	<b>3,861</b>	(5,243)	<b>13,886</b>	(2,779)
<b>Comprehensive income (loss)</b>	\$ <b>10,628</b>	\$ (2,076)	\$ <b>28,318</b>	\$ 6,135

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

# Migao Corporation

## Interim Consolidated Statements of Cash Flows

(in thousands of Canadian dollars)

(Unaudited)

	For the three months ended		For the nine months ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
<b>Cash flows from operating activities</b>				
Net income	\$ 6,767	3,167	\$ 14,432	8,914
Items not affecting cash:				
Amortization	697	543	1,751	1,514
Stock-based compensation	804	186	1,295	682
Gain on sale of non-operating subsidiary	(99)	-	(99)	-
Changes in non-cash working capital items:				
Accounts receivable	(3,155)	(6,920)	(12,561)	(7,185)
Prepayments, deposits, and other receivables	(4,369)	1,812	(22,563)	(2,103)
Inventory	(11,477)	(9,370)	(20,773)	(16,211)
Accounts payable and accrued liabilities	(1,062)	836	5,467	1,866
Customer deposits	(11,415)	(1,065)	1,058	(2,289)
Income taxes payable	1,070	(106)	1,761	(24)
	(22,239)	(10,917)	(30,232)	(14,836)
<b>Cash flows from investing activities</b>				
Purchase of plant and equipment	(897)	(284)	(2,278)	(4,838)
Construction in progress	(1,792)	(2,253)	(7,770)	(4,511)
Payments for land use rights	(871)	(397)	(1,360)	(5,317)
	(3,560)	(2,934)	(11,408)	(14,666)
<b>Cash flows from financing activities</b>				
Proceeds from bank loans	7,986	2,432	7,986	5,764
Repayment of bank loans	(2,178)	-	(2,879)	(4,530)
Advances from related parties, net	-	(1,206)	-	(564)
Issuance of common shares, net	24	(23)	26,568	22,993
Proceeds from exercise of underwriters' compensation options	447	291	455	472
Proceeds from exercise of warrants	7,060	2,249	10,108	3,269
Proceeds from exercise of stock options	727	-	898	-
	14,066	3,743	43,136	27,404

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

## Migao Corporation

### Interim Consolidated Statements of Cash Flows - continued

(in thousands of Canadian dollars)

(Unaudited)

	For the three months ended		For the nine months ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Foreign exchange gain on cash held in foreign currency	1,450	(143)	3,643	1,099
<b>Increase in cash and cash equivalents</b>	<b>(10,283)</b>	<b>(10,251)</b>	<b>5,139</b>	<b>(999)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>32,875</b>	<b>25,568</b>	<b>17,453</b>	<b>16,316</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 22,592</b>	<b>\$ 15,317</b>	<b>\$ 22,592</b>	<b>\$ 15,317</b>

#### Cash and cash equivalents consist of:

Cash on hand	\$ 14,213	\$ 9,417
Term deposit	40	40
Bank notes	8,339	5,860
	<b>\$ 22,592</b>	<b>\$ 15,317</b>

Total interest paid during the three and nine months period ended June 30, 2008 was \$82 and \$242 (RMB 0.6 million and RMB 1.8 million) (June 30, 2007 - \$33 or RMB 0.2 million and \$93 or RMB 0.6 million), respectively. Total tax paid during the three and nine months period ended June 30, 2008 was \$481 and \$852 (RMB 3.3 million and RMB 6.1 million) (June 30, 2007 - NIL and \$240 or RMB 1.6 million), respectively. Total tax refunded during the three and nine months period ended June 30, 2008 were both \$764 (RMB 5.3 million) (June 30, 2007 - NIL).

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

# Migao Corporation

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## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

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## 1. Nature of Operations and Basis of Presentation

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### 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 four 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, which in turn 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”), Migao Chemical (Changchun) Co., Ltd. (“Changchun Migao”), and Migao Chemical (Tianjin) Co., Ltd. (“Tianjin Migao”) (collectively, the “Subsidiaries”).

During the quarter, the Company disposed Migao Business Hotel Limited, a non-operating subsidiary of Guangdong Migao, for a gross proceeds of \$1,165 (RMB 8.0 million) and a gain of \$99 (RMB 0.7 million).

### Basis of Presentation

These unaudited interim consolidated 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 Migao, except as disclosed below. These financial statements do not contain all disclosures required by Canadian GAAP for annual financial statements, and accordingly, these financial statements should be read in conjunction with the audited financial statements of Migao for the year ended September 30, 2007. Interim results are not necessarily indicative of the results expected for the fiscal year.

### Adoption of New Accounting Policies

Effective October 1, 2007, the Company adopted the following new accounting standards.

#### *Capital Management*

The new standard 1535 – Capital Disclosures requires the Company to disclose information about the Company’s objectives, policies and processes for the management of its capital.

#### *Financial Instruments – Disclosure and Presentation*

The new standards 3862 – Financial Instruments – Disclosures and 3863 – Financial Instruments – Presentation require the disclosure of information with regards to the significance of financial instruments for the Company’s financial position and performance and the nature and extent of risks arising from financial instruments to which the Company is exposed during the period and at the balance sheet date, and how the Company manages those risks.

### Recent Accounting Pronouncements

#### *Goodwill and Intangible Assets*

The Canadian Institute of Chartered Accountants issued the new Handbook Section 3064 - Goodwill and intangible assets, which will replace Section 3062 - Goodwill and Other Intangible Assets and Section 3450 – Research and Development Costs. The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new

# Migao Corporation

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## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

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

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### Recent Accounting Pronouncements – continued

#### *Goodwill and Intangible Assets - continued*

standard also provides guidance for the treatment of preproduction and start-up costs and requires that these costs be expensed as incurred. The new standard applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. Management is currently assessing the impact of these new accounting standards on its consolidated financial statements.

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

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by Migao for the year ended September 30, 2011. While Migao has begun assessing the adoption of IFRS for 2011, the reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

## 2. Prepayments, Deposits, and Other Receivables

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	<b>June 30, 2008 (Unaudited)</b>	September 30, 2007 (Audited)
Prepayments for raw materials	\$ 30,784	\$ 7,478
Prepayments for construction costs	1,311	904
Prepayments for transportation services	124	23
Prepayments for machinery	2,880	632
Deposits for the supply of utilities	201	151
Deposits for the sale of finished goods	150	-
VAT receivable	905	583
Other receivables and deposits	2,654	1,026
	<b>\$ 39,009</b>	<b>\$ 10,614</b>

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## 3. Inventory

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	<b>June 30, 2008 (Unaudited)</b>	September 30, 2007 (Audited)
Raw materials	\$ 34,048	\$ 13,931
Finished goods	8,766	1,075
Packing materials	205	90
Goods in transit	-	4,005
	<b>\$ 43,019</b>	<b>\$ 19,101</b>

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# Migao Corporation

## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

### 4. Related Party Balance

At the end of the periods, the Company had the following related party balance:

	<b>June 30, 2008 (Unaudited)</b>	September 30, 2007 (Audited)
Amount due to:		
Liaoning Yongcheng Economic and Trade Development Co. Ltd. ("LYEDC")	\$ 24	\$ 45

LYEDC is controlled by an officer and director of Migao. The amounts are non-interest bearing, unsecured, and due on demand.

During the quarter, the Company prepaid \$297 of import agency fee to Beijing Wei De Sen, a company controlled by an officer and director of Migao. This transaction was in the normal course of business and was measured at the exchange amounts.

### 5. Plant and Equipment

	<b>June 30, 2008 (Unaudited)</b>		
	Cost	Accumulated Amortization	Net Book Value
Buildings and improvements	\$ 18,299	\$ 1,323	\$ 16,976
Machinery and equipment	17,390	3,493	13,897
Vehicles	1,092	428	664
Office equipment	435	178	257
	<b>\$ 37,216</b>	<b>\$ 5,422</b>	<b>\$ 31,794</b>
			September 30, 2007 (Audited)
	Cost	Accumulated Amortization	Net Book Value
Buildings and improvements	\$ 10,684	\$ 701	\$ 9,983
Machinery and equipment	11,984	2,181	9,803
Vehicles	794	289	505
Office equipment	338	111	227
	<b>\$ 23,800</b>	<b>\$ 3,282</b>	<b>\$ 20,518</b>

Amortization expense for the three and nine months ended June 30, 2008 were \$661 and \$1,646 (June 30, 2007 - \$513 and \$1,334), respectively, and are included in cost of goods sold and general and administrative expense.

# Migao Corporation

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## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

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### 5. Plant and Equipment - continued

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During the quarter ended June 30, 2008, Guangdong Migao and Changchun Migao were approved by the local tax authorities for value-added tax refund on purchases of domestic equipment of \$102 (RMB 0.7 million) and \$327 (RMB 2.2 million), respectively. These value-added tax refunds were recorded to reduce the cost of equipment.

### 6. Land Use Rights

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	June 30, 2008 (Unaudited)	September 30, 2007 (Audited)
Land use rights	\$ 19,778	\$ 18,597
Less: accumulated amortization	369	230
	\$ 19,409	\$ 18,367

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As of June 30, 2008, the Company had sixteen land leases from the Chinese government with terms of fifty to seventy years.

Amortization expense for the three and nine months ended June 30, 2008 were \$36 and \$105 (June 30, 2007 - \$30 and \$180), respectively, and are included in general and administrative expense.

As of June 30, 2008, the Company had not obtained the land use right certificates for eight of the land leases and approximately \$3,900 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. Bank Loans

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At June 30, 2008, the Company has short-term bank loans outstanding totaling \$10,328 (RMB 69.5 million) (September 30, 2007 - \$4,578 or RMB 34.5 million) for working capital purposes.

<u>Amount</u>	<u>Due Date</u>	<u>Interest per annum</u>	<u>Secured by</u>
\$ 2,155	August 20, 2008	6.9084%	certain land use rights and buildings
\$ 2,229	April 29, 2009	8.217%	certain land use rights
\$ 2,972	June 30, 2009	7.47%	corporate guarantees from Sichuan Migao and LYDEC
\$ 2,972	June 30, 2009	7.47%	corporate guarantees from Sichuan Migao and LYDEC

Total carrying value of the security was \$3,330 (RMB 22.4 million). Total interest expense during the three and nine months period ended June 30, 2008 was \$82 and \$242 (RMB 0.6 million and RMB

# Migao Corporation

## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

1.8 million) (June 30, 2007 - \$33 or RMB 0.2 million and \$93 or RMB 0.6 million), respectively.

## 8. Share Capital

### (a) Authorized:

Unlimited common shares without par value.

### (b) Issued common shares

	Number of Shares	Amount
<b>Balance – September 30, 2007</b>	<b>37,040,428</b>	<b>\$ 54,013</b>
Issued on exercise of underwriters' compensation options (i)	2,862	8
Fair value of underwriters' compensation options (i)	-	3
Fair value of warrants issued (i)	-	(2)
Issued on exercise of underwriters' compensation options (ii)	3,000	9
Fair value of underwriters' compensation options (ii)	-	3
Fair value of warrants issued (ii)	-	(2)
Issued on exercise of underwriters' compensation options (iii)	105,438	438
Fair value of underwriters' compensation options (iii)	-	247
Fair value of warrants issued (iii)	-	(90)
Exercise of warrants (iv)	2,340,264	8,659
Fair value of warrants exercised (iv)	-	1,545
Exercise of warrants (v)	273,369	1,449
Fair value of warrants exercised (v)	-	500
Exercise of stock options (vi)	315,000	898
Fair value of stock options exercised (vi)	-	441
Issued pursuant to a private placement (vii)	3,593,750	28,750
Share issuance costs (vii)	-	(2,182)
<b>Balance – June 30, 2008</b>	<b>43,674,111</b>	<b>\$ 94,687</b>

(i) Each of the 2,862 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 \$1.38 per warrant.

(ii) Each of the 3,000 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 \$1.13 per warrant.

(iii) Each of the 105,438 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 \$1.70 per warrant.

# Migao Corporation

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## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

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## 8. Share Capital - continued

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### (b) Issued common shares - continued

(iv) During the quarter ended June 30, 2008, 1,809,374 (2,340,264 for the nine months ended June 30, 2008) 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 originally valued at \$0.66 per warrant.

(v) During the quarter ended June 30, 2008, 68,919 (273,369 for the nine months ended June 30, 2008) 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 originally valued at \$1.83 per warrant.

(vi) During the quarter ended June 30, 2008, 255,000 (315,000 for the nine months ended June 30, 2008) of the common share purchase options with an exercise price of \$2.85 per common share issued to the employees and directors of the Company were exercised. The stock options were originally valued at \$1.40 per option.

(vii) On March 13, 2008, the Company completed a public offering of 3,593,750 common shares priced at \$8.00 per share. Pursuant to the Underwriting Agreement, the Company paid the underwriters an underwriting commission of \$0.46 per share, reflecting a commission of 5.75%. In addition to the underwriting commission, the Company paid \$529 in total for expenses incurred on this private placement.

### (c) Contributed surplus

	<b>Amount</b>
<b>Balance – September 30, 2007</b>	<b>\$ 8,551</b>
Fair value of exercised underwriters' compensation options	(253)
Fair value of warrants issued on the exercise of underwriters' compensation options	94
Stock-based compensation expense	1,295
Fair value of warrants exercised	(2,045)
Fair value of stock options exercised	(441)
<b>Balance – June 30, 2008</b>	<b>\$ 7,201</b>

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### (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 period.

# Migao Corporation

## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

### 8. Share Capital - continued

#### (d) Stock options - continued

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

	Options	Weighted average exercise price
<b>Outstanding – September 30, 2007</b>	<b>1,185,000</b>	<b>\$ 3.38</b>
Granted during the period	515,000	9.51
Exercised during the period	(315,000)	2.85
<b>Outstanding – June 30, 2008</b>	<b>1,385,000</b>	<b>\$ 5.78</b>

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

#### As of June 30, 2008

Exercise price	Number outstanding	Weighted average remaining contractual life (years)	Number exercisable	Exercise Price for exercisable options
\$2.85	750,000	2.88	361,666	\$2.85
\$7.69	60,000	4.00	20,000	\$7.69
\$8.46	60,000	4.00	40,000	\$8.46
\$9.93	40,000	4.50	NIL	N/A
\$9.48	300,000	4.92	50,000	\$9.48
\$9.48	175,000	4.92	NIL	N/A
<b>\$5.78</b>	<b>1,385,000</b>	<b>3.72</b>	<b>471,666</b>	<b>\$4.23</b>

During the quarter ended March 31, 2008, 40,000 options were issued to an employee of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$9.93 per common share. These options have vesting periods of up to three years and an exercise period of up to five years, expiring on January 7, 2013. The fair value of the options issued was estimated using the Black-Scholes option pricing model on the date of issue to be \$7.60 per option. Assumptions used to determine the value of the options were: dividend yield 0%; risk-free interest rate 3.22%; expected volatility 102%; and expected life of 5 years. Stock-based compensation expense for the three and nine months ended June 30, 2008 was \$46 and \$89 (June 30, 2007 – NIL), respectively.

During the quarter ended June 30, 2008, 300,000 options were issued to an officer of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$9.48 per common share. Upon granting of the options, 50,000 options were vested immediately and the balance of the options have vesting periods of up to three years and an exercise period of up to five years, expiring on June 1, 2013. The fair value of the options issued was estimated using the Black-Scholes option pricing model on the date of issue to be \$7.06 per option. Assumptions used to determine the value of the options were: dividend yield 0%; risk-free interest rate 3.14%; expected

# Migao Corporation

## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

### 8. Share Capital - continued

#### (d) Stock options – continued

volatility 97%; and expected life of 5 years. Stock-based compensation expense for the three months ended June 30, 2008 was \$439 (June 30, 2007 – NIL).

During the quarter ended June 30, 2008, 175,000 options were issued to directors and an officer of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$9.48 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 1, 2013. The fair value of the options issued was estimated using the Black-Scholes option pricing model on the date of issue to be \$7.06 per option. Assumptions used to determine the value of the options were: dividend yield 0%; risk-free interest rate 3.14%; expected volatility 97%; and expected life of 5 years. Stock-based compensation expense for the three months ended June 30, 2008 was \$60 (June 30, 2007 – NIL).

Total stock-based compensation expense on the options granted in the prior years for the three and nine months ended June 30, 2008 was \$259 and \$707 (June 30, 2007 - \$186 and \$682), respectively.

#### (e) Warrants

As at June 30, 2008, the following share purchase warrants were outstanding:

September 30, 2007	Issued	Exercised	Expired	June 30, 2008	Exercise Price	Expiry Date
2,337,333	2,931	2,340,264	-	-	\$ 3.70	May 18, 2008
2,825,450	52,719	273,369	-	2,604,800	\$ 5.30	February 22, 2009
5,162,783	55,650	2,613,633	-	2,604,800		

#### (f) Underwriters' Compensation Options

As at June 30, 2008, the following underwriters' compensation options were outstanding:

September 30, 2007 (outstanding and exercisable)	Issued	Exercised	Expired	June 30, 2008 (outstanding and exercisable)	Exercise Price	Weighted average remaining contractual life (years)
5,862	-	5,862	-	-	\$ 2.85	-
225,938	-	105,438	-	120,500	\$ 4.15	0.65
231,800	-	111,300	-	120,500	\$ 4.15	0.65

# Migao Corporation

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## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

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### 9. Retained Earnings

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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, 2008 was \$4,503 (RMB 30.3 million; September 30, 2007 – \$2,284 or RMB 17.2 million).

### 10. Accumulated Other Comprehensive Income (Loss)

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	Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations
<b>Balance – September 30, 2007</b>	<b>\$ (7,096)</b>
Unrealized foreign currency translation gains during the period	<b>13,886</b>
<b>Balance – June 30, 2008</b>	<b>\$ 6,790</b>

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### 11. Segmented Information

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

### 12. Commitments

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Purchase commitments for raw materials and supplies in the amount of approximately \$54,300 (RMB 365 million) exist as of June 30, 2008. These contracts were entered into in the normal course of business.

Commitments on capital expenditures in the amount of approximately \$12,103 (RMB 81 million) exist as of June 30, 2008. These contracts were entered into in the normal course of business.

### 13. Capital Management

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The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. Management defines capital as the Company's shareholders' equity. The Company has a small amount of debt for working capital purposes and therefore net earnings generated from operations are mostly available for reinvestment in the Company. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year over year sustainable profitable growth. The Company does

# Migao Corporation

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## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

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### 13. Capital Management - continued

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not have a defined share repurchase plan and buy and sell decisions are made depending on market prices and regulatory restrictions. There were no changes in the Company's approach to capital management during the period. Except for as disclosed in Note 9, neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

### 14. Financial Instruments and Risk Management

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#### Market Risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the Company's income or the value of its holding of financial instruments.

#### *Foreign currency risk*

The Company's global operations expose it to foreign currency fluctuations. Revenues and related expenses generated from the Company's Chinese subsidiaries are generally denominated in Chinese Renminbi ("RMB"), with certain raw material purchases and sales denominated in US dollars. Head office expenditures are generally denominated in Canadian dollars. Therefore, the Company's primary currencies include RMB, US dollars and Canadian dollars. The Consolidated Statements of Operations of the Company's global operations are translated into Canadian dollars at the average exchange rates in each applicable period. To the extent the Canadian dollar strengthens against foreign currencies, the foreign currency conversion of these foreign currency denominated transactions into Canadian dollars results in reduced revenues, operating expenses and net income for the Company's international operations. Similarly, the Company's revenues, operating expenses and net income will increase for its international operations if the Canadian dollar weakens against foreign currencies. The Company cannot predict the effect foreign exchange fluctuations will have on its results going forward. However, if there is an adverse change in foreign exchange rates versus the Canadian dollar, it could have a material effect on other comprehensive income.

At June 30, 2008, through its wholly owned, self-sustaining subsidiaries, the Company had cash and cash equivalents of \$21,949, accounts receivable of \$19,746, other receivables of \$2,574, accounts payable and accrued liabilities of \$15,719, and bank loans of \$10,328, which were denominated in RMB. Gains and losses arising upon translation of these amounts into Canadian dollars for inclusion in the consolidated financial statements are recorded within other comprehensive income, a component of shareholders' equity. A 10% change in the average exchange rate between C\$/RMB on the financial instruments would have a \$1,827 effect on the other comprehensive income in Canadian dollars.

#### *Interest rate risk*

The Company is exposed to interest rate risk on its short-term bank loans and does not currently hold any financial instruments that mitigate this risk. Management does not believe that the impact of interest rate fluctuation will be significant.

# Migao Corporation

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## Notes to Interim Consolidated Financial Statements

For the three and nine months ended June 30, 2008 and 2007

(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

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## 14. Financial Instruments and Risk Management - continued

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### Market Risk - continued

#### *Commodity Price Risk*

Manufacturing costs for the Company's products are affected by the price of raw materials, namely potassium chloride, sulfuric acid, ammonium nitrate and certain other energy generating sources. In order to manage this risk, the Company includes a clause regarding transfer of risk to customers in all the medium and long-term sales contract in order to renegotiate the prices in the event of change. In addition, the Company had been utilizing its strong working capital position in stocking raw materials when their price is anticipated to rise.

### Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's accounts receivable.

The Company's exposure to credit risk with its customers is influenced mainly by the individual characteristics of each customer. The Company's customers are for the most part, large PRC State-owned and private companies. A significant portion of the Company's accounts receivable is from long-time customers and the Company receives prepayments and deposits from them for a large portion of its sales. Over the last three years, the Company has not suffered any significant credit related losses with any of its customers.

At June 30, 2008, the Company does not consider any of its financial assets to be impaired.

The following table provides information regarding the ageing of financial assets that are past due but which are not impaired.

<b>Current</b>	<b>90 – 180 days</b>	<b>180 – 365 days</b>	<b>365 days +</b>	<b>Carrying value on the balance sheet</b>
\$15,804	\$3,348	\$1,169	\$68	\$20,389

The definition of items that are past due is determined by reference to terms agreed with individual customers. None of the amounts outstanding have been challenged by the respective customer(s) and the Company continues to conduct business with them on an ongoing basis. Accordingly, management expects that this balance is fully collectible in the future.

The Company reviews financial assets past due on an ongoing basis with the objective of identifying potential matters which could delay the collection of funds at an early stage. Once items are identified as being past due, contact is made with the respective customer to determine the reason for the delay in payment and to establish an agreement to rectify the breach of contractual terms.

# Migao Corporation

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## Notes to Interim Consolidated Financial Statements

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(in thousands of Canadian dollars, except per share amounts)

(Unaudited)

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The carrying amount of financial assets represents the maximum credit exposure. Based on historic default rates, the Company believes that there are minimal requirements for an allowance for doubtful

## 14. Financial Instruments and Risk Management - continued

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### Credit risk – continued

accounts. As well, deposits by certain customers are often made which also helps to mitigate the risk if there is any.

### Liquidity risk

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due. The Company's growth is financed through a combination of the cash flows from operations, borrowing under the existing credit facilities and the issuance of equity. One of management's primary goals is to maintain an optimal level of liquidity through the active management of the assets and liabilities as well as the cash flows. Given the Company's a v a i l a b l e l i q u i d r e s o u r c e s as compared to the timing of the payments of liabilities, management assesses the Company's liquidity risk to be low.

At June 30, 2008 the Company's cash and cash equivalents balance was \$22,592 and working capital balance was \$92,080. As at June 30, 2008, short-term bank loans in the amount of \$10,328 (RMB 69.5 million) were outstanding under the Company's credit facilities.

### Fair Value

The fair value of cash and cash equivalents, accounts receivable, other receivables, bank indebtedness, accounts payable and accrued liabilities approximates their carrying values due to their short-term maturities. The fair value of the amount due to related party is not readily determinable due to the related party nature of the advances.

## 15. Subsequent Events

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Subsequent to June 30, 2008 and as of August 11, 2008, 1,500 warrants were exercised for gross proceeds of \$7,950.