

# **Migao Corporation**

## **Management Discussion and Analysis**

**Third Quarter, Fiscal 2008  
Ended June 30, 2008**

Prepared by Management  
(Unaudited)

August 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 and nine months ended June 30, 2008. 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 June 30, 2008 and the audited Consolidated Financial Statements and related notes as at and for the year 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).

This MD&A is the responsibility of management. The Board of Directors carries out its responsibility for the review of this disclosure principally through its audit committee comprised exclusively of independent directors. The audit committee reviews and prior to its publication, approves, pursuant to the authority delegated to it by the Board of Directors, this disclosure.

All amounts are in Canadian dollars unless otherwise noted (tabular amounts are in thousands of Canadian dollars) and prepared in accordance with Canadian Generally Accepted Accounting Policies.

At June 30, 2008, the Company had 43,674,111 common shares outstanding. At August 11, 2008, the Company has 43,675,611 common shares outstanding.

### **Forward-Looking Information**

The statements made in this MD&A, particularly those in the "Outlook" section, 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. Management undertakes no obligation 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 August 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.

## **Overview**

Migao, through its wholly owned subsidiaries (referred herein as “Sichuan Migao”, “Guangdong Migao”, “Liaoning Migao”, “Shanghai Migao”, “Changchun Migao”, and “Tianjin Migao”), owns land use rights 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 region 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 the term earnings before interest, taxes, depreciation and amortization (“EBITDA”). EBITDA is 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 may describe certain ‘income’ and ‘expense’ items as 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.

## **Highlights for the Quarter**

Migao continues to execute on its strategic and operational initiatives, as highlighted in the quarter and shortly thereafter:

On May 29, 2008, the Company announced that Mr. S. Randall Smallbone has been appointed Chief Financial Officer effective July 1, 2008. Mr. Smallbone is a financial executive with more than 30 years of operational and public company board experience in diverse, global industries and will serve as a valuable addition to the Company’s senior management team.

On May 20, 2008, the Company announced that it had entered into a joint venture (“JV”) with Sociedad Quimica y Minera de Chile S.A. (“SQM”), the world’s largest producer and distributor of potassium nitrate, for the production of potassium nitrate in China for domestic and international distribution. The JV will create a new enterprise jointly owned 50/50 by Migao and SQM. The agreement calls for the construction of a new

40,000 tonne per year potassium nitrate facility in China, which is expected to be operational in the first half of calendar 2009.

On May 6, 2008, the Company announced that a patent protecting the Company's process for producing potassium nitrate has been approved. The national patent has been granted to Sichuan Migao for its Double Decomposition Process, a method of producing potassium nitrate and ammonium chloride using an economically efficient and environmentally responsible process.

On April 24, 2008, the Company announced that it had negotiated prices for its potash-based products reflecting more than a 100% increase over the average selling price in 2007, thereby demonstrating the Company's commitment and ability to maintain gross margin as a percentage of revenue.

On April 2, 2008, the Company announced the start of construction of a 120,000 tonne sulphuric acid production at Liaoning Migao. This facility will ensure Migao is able to obtain reliable supplies of this key product while at the same time improving gross profit. Sulphuric acid production is scheduled to begin in the first half of calendar 2009.

## **Performance of Migao**

### **Key performance indicators**

The key performance indicators for Migao are revenue growth, gross profit, EBITDA, and net income.

The success of the Company to expand will be measured by revenue growth. Revenue growth will be dependant on the Company being able to expand production capacity either at existing locations or by building facilities at new locations.

The Company is aiming to achieve gross profit in the range of 22% to 24% of revenue on an annual basis. The inputs into the Company's production process can be expensive and volatile in terms of price. Gross profit will be an indicator of how well the Company is managing its production costs and customer contract negotiations.

Management believes that EBITDA is a measure of how efficiently and effectively the business is running. Net income is also viewed as an important measure for determining the value created for shareholders.

### **Measurement**

Below in "Quarterly Results" and "Results of Operations" are two tables the Company uses to assess performance. The first table presents the Company's consolidated results for the last eight quarters. The second table sets out the Company's consolidated results for the quarter and nine months ended June 30, 2008, compared with the same periods last year.

**Quarterly Results**

<i>in thousands of Canadian dollars except per share and percentage data</i>	<b>Fiscal 2008</b>				<b>Fiscal 2007</b>			<b>Fiscal 2006</b>
	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>	<b>Q4</b>	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>	<b>Q4</b>
<b>Sales</b>	<b>49,681</b>	34,506	24,680	25,496	26,865	27,712	21,731	15,434
<b>Gross profit</b>	<b>12,320</b>	8,256	5,840	4,246	6,339	6,281	4,674	3,626
<b>Gross profit (% of revenue)</b>	<b>24.8%</b>	23.9%	23.7%	16.7%	23.6%	22.7%	21.5%	23.5%
<b>Selected operating expenses:</b>								
<b>Selling</b>	<b>2,185</b>	1,236	1,175	765	950	1,335	980	592
<b>General and administrative</b>	<b>1,367</b>	1,214	801	581	968	1,018	746	694
<b>Stock-based compensation</b>	<b>804</b>	264	227	226	186	245	251	251
<b>Professional and consulting</b>	<b>418</b>	264	108	261	321	179	211	156
<b>Finance costs</b>	<b>84</b>	88	81	288	-	-	-	-
<b>Pre-operating costs</b>	<b>250</b>	100	17	368	-	-	-	-
<b>Other income</b>	<b>131</b>	36	41	72	44	35	51	10
<b>Gain on sale of non-operating subsidiary</b>	<b>99</b>	-	-	-	-	-	-	-
<b>Income taxes</b>	<b>675</b>	561	371	(462)	791	200	128	112
<b>Income taxes (% of revenue)</b>	<b>1.4%</b>	1.6%	1.5%	(1.8%)	2.9%	0.7%	0.6%	0.7%
<b>Effective tax rate (% of income before taxes)</b>	<b>9.1%</b>	10.9%	10.7%	(25.2%)	20.0%	5.7%	5.0%	5.8%
<b>Net income</b>	<b>6,767</b>	4,565	3,100	2,292	3,167	3,338	2,409	1,956
<b>Net income (% of revenue)</b>	<b>13.6%</b>	13.2%	12.6%	9.0%	11.8%	12.0%	11.1%	12.7%
<b>EBITDA</b>	<b>8,222</b>	5,830	3,991	2,214	4,530	4,250	3,087	2,592
<b>EBITDA (% of revenue)</b>	<b>16.5%</b>	16.9%	16.2%	8.7%	16.9%	15.3%	14.2%	16.8%
<b>Earnings per share (in \$):</b>								
<b>Basic</b>	<b>0.16</b>	0.12	0.08	0.06	0.09	0.10	0.08	0.08
<b>Diluted</b>	<b>0.15</b>	0.11	0.08	0.06	0.08	0.10	0.08	0.08

## Results of Operations

### Consolidated Results

The following table sets out the Company's consolidated results for the quarter and nine months ended June 30, 2008, compared with the same periods last year.

<i>In thousands of Canadian dollars except per share and percentage data</i>	<b>Q3 2008</b>	<b>Q3 2007</b>	<b>Increase (Decrease)</b>	<b>% Increase (Decrease)</b>	<b>YTD 2008</b>	<b>YTD 2007</b>	<b>Increase (Decrease)</b>	<b>% Increase (Decrease)</b>
<b>Sales</b>	49,681	26,865	22,816	84.9%	108,866	76,308	32,558	42.7%
<b>Gross profit</b>	12,320	6,339	5,981	94.4%	26,414	17,293	9,121	52.7%
<b>Gross profit (% of sales)</b>	24.8%	23.6%	1.2%	5.1%	24.3%	22.7%	1.6%	7.0%
<b>Selling expenses</b>	2,185	950	1,235	130.0%	4,595	3,265	1,330	40.7%
<b>Selling expenses (% of sales)</b>	4.4%	3.5%	0.9%	25.7%	4.2%	4.3%	(0.1%)	(2.3%)
<b>G &amp; A</b>	1,367	968	399	41.2%	3,383	2,732	651	23.8%
<b>G &amp; A (% of sales)</b>	2.8%	3.6%	(0.8%)	(22.2%)	3.1%	3.6%	(0.5%)	(13.9%)
<b>Professional</b>	418	321	97	30.2%	790	711	79	11.1%
<b>Professional (% of sales)</b>	0.8%	1.2%	(0.4%)	(33.3%)	0.7%	0.9%	(0.2%)	(22.2%)
<b>Stock-based compensation</b>	804	186	618	332.3%	1,295	682	613	89.9%
<b>Stock-based compensation (% of sales)</b>	1.6%	0.7%	0.9%	128.6%	1.2%	0.9%	0.3%	33.3%
<b>Other income</b>	131	44	87	197.7%	208	130	78	60.0%
<b>Other income (% of sales)</b>	0.3%	0.2%	0.1%	50.0%	0.2%	0.2%	0.0%	0.0%
<b>Income taxes</b>	675	791	(116)	(14.7%)	1,607	1,119	488	43.6%
<b>Income taxes (% of sales)</b>	1.4%	2.9%	(1.5%)	(51.7%)	1.5%	1.5%	0.0%	0.0%
<b>Effective tax rate (% of net income before taxes)</b>	9.1%	20.0%	(10.9%)	(54.5%)	10.0%	11.2%	(1.2%)	(10.7%)
<b>EBITDA</b>	8,222	4,530	3,692	81.5%	18,042	11,868	6,174	52.0%
<b>EBITDA (% of sales)</b>	16.5%	16.9%	(0.4%)	(2.4%)	16.6%	15.6%	1.0%	6.4%
<b>Net income (loss)</b>	6,767	3,167	3,600	113.7%	14,432	8,914	5,518	61.9%
<b>Net income (loss) (% of sales)</b>	13.6%	11.8%	1.8%	15.3%	13.3%	11.7%	1.6%	13.7%
<b>Earnings per share</b>								
<b>Basic</b>	0.16	0.09			0.37	0.28		
<b>Diluted</b>	0.15	0.08			0.34	0.27		
<b>Weighted average number of common shares outstanding</b>								
<b>Basic</b>	42,650,696	36,019,784			39,356,093	32,334,403		
<b>Diluted</b>	44,703,286	38,399,026			42,214,482	33,292,664		

### Revenues

Revenues for the quarter ended June 30, 2008 increased by \$15.2 million (RMB 96.1 million) or 44.0% compared with the previous quarter ended March 31, 2008. The increased revenue is mainly due to increased production at both Changchun and Guangdong facilities and the significant increase in newly negotiated selling prices for potash-based products.

Revenues for the quarter and the nine months ended June 30, 2008 increased by \$22.8 million (RMB 154.3 million) or 84.9% and \$32.6 million (RMB 253.6 million) or 42.7%, respectively, compared with the same periods last year. The significant increases are mainly due to the expanded production capacities and higher selling prices at certain facilities. The run rate for the core products was at 260,000 tonnes as of June 30, 2008, compared with 200,000 tonnes as of June 30, 2007.

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 June 30, 2008 was \$0.1452 to 1 Chinese Renminbi. The average exchange rate for the quarter ended June 30, 2007 was \$0.1430 to 1 Chinese Renminbi. The average exchange rate for the previous quarter ended March 31, 2008 was \$0.1402 to 1 Chinese Renminbi.

The following is a summary of the Company's facilities and production capacities as of June 30, 2008.

	<b>Core Product</b>	<b>Annual Capacity (tonnes)</b>	<b>By-Product</b>	<b>Annual Capacity (tonnes)</b>	<b>Production Commencement</b>
Sichuan	Potassium Nitrate	80,000	Ammonium Chloride	44,800	December 2003
Guangdong	Potassium Sulphate	100,000	Hydrochloric Acid	120,000	December 2004
Liaoning	Potassium Sulphate	40,000	Hydrochloric Acid	48,000	December 2005
Changchun	Potassium Sulphate	40,000	Hydrochloric Acid	48,000	December 2007
<b>Total</b>		<b>260,000</b>		<b>260,800</b>	

*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.

### 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 June 30, 2008 increased by \$4.1 million (or 49.2%) compared with the previous quarter ended March 31, 2008. Gross margin as a percentage of sales for the quarter ended June 30, 2008 increased by 0.9% to 24.8% (from 23.9%) compared with the previous quarter ended March 31, 2008.

Gross profit for the quarter and nine months ended June 30, 2008 increased by \$6.0 million (or 94.4%) and \$9.1 million (or 52.7%), respectively, compared with the same periods last year. Gross margin as a percentage of sales for the quarter and nine months ended June 30, 2008 increased by 1.2% to 24.8% (from 23.6%) and by 1.6% to 24.3% (from 22.7%), respectively, compared with the same periods last year.

Increases in gross profit and gross margin are due to expanded capacity, timely raw material purchases, and increased selling prices of finished goods as a result of strong customer relations.

The Company expects gross profit margins on an annual basis to be within its targeted range of between 22% and 24% of revenues.

### ***Selling Expenditures***

Selling expenditures for the quarter ended June 30, 2008 increased by \$0.9 million (or 76.8%) compared with the previous quarter ended March 31, 2008. Selling expenditures as a percentage of sales for the quarter ended June 30, 2008 increased by 0.8% to 4.4% (from 3.6%) compared with the previous quarter ended March 31, 2008.

Selling expenditures for the quarter and nine months ended June 30, 2008 increased by \$1.2 million (or 130.0%) and \$1.3 million (or 40.7%), respectively, compared with the same period last year. Selling expenditures as a percentage of sales for the quarter and nine months ended June 30, 2008 increased by 0.9% to 4.4% (from 3.5%) and decreased by 0.1% to 4.2% (from 4.3%) compared with the same period last year.

Selling expenditures include transportation and related costs incurred for delivery of goods to customers by the sales department. In general, increases in selling expenditures were in line with increases in revenues in various periods.

### ***General and Administrative Expenditures***

General and administrative expenditures for the quarter ended June 30, 2008 increased by \$0.2 million (or 12.6%) compared with the previous quarter ended March 31, 2008. General and administrative expenditures as a percentage of sales for the quarter ended June 30, 2008 decreased by 0.7% to 2.8% (from 3.5%) compared with the previous quarter ended March 31, 2008.

General and administrative expenditures for the quarter and nine months ended June 30, 2008 increased by \$0.4 million (or 41.2%) and \$0.7 million (or 23.8%), respectively, compared with the same periods last year. General and administrative expenditures as a percentage of sales for the quarter and nine months ended June 30, 2008 decreased by 0.8% to 2.8% (from 3.6%) and by 0.5% to 3.1% (from 3.6%), respectively, compared with the same periods last year.

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 June 30, 2008 increased by \$0.2 million (or 58.3%) compared with the previous quarter ended March 31, 2008. Professional and consulting expenditures as a percentage of sales for the quarter ended June 30, 2008 remained the same compared with the previous quarter ended March 31, 2008.

Professional and consulting expenditures for the quarter and nine months ended June 30, 2008 increased by \$0.1 million (or 30.2%) and \$0.1 million (or 11.1%), respectively, compared with the same periods last year. Professional and consulting expenditures as a percentage of sales for the quarter and nine months ended June 30, 2008 decreased by 0.4% to 0.8% (from 1.2%) and 0.2% to 0.7% (from 0.9%) compared with the same periods last year.

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

### ***Earnings***

Net earnings for the quarter ended June 30, 2008 were \$6.8 million. Net earnings for the quarter increased by \$2.2 million (or 48.2%) compared with the previous quarter ended March 31, 2008. Net earnings as a percentage of sales for the quarter ended June 30, 2008 increased by 0.4% to 13.6% (from 13.2%) compared with the previous quarter ended March 31, 2008. The increase in net earnings compared to the previous quarter is mainly due to expanded capacity and increased selling prices of products.

Net earnings for the quarter and nine months periods ended June 30, 2008 increased by \$3.6 million (or 113.7%) and \$5.5 million (or 61.9%), respectively, compared with the same periods last year. Net earnings as a percentage of sales for the quarter and nine months ended June 30, 2008 increased by 1.8% to 13.6% (from 11.8%) and 1.6% to 13.7% (from 11.7%), respectively, compared with the same periods last year.

### ***Earnings per Share***

Earnings per share for the quarter and nine months periods ended June 30, 2008 were \$0.16 (\$0.15 fully diluted) and \$0.37 (\$0.34 fully diluted), respectively, compared to \$0.09 (\$0.08 fully diluted) and \$0.28 (\$0.27 fully diluted) from the same periods last year. During the quarter, 475,000 options were issued to directors, an employee, and an officer of the Company. Total stock-based compensation expense for the three months period ended June 30, 2008 was \$0.8 million, resulting in a decrease of \$0.02 (0.02 fully diluted) on earnings per share for the quarter.

***Earnings before Income Taxes, Depreciation and Amortization (“EBITDA”)***

EBITDA for the quarter ended June 30, 2008 increased by \$2.4 million (or 41.0%) compared with the previous quarter ended March 31, 2008. EBITDA as a percentage of sales for the quarter ended June 30, 2008 decreased slightly by 0.4% to 16.5% (from 16.9%) compared with the previous quarter ended March 31, 2008.

EBITDA for the quarter and nine months periods ended June 30, 2008 increased by \$3.7 million (or 81.5%) and \$6.2 million (or 52.0%), respectively, compared with the same periods last year. EBITDA as a percentage of sales for the quarter and nine months ended June 30, 2008 decreased by 0.4% to 16.5% (from 16.9%) and increased by 1.0% to 16.6% (from 15.6%), respectively, compared with the same periods last year. EBITDA was also impacted by increased stock-based compensation expense.

**Liquidity and Capital Resources**

*(in thousands of Canadian dollars except for ratios)* **June 30, 2008** **September 30, 2007**

	<b>June 30, 2008</b>	<b>September 30, 2007</b>
<b>Current Ratio</b>	3.75 : 1	3.03 : 1
<b>Cash</b>	22,592	17,453
<b>Working Capital</b>	92,080	36,669
<b>Total Assets</b>	184,141	100,027
<b>Total Debt</b>	33,504	18,031
<b>Total Equity</b>	149,637	81,995
<b>Debt to Equity Ratio</b>	0.22 : 1	0.22 : 1

***Cash Position***

Cash and cash equivalents totalled \$22.6 million as of June 30, 2008, representing an increase of \$5.1 million and a decrease of \$10.3 million compared with the balances as of September 30, 2007 and March 31, 2008, respectively. The decrease for the quarter ended June 30, 2008 is a result of \$22.2 million cash outflow used in operations, \$3.6 million invested in capital assets mainly for the expansion of Sichuan and Liaoning Migao, offset by \$8.2 million of cash flow from proceeds from exercise of options and warrants, \$5.8 million net proceeds from bank loan, and \$1.5 million foreign exchange gain.

At June 30, 2008, the Company has short-term bank loans outstanding totalling \$10.3 million for working capital purposes. The loans are secured by certain land use rights and building and the total carrying value of the security on the loan is \$2.4 million.

Migao has approximately \$3.9 million of land use rights payable.

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

***Working Capital***

Working capital was \$92.1 million as of June 30, 2008, representing an increase of \$55.4 million and \$17.6 million compared with balances as of September 30, 2007 and March 31, 2008, respectively. This latter increase is primarily attributable to \$3.4 million increase in accounts receivable, \$6.0 million increase in prepayments, deposits and other receivables, \$12.2 million increase in inventory, \$1.7 million decrease in accounts payable and accrued liabilities, \$11.4 million decrease in customer deposits, and offset by \$10.3 million decrease in cash and cash equivalents, \$6.0 million increase in bank loans, \$0.8 million decrease in net income taxes receivable.

At the end of the quarter, the Company has 50,504 tonnes of potassium chloride inventory on hand. Depending on the facility, the Company's goal is to maintain at least four to six months of raw material inventory at its warehouses.

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

Plant and equipment net of accumulated depreciation and amortization was \$31.8 million at June 30, 2008 compared with \$20.5 million and \$31.3 million as of September 30, 2007 and March 31, 2008, respectively.

Construction in progress was \$5.9 million at June 30, 2008 compared with \$6.0 million and \$3.4 million as of September 30, 2007 and March 31, 2008, respectively.

Land use rights net of accumulated amortization was \$19.4 million at June 30, 2008 compared with \$18.4 million and \$20.2 million as of September 30, 2007 and March 31, 2008. The slight decrease is due to unrealized foreign exchange losses on land use rights experienced during the quarter.

***Contractual Obligation Summary***

- Purchase contracts for raw materials and supplies in the amount of approximately \$54.3 million exist as of June 30, 2008. They were entered into in the normal course of business.
- Commitments on capital expenditures in the amount of approximately \$12.1 million exist as of June 30, 2008. They were entered into in the normal course of business.

**Report on Controls*****Disclosure Controls and Procedures***

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.

***Internal Control over Financial Reporting***

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, including formalizing approval and review processes by using checklists and initialing source documents, and performing 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 during the first quarter hired an additional designated accountant at the corporate head office into the role of Corporate Controller.

Other control factors that readers should be aware of include the fact that 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 misstatement occurring in this statement can be reduced. Also, the Company does not have a significant number of staff that possess an understanding of Canadian GAAP given that the Company operates primarily in the PRC and that PRC accounting follows policies prescribed and required by the PRC tax authorities. The Company is looking to hire an additional designated accountant to be based in China to provide additional technical support.

The Company is also required to disclose any change in internal control that has materially affected, or is reasonably likely to materially affect, the issuers controls over financial reporting. At the beginning of the quarter, the Company reported that its Chief Financial Officer ("CFO") had resigned and that an interim CFO had been appointed while the search for a new CFO was being conducted. Towards the end of the quarter, the Company announced that a new CFO had been appointed effective July 1, 2008. Whenever there is a change in senior financial personnel, there can be no assurance that internal controls and procedures previously established will continue to function as designed and intended.

It should be noted that while the officers of the Company have certified in the Company's Interim Filings 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 August 11, 2008, there were:

- 43,675,611 common shares outstanding.
- 1,385,000 stock options outstanding, with exercise prices of between \$2.85 to \$9.93, and weighted average remaining life of 3.72 years. 471,666 of these stock options are exercisable as of August 11, 2008.
- 2,603,300 warrants outstanding, with exercise price of \$5.30, exercisable before February 22, 2009.
- 120,500 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 June 30, 2008, 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. In addition, 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.

## **Proposed Transactions**

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

## **Outlook**

The Company is positioned to become the leading producer of specialty potash fertilizer in the Chinese market. As China's citizens continue to benefit from strong economic growth, demand for improved crop yield, higher quality food, and more variety is fuelling the growth of the fertilizer market in China. The Company's specialty fertilizers increase the yield, enhance the quality of the crops they are applied to, and provide a higher return to farmers, allowing the Company to continue experiencing high demand for its potash-based products in China.

Recently, global demand for potassium chloride ("MOP") has resulted in significant increases in the Company's raw material costs. China's government has responded to increased fertilizer costs by announcing and implementing several policies including those affecting fertilizer exports from China and selling prices of MOP and compound fertilizers within China. The policies are an effort to ensure adequate domestic supply of fertilizer and food, and to the extent possible, moderate upswings in food prices. No policies have been announced or implemented to restrict the selling price of specialty potash fertilizers within China. During the quarter, the Company has negotiated prices for its potash-based products reflecting more than a 100% increase over the average selling price in 2007. The new prices are now in effect and will have a positive impact on the financial results of the current quarter.

To accelerate revenue growth, the Company has undertaken the following projects to expand production capacity either at existing locations or by building facilities at new locations:

### **Sichuan Migao**

Sichuan Migao is currently operating at full production capacity of 80,000 tonnes of potassium nitrate per year. All of the production from the 80,000 tonne potassium nitrate facility has been sold to the end of the fourth quarter of fiscal 2008. The facility is adding the capability to produce potassium nitrate in an upgraded form. The upgrade will be completed in September and production will begin in October 2008. The upgraded potassium nitrate allows the Company to increase its competitive advantage.

### **Guangdong Migao**

An additional 60,000 tonnes of annual potassium sulphate capacity will be completed in September and full production will begin in October 2008. Both the production schedule and the construction costs are in line with company expectations. The expanded production capacity brings the total annual production capacity of the Guangdong Migao facility to 160,000 tonnes of potassium sulphate.

### **Shanghai Migao**

A potassium sulphate facility with 40,000 tonnes of initial capacity is under construction in Shanghai and is expected to be completed during calendar 2009. Delays at the Shanghai construction site are a result of a lack of approvals from Chinese government officials who are being allocated to prioritized government local

construction projects. These approvals are expected to be obtained in 2008, allowing for the completion in calendar 2009.

#### Changchun Migao

A new potassium sulphate facility, with 40,000 tonnes of initial capacity, was constructed in the city of Changchun, province of Jilin. The facility was completed on October 18, 2007 and production began on December 21, 2007. The project was on budget and completed ahead of schedule.

#### Liaoning Migao

On April 2, 2008, the Company announced plans to build a 120,000 tonne sulphuric acid production facility. Construction is estimated to be completed by the first half of calendar 2009. Sulphuric acid from this facility will be consumed by the Company's facilities located at Liaoning and nearby Changchun for the production of potassium sulphate.

#### Tianjin Migao

A potassium sulphate facility with 40,000 tonnes of initial annual capacity is under construction in the city of Tianjin and is scheduled to be completed in calendar 2009.

#### Zunyi Migao

A potassium sulphate facility with 40,000 tonnes of initial capacity is under construction in the city of Zunyi and is scheduled to be completed in calendar 2009.

#### Joint Venture with SQM

A potassium nitrate facility, jointly owned 50/50 by the Company and Chile based SQM, with 40,000 tonnes of initial capacity, is scheduled to be completed by the first half of calendar 2009.

Total capital expenditure for all the expansion projects noted above is budgeted to be approximately \$5,500,000 for the quarter ended September 30, 2008.

### **Critical Accounting Policies**

This MD&A should be read in conjunction with the Company's unaudited Consolidated Financial Statements for the three and nine month periods ended June 30, 2008, and the audited Consolidated Financial Statements for the year ended September 30, 2007 and the 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.

***Recent accounting pronouncements***

The Canadian Institute of Chartered Accountants issued the new Handbook Section 3064, "Goodwill and Intangible Assets", which will replace Section 3062, "Goodwill and Intangible Assets". The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of pre-production 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.

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

**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.