

# **Migao Corporation**

## **Management’s Discussion and Analysis**

**Six months ended March 31, 2009**

June 3, 2009

The following is Management’s Discussion and Analysis (“MD&A”) of the financial condition of Migao Corporation (the “Company” or “Migao”) and its financial performance for the six months ended March 31, 2009. This MD&A should be read in conjunction with the audited Consolidated Financial Statements and related notes as at and for the six months ended March 31, 2009 and the year ended September 30, 2008. Reference should also be made to the Company’s filings, including the Company’s annual information form, 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 directly and 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 Principles.

At March 31, 2009, the Company had 46,459,661 common shares outstanding. At June 3, 2009, the Company has 46,459,661 common shares outstanding.

### **Forward-Looking Information**

The statements made in this MD&A that are not historical facts, particularly those in the “Outlook” section, and also in “Results of Operations – Gross Profits”, 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 herein under “Risk Factors” and in the Company’s other 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 June 3, 2009.

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 to 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 (the “PRC”) for the production and sale of specialty potash fertilizer (potassium nitrate, potassium sulphate, and other related compounds), along with their co-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. As a result 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. Management of Migao believe it 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 Year**

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

On February 25, 2009, the Company announced that all warrants related to the February 22, 2007 private placement financing were exercised, including underwriter compensation warrants for a total of \$14.1 million in proceeds.

On February 25, 2009, the Company announced that as part of a policy driven initiative by China’s central government to fund agricultural businesses in China, Liaoning Migao and Guangdong Migao both obtained interest subsidized loans of RMB 40 million and 60 million, respectively. Liaoning Migao received an interest subsidy of RMB 1,785,600 from the Government in relation to the loan on February 23, 2009. The two loans, totalling RMB 100 million (approximately CDN \$18 million), each have an interest rate of approximately 4.8%, a term of one year, and are eligible for renewal after one year.

On February 12, 2009, the Company reported revenue of \$76.5 million and net income of \$12 million for the three-month period ended December 31, 2008. These results represent an increase of 210% and 287% over revenue and net income of the same quarter in 2007, respectively.

On December 22, 2008, the Company announced that it had changed its fiscal year end to March 31 from the current fiscal year end of September 30. The change in year end has been made to better align Migao’s financial reporting, tax planning, and business cycles with customers and suppliers. Accordingly, the financial year ended March 31, 2009 reflects a six month transitional period from October 1, 2008 to March 31, 2009.

On December 4, 2008, the Company reported record annual net income of \$27.3 million or \$0.67 per basic share from revenues of \$187 million for the year ended September 30, 2008. This record achievement represents an increase of 84% and 140% over fiscal 2007 revenues and net income, respectively.

On October 27, 2008, the Company announced that a 100,000 tonne per year compound fertilizer facility is under construction at Sichuan Migao. The new specialty fertilizer will combine the Company’s low-chloride potassium nitrate and/or potassium sulphate with other essential crop nutrients, as required, and is to be applied directly to tobacco crops. This new facility makes the Company the largest provider of specialty fertilizer to the tobacco industry in China. The decision to expand the Company’s line of business into compounding is a result of requests by one of Migao's tobacco customers for compound fertilizer and Migao's after sales and service. The Company plans to expand this line of business into other tobacco growing regions in China after the Sichuan facility is fully established at full production levels. Construction of the Sichuan-based facility was substantially completed at the end of March 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.

Based on historical performance and product pricing strategy, 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 raw material costs, variable production costs, and customer contract negotiations.

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

Measurement

Below under “Quarterly Results”, “Selected Annual Results”, and “Results of Operations” are three tables the Company uses to assess performance. The first table presents the Company’s consolidated results for the last eight quarters. The second table provides the Company’s consolidated results for the three periods ended March 31, 2009, September 30, 2008, and September 30, 2007. The last table sets out the Company’s consolidated results for the quarter and six month period ended March 31, 2009, compared with the quarter ended March 31, 2008 and the year ended September 30, 2008, respectively. Due to the difference in period lengths, the results of the six month period ended March 31, 2009 is not directly comparable to those of the year ended September 30, 2008.

Quarterly Results

<i>in thousands of Canadian dollars except per share and percentage data</i>	<b>Fiscal 2009</b>		<b>Fiscal 2008</b>				<b>Fiscal 2007</b>	
	<b>Q2</b>	<b>Q1</b>	<b>Q4</b>	<b>Q3</b>	<b>Q2</b>	<b>Q1</b>	<b>Q4</b>	<b>Q3</b>
<b>Revenues</b>	<b>84,953</b>	76,531	78,161	49,681	34,506	24,680	25,496	26,865
<b>Gross profit</b>	<b>18,977</b>	17,313	19,104	12,320	8,256	5,840	4,246	6,339
<b>Gross profit (% of revenues)</b>	<b>22.3%</b>	22.6%	24.4%	24.8%	23.9%	23.7%	16.7%	23.6%
<b>Selected operating expenses:</b>								
<b>Selling</b>	<b>1,617</b>	1,708	1,738	2,185	1,236	1,175	765	950
<b>General and administrative</b>	<b>2,614</b>	2,114	2,445	1,785	1,214	909	842	1,289
<b>Stock-based compensation</b>	<b>556</b>	592	593	804	264	227	226	186
<b>Finance costs</b>	<b>(18)</b>	305	208	84	88	81	288	-
<b>Pre-operating costs</b>	<b>38</b>	128	52	250	100	17	368	-
<b>Other income</b>	<b>51</b>	309	-	131	36	41	72	44
<b>Gain on sale of non-operating subsidiary</b>	<b>-</b>	-	-	99	-	-	-	-
<b>Income taxes</b>	<b>1,510</b>	824	1,168	675	561	371	(462)	791
<b>Income taxes (% of revenues)</b>	<b>1.8%</b>	1.1%	1.5%	1.4%	1.6%	1.5%	(1.8%)	2.9%
<b>Effective tax rate (% of income before taxes)</b>	<b>10.6%</b>	6.5%	8.3%	9.1%	10.9%	10.7%	(25.2%)	20.0%
<b>Net income</b>	<b>12,711</b>	11,951	12,870	6,767	4,565	3,100	2,292	3,167
<b>Net income (% of revenues)</b>	<b>15.0%</b>	15.6%	16.5%	13.6%	13.2%	12.6%	9.0%	11.8%
<b>EBITDA</b>	<b>15,296</b>	13,983	14,967	8,222	5,830	3,991	2,214	4,530
<b>EBITDA (% of revenues)</b>	<b>18.0%</b>	18.3%	19.1%	16.5%	16.9%	16.2%	8.7%	16.9%
<b>Earnings per share (in \$):</b>								
<b>Basic</b>	<b>0.28</b>	0.27	0.32	0.16	0.12	0.08	0.06	0.09
<b>Diluted</b>	<b>0.28</b>	0.27	0.31	0.15	0.11	0.08	0.06	0.08

**Selected Annual Results**

<i>In thousands of Canadian dollars except per share and percentage data</i>	<b>Six months ended March 31, 2009</b>	<b>Year ended September 30, 2008</b>	<b>Year ended September 30, 2007</b>
<b>Revenues</b>	<b>161,484</b>	187,028	101,804
<b>Net income (loss)</b>	<b>24,662</b>	27,303	11,206
<b>Earnings per share</b>			
<b>Basic</b>	<b>0.56</b>	0.67	0.33
<b>Diluted</b>	<b>0.55</b>	0.63	0.32
<b>Total Assets</b>	<b>275,192</b>	209,394	100,027
<b>Total Long Term Liabilities</b>	<b>375</b>	-	-
<b>Dividends</b>	-	-	-

## Results of Operations

### *Consolidated Results*

The following table sets out the Company’s consolidated results for the quarter and six month period ended March 31, 2009, compared with the quarter ended March 31, 2008 and the year ended September 30, 2008, respectively.

<i>In thousands of Canadian dollars except per share and percentage data</i>	<b>Q2 2009</b>	<b>Q2 2008</b>	<b>Increase (Decrease)</b>	<b>% Increase (Decrease)</b>	<b>YTD 2009</b>	<b>YTD 2008</b>	<b>Increase (Decrease)</b>	<b>% Increase (Decrease)</b>
<b>Revenues</b>	84,953	34,506	50,477	146.2%	161,484	187,028	(25,544)	(13.7%)
<b>Gross profit</b>	18,977	8,256	10,721	129.9%	36,290	45,520	(9,230)	(20.3%)
<b>Gross profit (% of revenues)</b>	22.3%	23.9%	(1.6%)	(6.7%)	22.5%	24.3%	(1.8%)	(7.4%)
<b>Selling expenses</b>	1,617	1,236	381	30.8%	3,325	6,334	(3,009)	(47.5%)
<b>Selling expenses (% of revenues)</b>	1.9%	3.6%	(1.7%)	(47.2%)	2.1%	3.4%	(1.3%)	(38.2%)
<b>G &amp; A</b>	2,614	1,214	1,400	115.3%	4,728	6,618	(1,890)	(28.6%)
<b>G &amp; A (% of revenues)</b>	3.1%	3.5%	(0.4%)	(11.4%)	2.9%	3.5%	(0.6%)	(17.1%)
<b>Stock-based compensation</b>	556	264	292	110.6%	1,148	1,888	(740)	(39.2%)
<b>Stock-based compensation (% of revenues)</b>	0.7%	0.8%	(0.1%)	(12.5%)	0.7%	1.0%	(0.3%)	(30.0%)
<b>Other income</b>	51	36	15	41.7%	360	180	180	100.0%
<b>Other income (% of revenues)</b>	0.1%	0.1%	0.0%	0.0%	0.2%	0.1%	0.1%	100.0%
<b>Income taxes</b>	1,510	561	949	169.2%	2,334	2,775	(441)	(15.9%)
<b>Income taxes (% of revenues)</b>	1.8%	1.6%	0.2%	12.5%	1.4%	1.5%	(0.1%)	(6.7%)
<b>Effective tax rate (% of net income before taxes)</b>	10.6%	10.9%	(0.3%)	(2.8%)	8.6%	9.2%	(0.6%)	(6.5%)
<b>EBITDA</b>	15,296	5,830	9,466	162.4%	29,279	33,010	(3,731)	(11.3%)
<b>EBITDA (% of revenues)</b>	18.0%	16.9%	1.1%	6.5%	18.1%	17.6%	0.5%	2.8%
<b>Net income (loss)</b>	12,711	4,565	8,146	178.4%	24,662	27,303	(2,641)	(9.7%)
<b>Net income (loss) (% of revenues)</b>	15.0%	13.2%	1.8%	13.6%	15.3%	14.6%	0.7%	4.8%
<b>Earnings per share</b>								
<b>Basic</b>	0.28	0.12	0.16	133.3%	0.56	0.67	(0.11)	(16.4%)
<b>Diluted</b>	0.28	0.11	0.17	154.5%	0.55	0.63	(0.08)	(12.7%)
<b>Weighted average number of common shares outstanding</b>								
<b>Basic</b>	45,102,080	38,187,058			44,381,008	40,658,089		
<b>Diluted</b>	45,677,958	40,820,628			44,708,973	43,099,724		

### Revenues

Revenues were \$85.0 million and \$161.5 million for the quarter and six months ended March 31, 2009, respectively, compared with \$34.5 million and \$187.0 million for the quarter ended March 31, 2008 and year ended September 30, 2008, respectively, representing an increase of \$50.5 million (RMB 220.8 million) or 146.2% and a decrease of \$25.5 million (RMB 465.7 million) or 13.7%, respectively. The increase compared to the same quarter last year is mainly due to expanded production capacity at certain facilities, production improvements, and higher selling prices. The decrease compared to year ended September 30, 2008 is due to the varying length of periods compared herein. The higher annualized revenue for the six months ended March 31, 2009 compared to year ended September 30, 2008 is mainly due to higher selling prices for potash-based products. The run rate for the core products was at 320,000 tonnes as of March 31, 2009, compared with 260,000 tonnes as of September 30, 2008.

Revenues for the quarter ended March 31, 2009 increased by \$8.4 million (RMB 35.1 million) or 11.0% to \$85.0 million (RMB 466.8 million) compared with the previous quarter ended December 31, 2008. The increased revenue is mainly due to production improvements and foreign exchange gains.

Migao earns all of its revenues in Chinese Renminbi (“RMB”). Accordingly, reported revenues will fluctuate with changes in the exchange rate of RMB to Canadian dollars. The average exchange rate for the quarter and six months ended March 31, 2009 were \$0.1822 and \$0.1797 to 1 RMB. The average exchange rate for the quarter ended March 31, 2008 and year ended September 30, 2008 were \$0.1402 and \$0.1425 to 1 RMB. The average exchange rate for the previous quarter ended December 31, 2008 was \$0.1773 to 1 RMB.

The following is a summary of the Company’s facilities and production capacities as of March 31, 2009.

	<b>Core Product</b>	<b>Annual Capacity (tonnes)</b>	<b>Co-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	160,000	Hydrochloric Acid	192,000	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>320,000</b>		<b>332,800</b>	

The Company continues to see strong demand for its core products: potassium nitrate and potassium sulphate, as well as its co-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 have significant export sales until the current 105% export tax is reduced or at such time that Migao builds a production facility outside of PRC. Currently, domestic Chinese demand consumes all of Migao’s production output.

***Gross Profit***

Gross profit was \$19.0 million and \$36.3 million for the quarter and six months ended March 31, 2009, respectively, compared to \$8.3 million and \$45.5 million for the quarter ended March 31, 2008 and year ended September 30, 2008, respectively, representing an increase of \$10.7 million (or 129.9%) and a decrease of \$9.2 million (or 20.3%), respectively. Gross margin as a percentage of sales for the quarter and six months ended March 31, 2009 decreased by 1.6% to 22.3% (from 23.9%) and by 1.8% to 22.5% (from 24.3%), respectively, compared with the quarter ended March 31, 2008 and year ended September 30, 2008, respectively. The increase in gross profit compared to the same period last year is due to expanded capacity and higher selling prices.

Gross profit for the quarter ended March 31, 2009 increased by \$1.7 million (or 9.6%) to \$19.0 million (from \$17.3 million) compared with the previous quarter ended December 31, 2008. Gross margin as a percentage of sales for the quarter ended March 31, 2009 decreased by 0.3% to 22.3% (from 22.6%) compared with the previous quarter ended December 31, 2008. Increase in gross profit compared to the previous quarter was due to production improvements and the decrease in gross profit margin was due to slight decrease in selling prices. Migao’s policy is to gradually adjust selling prices to key customers to maintain consistent gross margin level.

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 and six months ended March 31, 2009 increased by \$0.4 million (or 30.8%) to \$1.6 million (from \$1.2 million) and decreased by \$3.0 million (or 47.5%) to \$3.3 million (from \$6.3 million), respectively, compared with the quarter ended March 31, 2008 and year ended September 30, 2008, respectively. Selling expenditures as a percentage of sales for the quarter and six months ended March 31, 2009 decreased by 1.7% to 1.9% (from 3.6%) and 1.3% to 2.1% (from 3.4%) compared with the quarter ended March 31, 2008 and year ended September 30, 2008, respectively. The significant decrease in selling expenditure compared to the year ended September 30, 2008 can be explained by the varying comparative periods. The higher annualized expenditure for the six months ended March 31, 2009 compared to year ended September 30, 2008 is consistent with the increase in annualized revenue in the relevant periods.

Selling expenditures for the quarter ended March 31, 2009 decreased by \$0.1 million (or 10.7%) to \$1.6 million (from \$1.7 million) compared with the previous quarter ended December 31, 2008. Selling expenditures as a percentage of sales for the quarter ended March 31, 2009 decreased by 0.3% to 1.9% (from 2.2%) compared with the previous quarter ended December 31, 2008.

Selling expenditures include transportation and related costs incurred for delivery of goods to customers by the sales department. Excluding transportation cost, the majority of selling costs are fixed. In general, changes in selling expenditures were in line with fluctuations in revenues in the relevant periods.

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

General and administrative expenditures for the quarter and six months ended March 31, 2009 increased by \$1.4 million (or 115.3%) to \$2.6 million (from \$1.2 million) and decrease by \$1.9 million (or 28.6%) to \$4.7 million (from \$6.6 million), respectively, compared with the quarter ended March 31, 2008 and year ended September 30, 2008, respectively. General and administrative expenditures as a percentage of sales for the quarter and six months ended March 31, 2009 decreased by 0.4% to 3.1% (from 3.5%) and 0.6% to 2.9% (from 3.5%), respectively, compared with the quarter ended March 31, 2008 and year ended September 30, 2008, respectively. The decrease in general and administrative expenditures compared to the year ended September 30, 2008 can also be explained by the varying comparative periods.

General and administrative expenditures for the quarter ended March 31, 2009 increased by \$0.5 million (or 23.7%) to \$2.6 million (from \$2.1 million) compared with the previous quarter ended December 31, 2008. General and administrative expenditures as a percentage of sales for the quarter ended March 31, 2009 increased by 0.3% to 3.1% (from 2.8%) compared with the previous quarter ended December 31, 2008.

General and administrative expenditures include finance, human resources and management staff as well as facilities expenses, supplies and non-production equipment depreciation. It also includes corporate level expenses such as legal, accounting, auditing, consulting and directors’ fees. The majority of these costs are, for the most part, fixed and therefore fluctuate to a much lesser extent in relation to revenues.

### ***Earnings***

Net earnings for the quarter and six months ended March 31, 2009 increased by \$8.1 million (or 178.4%) to \$12.7 million (from \$4.6 million) and decreased by \$2.6 million (or 9.7%) to \$24.7 million (from \$27.3 million), respectively, compared with the quarter ended March 31, 2008 and year ended September 30, 2008, respectively. Net earnings as a percentage of sales for the quarter and six months ended March 31, 2009 increased by 1.8% to 15.0% (from 13.2%) and by 0.7% to 15.3% (from 14.6%), respectively, compared with the quarter ended March 31, 2008 and year ended September 30, 2008, respectively. Increase in net earnings was due to expanded production capacity and production improvements.

Net earnings for the quarter ended March 31, 2009 increased by \$0.7 million (or 6.4%) to \$12.7 million (from \$12.0 million) compared with the previous quarter ended December 31, 2008. Net earnings as a percentage of sales for the quarter ended March 31, 2009 decreased by 0.6% to 15.0% (from 15.6%) compared with the previous quarter ended December 31, 2008. Increases in net earnings were due to production improvements and decrease in net earnings percentage is due to the slight decrease in selling prices.

***Earnings per Share***

Earnings per share were \$0.28 (\$0.28 fully diluted) and \$0.56 (\$0.55 fully diluted) for the quarter and six months ended March 31, 2009, respectively, compared with \$0.12 (\$0.11 fully diluted) and \$0.67 (\$0.63 fully diluted) for the quarter ended March 31, 2008 and year ended September 30, 2008, respectively, representing an increase of \$0.16 (or 133.3%) and a decrease of \$0.11 (or 16.4%), respectively. The increase in earnings per share compared to the same quarter last year can be explained by expanded production capacity and higher year over year selling prices. The decrease in earnings per share compared to the year ended September 30, 2008 can be explained by the differing comparative periods. The higher annualized earnings per share for the six months ended March 31, 2009 compared to year ended September 30, 2008 is due to expanded capacity and higher selling prices for potash-based products.

Earnings per share for the quarter ended March 31, 2009 increased by \$0.01 (or 3.7%) to \$0.28 (from \$0.27) compared with the previous quarter ended December 31, 2008. Increase in earnings per share was mainly due to production improvements.

The total stock-based compensation expense for the quarter and six months ended March 31, 2009 were \$0.6 million and \$1.1 million, respectively, resulting in a decrease of \$0.01 (\$0.01 fully diluted) and \$0.02 (\$0.03 fully diluted) on earnings per share.

***EBITDA***

EBITDA for the quarter and six months ended March 31, 2009 increased by \$9.5 million (or 162.4%) to \$15.3 million (from \$5.8 million) and decrease by \$3.7 million (or 11.3%) to \$29.3 million (from \$33.0 million), respectively, compared with the quarter ended March 31, 2008 and year ended September 30, 2008, respectively. EBITDA as a percentage of sales for the quarter and six months ended March 31, 2009 increased by 1.1% to 18.0% (from 16.9%) and 0.5% to 18.1% (from 17.6%), respectively, compared with the quarter ended March 31, 2008 and year ended September 30, 2008, respectively. The increase in EBITDA over the same period last year and EBITDA percentage is due to increased production capacity and higher year over year selling prices. The decrease in EBITDA compared to the year ended September 30, 2008 is due to the varying length of periods compared herein. The higher annualized EBITDA for the six months ended March 31, 2009 compared to year ended September 30, 2008 is due to expanded capacity and higher selling prices.

EBITDA for the quarter ended March 31, 2009 increased by \$1.3 million (or 9.4%) to \$15.3 million (from \$14.0 million) compared with the previous quarter ended December 31, 2008. EBITDA as a percentage of sales for the quarter ended March 31, 2009 decreased by 0.3% to 18.0% (from 18.3%) compared with the previous quarter ended December 31, 2008. Increase in EBITDA was due to production improvements and decrease in EBITDA percentage is due to the slightly higher selling prices.

### *Income Tax Rates*

Income tax is levied on a calendar year basis separately for each subsidiary of the Company in accordance with the tax regulations of the PRC. Each of the Company’s operating subsidiaries has been and will be enjoying the “Exempt Two, Reduced Three” income tax policy for being Foreign Invested Enterprise (“FIE”), and is income tax exempt for the first two profitable years and at a reduced rate (50% of normal State level income tax plus local tax) for the next three profitable years.

More specifically, Sichuan Migao was exempt from income tax for the calendar years 2004 and 2005, and started to pay a combined 7.5% income tax (reduced from the normal 15%) from the beginning of calendar 2006 until the end of calendar 2008. Beginning calendar 2009, it started to pay the normal income tax rate of 15%.

Guangdong Migao was exempt from income tax for the calendar years 2005 and 2006, and started to pay income tax at 12% (reduced from the normal 24%) from the beginning of calendar 2007 until the end of calendar 2008 and 12.5% (reduced from the normal 25%) for calendar 2009. Beginning calendar 2010, it will start to pay the normal income tax rate of 25%.

Liaoning Migao is exempt from income tax for the calendar years 2006 and 2007, and started to pay income tax at 12.5% (reduced from the normal 25%) from the beginning of calendar 2008 until the end of calendar 2010. Beginning calendar 2011, it will start to pay the normal income tax rate of 25%.

Changchun Miago received full exemptions from income tax starting calendar years 2008 until the end of calendar 2009, and will start to pay income tax at 12.5% (reduced from the normal 25%) from the beginning of 2010 through 2012. Beginning calendar 2013, it will start to pay the normal income tax rate of 25%.

The National People’s Congress of China approved legislation relating to tax reforms on March 16, 2007. As of January 1, 2008, the tax incentives for FIE’s were removed. The State level income tax rate reduced to 25% from 30%. Each of the four operating subsidiaries of the Company will enjoy the favourable income tax policy as summarized above with new State level income tax rate applicable once coming out of its respective favourable income tax policy period. It is management’s belief that out of the three subsidiaries currently under construction (Shanghai Migao, Tianjin Migao and Zunyi Migao), only Shanghai Migao will enjoy a similar tax policy as the four operational subsidiaries. Tianjin Migao and Zunyi Migao will not be eligible to enjoy the favourable income tax policy as they were both incorporated after March 16, 2007.

Tax losses within the Canadian corporate office are not currently tax benefited. The Company, along with its tax advisors, have developed and are implementing a tax plan that will allow the Company to benefit any such tax losses in the near future.

## **Liquidity and Capital Resources**

*(in thousands of Canadian dollars except for ratios)*

	<b>March 31, 2009</b>	<b>September 30, 2008</b>
<b>Current Ratio</b>	5.40 : 1	3.32 : 1
<b>Cash</b>	42,241	16,850
<b>Working Capital</b>	146,210	95,343
<b>Total Assets</b>	275,192	209,394
<b>Total Debt</b>	33,639	41,016
<b>Total Equity</b>	241,553	168,378
<b>Debt to Equity Ratio</b>	0.14 : 1	0.24 : 1

### ***Cash Position***

Cash and cash equivalents totalled \$42.2 million as of March 31, 2009, representing an increase of \$25.4 million and \$24.4 million compared with the balances as of September 30, 2008 and December 31, 2008, respectively. The increase for the six months ended March 31, 2009 is a result of \$18.0 million cash inflow from operations, \$14.6 million of cash flow from proceeds from exercise of options and warrants, \$4.1 million net proceeds from bank loans, \$2.9 million foreign exchange gain, offset by \$14.2 million invested in capital assets mainly for the expansion of Sichuan Migao, Guangdong Migao and Liaoning Migao, as well as payments made to reduce the Company’s land use rights payable balance.

At March 31, 2009, the Company had short-term bank loans outstanding totalling \$20.7 million for working capital purposes and to fund fixed asset additions. The loans are secured by certain land use rights and buildings and the total carrying value of the security on the loans is \$1.3 million.

Migao has approximately \$0.7 million of land use rights payable.

The Company believes that its current cash position, working capital and cash flow is sufficient to meet the current ongoing needs of the business, which includes budgeted production expansion activities. 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 \$146.2 million as of March 31, 2009, representing an increase of 50.9 million and \$29.5 million compared with balances as of September 30, 2008 and December 31, 2008, respectively. This latter increase is primarily attributable to \$24.4 million increase in cash and cash equivalents, \$13.1 million increase in inventory, \$0.6 million decrease in accounts payable and accrued liabilities, \$13.4 million decrease in customer deposits, \$0.1 million increase in due from related parties, \$0.4 decrease in future income taxes, and offset by \$7.1 million decrease in accounts receivable, \$10.3 million decrease in prepayments, deposits and other receivables, \$4.1 million increase in bank loans, and \$1.0 million increase in net income taxes payable.

At the end of the period, the Company had \$66 million (106,587 tonnes) of potassium chloride inventory with an average delivered price of \$619 per tonne, of which 49,221 tonnes were on hand and the remainder in transit. In addition, at the end of the period, the Company had \$12.2 million (34,596 tonnes) of finished goods inventory on hand, including co-products.

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

Plant and equipment net of accumulated depreciation and amortization was \$52.1 million at March 31, 2009 compared with \$34.3 million and \$46.1 million as of September 30, 2008 and December 31, 2008, respectively.

PRC regulations allow tax credits to be applied for up to 40% of expenditures on purchases of domestic made equipment. Once approved, such credits can be refunded or utilized against income taxes to be levied in future years. During the period ended March 31, 2009, Sichuan Migao was approved and paid by the local tax authority a value-added tax refund totaling \$228 (RMB 1.3 million) on the purchase of domestic equipment. The value-added tax refund was recorded as a reduction of the cost of the related equipment.

Construction in progress was \$16.0 million at March 31, 2009, compared with \$10.3 million and \$17.1 million as of September 30, 2008 and December 31, 2008, respectively. These balances consist mainly of the construction costs attributable to expenses at Sichuan Migao compounding facility, Liaoning Migao sulphuric acid facility, as well as additional potassium sulphate capacity at Guangdong Migao and Shanghai Migao.

Land use rights net of accumulated amortization was \$25.1 million at March 31, 2009 compared with \$21.1 million and \$24.6 million as of September 30, 2008 and December 31, 2008, respectively.

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

- Purchase contracts for raw materials and supplies in the amount of approximately \$31.0 million exist as of March 31, 2009. They were entered into in the normal course of business.
- Commitments on capital expenditures in the amount of approximately \$6.3 million exist as of March 31, 2009. They were entered into in the normal course of business.

The following table summarizes our contractual obligations as at March 31, 2009, and the effect such obligations are expected to have on our liquidity and cash flows in future years. The table excludes amounts already recorded on the consolidated balance sheet as current liabilities and certain other purchase obligations discussed above.

	2010	2011	2012 and thereafter
<b>Operating lease</b>	<b>\$ 72</b>	<b>\$ 73</b>	<b>36</b>

## **Report on Controls**

### ***Disclosure Controls and Procedures***

Management has evaluated the effectiveness of the Company’s disclosure controls and procedures as at March 31, 2009 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 GAAP. Management has engaged independent external consultants to evaluate the design of the Company’s internal controls and procedures over financial reporting as at March 31, 2009, 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 consultants’ recommendations.

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 tracking when incompatible functions are performed and providing additional review and oversight at such times. Despite management’s best efforts, there can be no assurance that the risk of material misstatement occurring during such periods 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 PRC accounting follows policies are prescribed and required by the PRC tax authorities. The Company is reviewing the organizational structure of the accounting group to strengthen its resources to reflect the Company’s growth.

It should be noted that while the officers of the Company have certified the Company’s Annual 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 implemented, 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 June 3, 2009, there were:

- 46,459,661 common shares outstanding.
- 1,520,000 stock options outstanding, with exercise prices of between \$2.85 to \$9.93, and weighted average remaining life of 3.73 years. 454,999 of these stock options are exercisable as of June 3, 2009.

## **Off-Balance Sheet Arrangements**

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**

During the period ended March 31, 2009, the Company paid or accrued service fees of \$Nil for services performed by Liaoning Yongcheng Economic and Trade Development Co. Ltd. (“LYEDC”). Because of the difficulty in determining the fair market value, the values of these contributed services were not recognized in the financial statements. In addition, the Company prepaid \$157,798 to Beijing Wei De Sen (“BWDS”) for import agency fees. The transaction was in the normal course of business and was measured at the exchange amount, which is the amount agreed upon by the parties. Lastly, LYEDC has provided corporate guarantees on \$7,376,000 of the Company’s short-term bank loans outstanding as of March 31, 2009 and LYEDC has not charged any fees relating to these guarantees.

BWDS and LYEDC are both controlled by an officer and director of Migao.

During the period ended March 31, 2009, an officer and director of the Company had forgiven his salary of \$50,000. The forgiven salary has been included in the Company’s contributed surplus.

## **Proposed Transactions**

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

## **Outlook**

Based on market information and estimates of Chinese speciality potash fertilizer companies, management believes Migao 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 increased variety is fuelling the growth of the fertilizer market in China. The Company’s specialty fertilizers increase 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 the PRC.

Global demand and controlled supply 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.

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. During calendar 2008, the facility added the capability to produce potassium nitrate in an upgraded form and phase-in production began in December 2008. In addition, a 100,000 tonne per year compound fertilizer facility was constructed and test batch production began in March 2009. The first order for the compound facility will go into production during the first quarter of fiscal 2010. The upgraded potassium nitrate and the specialty compound fertilizer facility allow the Company to increase its competitive advantage.

#### Guangdong Migao

Construction of an additional 60,000 tonnes of annual potassium sulphate capacity is completed and production began in mid-November 2008. Both the production schedule and the construction costs were in line with the Company’s expectations. The expanded production capacity brings the total annual production capacity of the Guangdong Migao facility to 160,000 tonnes of potassium sulphate.

#### Changchun Migao

A 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. The facility has been running at full production since the beginning of calendar 2008.

Liaoning Migao

On April 2, 2008, the Company announced plans to build a 120,000 tonne per annum sulphuric acid production facility. Construction is estimated to be completed by June 2009. Sulphuric acid from this facility will be consumed by Liaoning Migao and nearby Changchun Migao for the production of potassium sulphate.

Shanghai Migao

A potassium sulphate facility with 40,000 tonnes of initial annual capacity in Shanghai is expected to be completed by the first half of calendar 2010. Delays at the Shanghai construction site are a result of delays in receiving necessary approvals from Chinese government officials and resources which are being allocated to local prioritized government construction projects. These approvals were obtained at the end of May 2009, allowing for the completion of construction by calendar 2010.

Tianjin Migao

A potassium sulphate facility with 40,000 tonnes of initial annual capacity will be constructed in the city of Tianjin. Constructions will begin as soon as necessary environmental approvals are obtained from Chinese government officials.

Zunyi Migao

A potassium sulphate facility with 40,000 tonnes of initial annual capacity will be constructed in the city of Zunyi. Delays at the Zunyi construction site are a result of delays in the construction of a public road connected to the construction site. Constructions of the facility will begin as soon as the public road is built by the Chinese government.

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 annual capacity, is scheduled to be completed by the first half of calendar 2010.

Capital Expenditure Summary

For the quarter and six months ended March 31, 2009, the total capital expenditure paid for all of the expansion projects noted above as well as plant and equipment additions was \$7.3 million and \$14.4 million, respectively. For the year ended March 31, 2010, the capital expenditure is budgeted for approximately \$40 million.

The following is a summary of the Company’s facilities and expected production capacities as of June 3, 2009.

	<b>Core Product</b>	<b>Annual Capacity (tonnes)</b>	<b>Co-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	160,000	Hydrochloric Acid	192,000	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>320,000</b>		<b>332,800</b>	

	<b>Other Products</b>	<b>Annual Capacity (tonnes)</b>	<b>Production Commencement</b>
Sichuan	Compound Fertilizer	100,000	June 2009
Liaoning	Sulphuric Acid	120,000	June 2009

It is anticipated that revenues for fiscal 2010 will be in the range of \$330 million to \$360 million. This forecast is based on the Company’s current pricing, prevailing foreign exchange rate, and production capacity.

### **Critical Accounting Policies**

This MD&A should be read in conjunction with the Company’s audited consolidated financial statements for the six months ended March 31, 2009 and the notes thereto. To aid in understanding the Company’s financial reporting, its critical accounting policies are described below. 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.

#### ***Basis of presentation***

The consolidated financial statements (the “financial statements”) have been prepared by management in accordance with Canadian GAAP and include the accounts of the Company and its subsidiaries in the PRC. All intercompany balances and transactions have been eliminated upon consolidation.

#### ***Cash equivalents***

The Company considers cash equivalents to be cash and highly liquid investments with original maturities of three months or less.

#### ***Inventory***

Effective October 1, 2008, the Company adopted CICA Handbook Section 3031- Inventories, which has replaced Section 3030 of the same title. The new standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories. In accordance with the new standard, raw materials and finished goods are valued at the lower of cost and net realizable value. The cost of finished goods comprises direct materials and, where applicable, direct labour costs and overhead costs. Cost is

determined using the weighted-average method. Net realizable value represents the anticipated selling price less all further costs for distribution. The Company now carries raw materials inventory at the lower of cost and net realizable value. Previously, the Company carried raw materials inventory at the lower of cost and replacement cost, however, the adoption of the new standard did not have a material impact on its consolidated financial position, results of operations or cash flows.

### ***Plant and equipment***

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

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

### ***Construction in progress***

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

### ***Land use rights***

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

### ***Impairment of long-lived assets***

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

### ***Income taxes***

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

***Income per share***

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

***Revenue recognition***

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

***Pre-operating costs***

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

***Stock-based compensation***

The Company has in effect a Stock Option Plan (“the Plan”). Stock options awarded to non-employees and employees are accounted for at fair value. Fair value is calculated using the Black-Scholes model and any consideration paid on the exercise of stock options is credited to share capital together with any accumulated contributed surplus.

***Government assistance***

The Company makes periodic applications for financial assistance under available government incentive programs including interest subsidies and tax credits or value-added tax refunds related to purchases of domestic equipments. The Company recognizes government assistance when it is approved by the government. Government interest subsidies are recorded as a reduction of finance costs when the expense is incurred. Government assistance relating to capital expenditures is reflected as a reduction of the cost of such assets.

***Foreign exchange***

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

***Financial Instruments***

The Company has classified its cash and cash equivalents as held-for-trading, which are measured at fair value. Accounts receivable, other receivables, and due from related parties are classified as loans and receivables, which are measured at amortized cost. Bank loans and accounts payable and accrued liabilities are classified as other financial liabilities, which are measured at amortized cost.

***Measurement uncertainty***

The preparation of the financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Significant items subject to such estimates and assumptions include the carrying amounts of plant and equipment, intangible assets, valuation allowances for receivables and inventories, and future income taxes and stock-based compensation (note 9). Actual results could differ from those estimates.

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

***Comparative Figures***

Certain comparative figures have been reclassified to conform to the presentation adopted in the current period.

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

The CICA issued the new Handbook Section 3064 - Goodwill and intangible assets, which replaces 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 standard also provides guidance for the treatment of preproduction and start-up costs and requires that these costs be expensed as incurred.

The adoption of this new standard did not impact the amounts reported in the Company’s 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 IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for profit-oriented publicly accountable enterprises to use IFRS, replacing Canadian GAAP for interim and annual financial statements relating to fiscal years

beginning on or after January 1, 2011. The Company is required to adopt IFRS for the year beginning April 1, 2011 and is required to restate the comparative figures. While the Company has begun assessing and reviewing the impact of IFRS, and has engaged in professional development for its adoption in 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

In January 2009, the CICA issued Handbook Sections 1582 - Business Combinations (“Section 1582”), Section 1601 - Consolidated Financial Statements (“Section 1601”), and Section 1602 - Non-controlling Interests (“Section 1602”). Section 1582 replaces CICA Handbook Section 1581- Business Combinations and establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under IFRS. Section 1582 is applicable for the Company’s business combinations with acquisition dates on or after April 1, 2011. Early adoption of this section is permitted. Section 1601 together with Section 1602 replaces CICA Handbook Section 1600 - Consolidated Financial Statements. These new sections establish standards for the preparation of consolidated financial statements. Sections 1601 and 1602 are applicable for the Company’s interim and annual consolidated financial statements for its fiscal year beginning April 1, 2011. Early adoption of these sections is permitted. If the Company chooses to early adopt any one of these sections, the other two sections must also be adopted at the same time. The Company does not expect the adoption of these new sections to have a material impact on its consolidated financial position or results of operations unless transactions occur.

## **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 following are certain risk factors inherent in the Company’s business and an investment in shares of the Company. These risks and uncertainties are not the only ones facing the Company. Additional risks and uncertainties not currently known to the Company, or that the Company currently considers immaterial, may also impair the operations of the Company. If any such risks actually occur, the business, financial condition, liquidity and operating results of the Company could be materially adversely affected.

### **Company Risk Factors**

#### ***Execution of the Business Plan***

Although management of the Company has developed a business plan, there can be no assurance that the business plan will succeed in whole or in part.

The success of the Company’s expansion strategy will depend on a number of factors. There can be no assurance that the Company will be able to achieve its planned growth. There can be no assurance that the

Company’s expansion strategy will be successful, that modifications to its strategy will not be required or that the Company will be able to enhance profitability. In addition, such growth could place a significant strain on the Company’s management, operational, financial and other resources. The Company’s ability to manage its growth effectively will require it to develop its management information systems capabilities and improve its operational and financial systems. Moreover, the Company will need to train, motivate and manage its employees and attract senior managers and technical professionals. Any failure to expand these areas and implement and improve such systems, procedures, and controls in an efficient manner and to train, motivate and manage its employees and attract senior managers and technical professionals at a pace consistent with the Company’s business could have a material adverse effect on the Company’s business, financial condition and operating results.

The Company has targeted the potash chemical fertilizer market in China as a focus for its business. There can be no assurance that this market will continue to develop and, given the Company’s limited experience and operating history in this market, there is no assurance that the Company’s investment and efforts in this market will be successful, which may adversely affect the Company’s business, financial condition and operating results.

#### ***Dependence on Key Personnel***

Due to the specialized and sophisticated nature of the Company’s business, the Company is highly dependent on the continued service of, and on its ability to attract and retain, qualified technical, marketing and managerial personnel, particularly highly skilled engineers involved in the development of new products and processes and test technicians involved in the quality of existing products. Due to the relatively small size of the Company, the loss of any of these persons or the Company’s inability to attract and retain additional highly skilled employees may adversely affect its business operations, financial condition and operating results. The Company does not currently carry any keyman life insurance on any of its executives.

Personnel matters are a particular concern in China for a number of reasons. First, intellectual property rights are not as well protected or highly valued in China as in certain other countries, and it is not uncommon for employees to take trade secrets and confidential information with them to new employers. This could have a significant negative impact on the Company’s competitiveness. Second, when senior managers quit or are terminated, it is not uncommon for the employees they supervised to leave with them, taking significant institutional knowledge. Finally, with the growth of China’s economy has come newfound mobility for employees such that many employees change jobs on a regular basis. The Company expects that it will need to provide incentives to retain its key personnel and such incentives could decrease its profitability, and affect its financial condition and operating results.

***Key Relationships***

To date, the success of Migao has been, in part, dependent on personal and corporate relationships with suppliers, customers and certain government officials. The alteration or termination of these relationships could have a substantial impact on the future success of the Company and may adversely affect the Company’s business, financial condition and operating results.

***Dependence on Key Customers***

For the six months ended March 31, 2009, one customer comprised 39% of revenue for Migao. There can be no assurance that Migao will be able to retain its relationship with this customer or other key customers, and there can be no assurance that such customers will continue to purchase products from Migao in the future. Any negative change involving any of Migao’s largest customers, including but not limited to any such customer’s financial condition or desire to continue purchasing Migao’s products, could result in a significant reduction in business that could have a material adverse effect on the Company’s business, financial condition and operating results.

***Competition***

The Company expects to encounter competition from other entities having a business objective similar to its own. Many of these entities are well established and have extensive experience in connection with identifying and effecting business acquisitions directly or through affiliates. Many of these competitors possess greater financial, technical, personnel and other resources than the Company, and there can be no assurance that the Company will have the ability to compete successfully.

Competitors may introduce technological innovation in any of the Company’s businesses, resulting in increased competitive pressures. The Company’s financial resources will be relatively limited when contrasted with those of many of their competitors. Although the Company’s projections assume that the industry will generate competition, there can be no assurances on how any level of competition may impact the future revenues of the Company. China can be a fiercely competitive market and small price or quality differentials between otherwise competitive goods and services can make an enormous difference to the consumer.

***Market Factors and Volatility of Commodity Prices***

Various commodity raw materials are used in the products manufactured by Migao. Commodity prices are subject to volatile price changes resulting from a variety of factors including international economic trends, global and regional demand, interest rates and global and regional consumption patterns. Accordingly, the Company is exposed to market risk from fluctuating market prices of certain commodity raw materials.

There is also a risk that market prices of other inputs required for the Company’s business, such as electricity and natural gas, may fluctuate, exposing the Company to market risk. In addition, if temporary shortages due to disruptions in supply caused by weather, transportation, production delays or other factors require the

Company to secure its raw materials or other inputs from other sources than its current suppliers, there can be no assurance that the Company will be able to do so on terms as favourable as its current terms or at all.

The Company’s financial performance is also linked to the selling prices of its products. Historically, prices for fertilizer products have been volatile. The price at which the Company sells its fertilizer products and other products could fall or fluctuate unpredictably in the event of changes in industry supply and demand conditions. The Company is not able to predict future market conditions and selling prices of its products with any certainty.

Any price volatility in raw materials, other inputs or in the Company’s products may have a material adverse effect on the Company’s business, operating results, cash flow and the Company’s ability to satisfy its debt obligations and capital expenditure requirements. There is a potential risk that the Chinese government may impose price controls on the Company’s products which could have a material adverse effect on the Company’s business, financial condition and results of operations.

#### ***Environmental Risks and Hazards***

The Company’s operations are subject to various environmental laws which regulate matters such as health, safety, treatment of waste and land use. Failure to comply with applicable laws, regulations, and licensing requirements may result in enforcement actions thereunder. Penalties could include suspension or revocation of necessary licenses or permits, civil liability or the imposition of fines. The cost of compliance, remediation or liability could materially affect future operating results. Furthermore, the operational or financial impact of new or amended laws or regulations cannot be predicted and could have a material adverse impact on the Company’s business, financial condition and operating results.

#### ***Operating Risks***

The majority of the Company’s plants are in the early stages of development and have short operating histories, if any. There is a risk that the plants may not be or continue to be profitable or successful. There can be no assurance that the additional plants will commence commercial operation on schedule or at all, or that the plants will operate at planned production capacity. The delay or cancellation of any of planned plant expansions may affect the Company’s ability to satisfy customer orders.

There are also many risks associated with the operating facilities, including the ability to secure raw materials and components, utility prices, the failure or substandard performance of equipment, hiring and maintaining a productive and reliable workforce, labour disputes, natural disasters, suspension of operations and compliance with existing and new governmental statutes, regulations, and policies. The occurrence of material operational problems, including but not limited to any of the events described above, could have a material adverse effect on the Company’s business, financial condition and operating results.

Achieving market success will require substantial marketing efforts and the expenditure of significant funds to inform potential customers, including third party distributors, of the distinctive characteristics and benefits of

Migao’s products and services. The Company’s long-term success may also depend, to a significant extent, on its ability to expand its present internal marketing organization. The Company will, among other things, have to attract and retain experienced marketing and sales personnel. No assurance can be given that the Company will be able to attract and retain qualified or experienced marketing and sales personnel or that any efforts undertaken by such personnel will be successful.

To the extent that customers delay, reduce, or cancel orders or are unable or refuse to pay for products and services purchased in a timely fashion or at all, the Company’s business, financial condition and operating results could be adversely affected.

### ***Proprietary Rights***

Proprietary protection of Migao’s processes, apparatuses and other technology is important to the business. Consequently, the Company relies on judicial enforcement for protection of its patents. There can be no assurance that any of the Company’s patents will not be challenged, invalidated or circumvented. Furthermore, if any pending patent application filed by Migao does not result in an issued patent, then the use of any such intellectual property by competitors could have an adverse effect on the Company’s business, financial condition and operating results. Additionally, competitors or other third parties may obtain patents that restrict or preclude the Company’s ability to lawfully produce or sell its products in a competitive manner which could have an adverse effect on the Company’s business, financial condition and operating results.

### ***Infrastructure***

Industrial activities depend, to one degree or another, on adequate infrastructure. Reliable roads, bridges, power sources and water supply are important determinations, which affect capital and operating costs. Unusual or infrequent weather phenomena, malfunction, sabotage, government or other interference in the maintenance or provision of such infrastructure could adversely affect the Company’s business and operations, financial condition and operating results.

### ***Future Capital Requirements***

The development of the Company’s business may require additional financing, which may be substantial. The Company’s future capital requirements will depend upon many factors, including maintenance, plant expansion and expansion of its sales and marketing efforts. Failure to obtain sufficient financing may result in delaying, scaling back, eliminating or indefinitely postponing the development schedule and its current or future programs. There can be no assurance that additional capital or other types of financing will be available if needed or that, if available, the terms of such financing will be favourable to the Company.

There is no assurance that the Company’s business will generate sufficient cash flow from operations in the future to service its debt and make necessary capital expenditures, in which case the Company may seek additional financing, dispose of certain assets or seek to refinance some or all of its debt.

Although Chinese banks are in the midst of reform, the basis on which they can lend money is not transparent and they do not often lend money to foreign invested enterprises. Obtaining financing from a Chinese bank will, to a certain extent, involve leveraging personal relationships. There is no guarantee that Migao will have the right relationships if and when it requires further financing. The Chinese government has articulated the need to try and control the rate of economic growth in China and has set out stricter lending policies, and this too could adversely affect the Company’s ability to obtain future bank financing in China.

### ***Technical Substitution***

Presently, the “Double Decomposition Process” process is used by Sichuan Migao to produce agricultural potassium nitrate. However, along with the discovery of new resources, technical progress, and the increasing advances in chemical production, new processes may be developed to produce higher quality and/or lower cost agricultural potassium nitrate.

Guangdong Migao and Liaoning Migao installed the “Mannheim Process” to produce potassium sulphate, one of the most commonly used quality potassium sulphate processes in the world. In recent years, a number of different potassium sulphate productive technologies have been developed in China. Although none of them are currently widely used due to lack of operational history and a lack of raw materials, there may be new potassium sulphate production processes developed or employed which may have new or additional benefits.

The development of new technologies and fertilizer-related products could have an adverse effect on the Company’s business, financial condition and operating results.

### ***Exchange Rate Fluctuations***

The value of the RMB fluctuates and is subject to various factors such as changes in political and economic conditions. Since 1994, the official exchange rate for the conversion of RMB to US dollars has generally been stable. On July 21, 2005, the RMB was revaluated upwards by approximately 2% against the US dollar when the People’s Bank of China (“**PBOC**”) announced the change of the RMB exchange regime from a US dollar peg system to a managed floating exchange rate regime based on a basket of currencies. Thereafter, the RMB has been allowed to fluctuate daily by not more than 0.3% against the US dollar.

Exchange rate fluctuations may adversely affect the Company’s financial position and operating results. There is no assurance that the value of the RMB will remain at the current level against the US dollar or against any other foreign currency. The Company does not currently have in place a policy for managing or controlling foreign currency risks since, to date, its primary activities have not resulted in material exposure to foreign currency risk.

As the Company reports financial results in Canadian dollars but earns its revenue in RMB, an increase in the Canadian dollar relative to the RMB will adversely affect the value, translated or converted into Canadian dollars, of the Company’s revenue and net income.

***Insurance***

Migao’s operating subsidiaries maintain property and casualty insurance on certain of their assets. However, not all risks are covered by insurance and no assurance can be given that insurance will be consistently available or will be consistently available on an economically feasible basis. Operating subsidiaries of the Company may also elect not to be insured against certain liabilities due to high premium costs or for other reasons. Furthermore, although the subsidiaries maintain insurance against such claims and in such amounts as each considers adequate, there can be no assurance that such insurance policies will be sufficient to cover each and every claim or loss. In the event the subsidiaries were to suffer an uninsured loss, their business, financial condition and operating results could be materially adversely affected.

***Foreign Operations***

Currently, the Company’s operations are conducted in the PRC and it is anticipated that this will continue to be the case. As such, the Company’s operations are exposed to various levels of political, economic and other risks and uncertainties. These risks and uncertainties include, but are not limited to: currency exchange rates; high rates of inflation; labour unrest; renegotiation or nullification of existing concessions, licenses, permits and contracts; changes in taxation policies; restrictions on foreign exchange; government corruption; changing political conditions; currency controls and governmental regulations that favour or require the awarding of contracts to local contractors or require foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction.

Changes, if any, in investment policies or shifts in political attitudes in China may adversely affect the Company’s operations or profitability. Operations may be affected in varying degrees by government regulations with respect to, but not limited to, restrictions on production, price controls, export controls, currency remittance, income taxes, foreign investment, environmental legislation, land use, land claims of local peoples and water use. Any events resulting in an adverse impact on the Chinese economy may have an adverse effect on the Company’s profitability and prospects.

The occurrence of these various factors and uncertainties cannot be accurately predicted and could have an adverse effect on the Company’s business, financial condition and operating results. See “Risks of Doing Business in China” below.

***Weather Conditions and Natural Disasters***

Weather conditions affect the demand for the Company’s products and the availability of raw materials and other inputs. For example, weather conditions such as floods, droughts, or frost can cause crop failures that in turn affect the demand for fertilizer. Unfavourable weather conditions or the occurrence of natural disasters (such as fire, insect infestation and earthquake) may affect the Company’s business, financial condition and operating results.

***Control by Management***

Management has significant aggregate stock ownership and effective control, with the ability to perpetuate their status as officers and directors and, therefore, conduct the business and affairs of the Company. While the rights of minority shareholders would be protected in Canada, judgements rendered against the Company and/or its subsidiaries would likely not be enforceable in China.

***Seasonality***

The Company is exposed to some seasonality risk due to factors including, but not limited to, the nature of its products, weather conditions and the buying patterns of major customers. These potential seasonality factors should also be considered together with the growth of the business. While some factors are not within its control, the Company can mitigate the risk by negotiating purchasing times with major customers and establishing a sales network across PRC to span different regions and weather conditions.

***Dividends***

The Company currently does not plan on declaring any dividends in the foreseeable future. Any future dividend policy will be determined by the Board of Directors of the Company.

***Conflicts of Interest***

Certain of the directors and officers of the Company also serve as directors and/or officers of other companies and consequently there exists the possibility for such directors and officers to be in a position of conflict. Any decision made by any of such directors and officers involving the Company will be made in accordance with their duties and obligations to deal fairly and in good faith with a view to the best interests of the Company and its shareholders.

**Risks of Doing Business in China*****State Ownership***

The Company carries on its business in China and derives all of its profit from the activities of its operating subsidiaries. As such, the Company’s subsidiaries’ operating results, financial positions and prospects are subject to a significant degree of risk relating to certain economic, political, social and legal developments in China.

The Chinese economy differs from the economies of most developed countries in a number of respects, including its structure, the level of government involvement, the level of development, the control of foreign exchange and the allocation of resources.

Before its adoption of reform and open door policies beginning in 1978, China was primarily a planned economy. Since that time, China’s economy has been undergoing a transition from a planned economy to a more market-oriented economy. Although in recent years the Chinese government has implemented economic

reforms, reduced state ownership and established sound corporate governance in business enterprises, a substantial portion of productive assets in China are still owned by the Chinese government. In addition, the Chinese government continues to play a significant role in regulating industry by imposing industrial policies. It also exercises significant control over China’s economic growth through the allocation of resources, control for foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Furthermore, government policies relating to currency conversion, taxation, import restrictions and the trading of imported goods, among others, continue to have a significant impact on the overall economy, as does the presence of the government as a market participant as well as the market regulator. Many of the policy changes initiated since 1978 are unprecedented in China, experimental in nature, and are frequently refined and readjusted. Political and social factors may also lead to further refinements and readjustments. Any changes in Chinese political, economic or social conditions, or to the current laws and regulations, or their interpretations, may adversely affect the Company’s profitability and prospects.

The economy of China has experienced significant growth in the past 20 years, but growth has been uneven both geographically and among various sectors of the economy. The Chinese government has implemented various macro-economic control measures from time to time in order to try and control the rate of economic growth, including certain measures which were put in place to restrict bank lending. Some of these measures may have a negative effect on the Company. For example, the Company’s operating results and financial position may be adversely affected by: changes in the rate or method of taxation; imposition of additional restrictions on currency conversion and remittances abroad; reduction in tariff or quota protection and other import restrictions; changes in the usage and costs of state-controlled transportation services; and state policies affecting the fertilizer industry. In addition, such macro-economic control measures may have a general adverse impact on the Chinese economy that would, in turn, likely have an adverse impact on the Company’s business, financial condition and operating results.

### ***Government Sector Intervention***

The central and local governments exercise a substantial degree of influence over the fertilizer industry in China and, as a result, set standards that new entrants must meet through approval of major capital expenditure projects; setting or approving the framework for the pricing of electricity and other utilities and railway transportation; and setting tax levies and incentives, import quotas and tariffs, and safety, environmental and quality standards.

If the Chinese government changes its current policies, or the interpretation of those policies, the Company may face significant constraints on its flexibility and ability to expand its business operations or to maximize its profitability. Under current Chinese regulatory requirements, all major capital expenditure projects require Chinese national and/or provincial government approval.

***Tobacco Industry***

Customers in the tobacco industry in China represented approximately 50% of revenue for Migao in Fiscal 2009. While tobacco consumption in China has been increasing, there is a risk that China will adopt anti-smoking policies similar to those in developed countries which could curb tobacco consumption. Such policies could include increased tobacco taxes, warning pictures on cigarette packages, a ban on tobacco advertising, a ban on smoking in public places and/or other measures. Such policies could have an adverse effect on the Company’s business, financial condition and operating results.

***Foreign Investment***

In China, companies with a foreign ownership component could be required to work within a framework which is different to that imposed on local companies. The Chinese government is currently opening up opportunities for foreign investment in fertilizer projects and this process is expected to continue, especially given China’s recent entry into the World Trade Organization. If, however, the Chinese government should reverse this trend and impose greater restrictions on foreign companies, the Company’s ability to conduct business in China could be negatively affected.

***Repatriation of Profit and Currency Conversion***

The Chinese government imposes control over the convertibility of the RMB into foreign currencies. With effect from July 21, 2005, the PRC government has reformed the RMB exchange rate regime into a managed floating exchange rate regime based on market supply and demand with reference to a portfolio of currencies, giving more flexibility as compared with the former system in which the RMB was pegged to the US dollar. See “Exchange Rate Fluctuations” above. Under the reformed system, the PBOC announces the closing price of a foreign currency traded against the RMB in the inter-bank foreign exchange market after the closing of the market on each working day, and will make it the central parity for trading against the RMB on the following working day. PRC banks licensed to engage in foreign exchange transactions use the closing price announced by the PBOC as a basis and decide a rate of their own to enter into foreign exchange sale and purchase transactions with customers; such rate shall be within a specified floating band around the central parity which may be adjusted by the PBOC from time to time according to the economic and financial condition of the PRC. Although such new regulations have provided for greater liquidity of the RMB, the RMB is still not a freely convertible currency.

Migao’s operating subsidiaries earn all of their revenues in RMB. Under current regulations, there is no restriction on foreign exchange conversion on the current account (including dividend payments to foreign investors) although any foreign exchange transaction on the capital account is subject to significant foreign exchange controls and requires the prior approval from the State Administration of Foreign Exchange (“SAFE”). However, even on the current account, the RMB is not a freely convertible currency. Migao’s operating subsidiaries are allowed to pay outstanding current account obligations in foreign exchange but must

present the proper documentation to a designated foreign exchange bank to prove the authenticity of foreign exchange under the current account. While the Chinese government is generally relaxing restrictions on foreign trade and investment, there is no certainty that all future local currency can be repatriated.

There can also be no assurance that the availability of foreign currency will be sufficient for the Company’s operating subsidiaries to satisfy their other foreign currency obligations. This may, in turn, adversely affect the Company’s ability to pay dividends. There is also no guarantee that foreign exchange control policies will not be changed so as to require government approval to convert RMB into foreign currency on the current account. In addition, failure to obtain approval from SAFE for currency conversion on the capital account may impact on the Company’s capital expenditure plans and its ability to expand in accordance with its objectives.

### ***Tax***

The Company’s subsidiaries currently receive special tax treatment in China. As a result of national tax regulations and local incentives, a reduced enterprise income tax rate is granted to foreign invested companies registered in specific economic development zones. Accordingly, the subsidiaries pay enterprise income tax at a reduced rate.

The Enterprise Income Tax Law (“EITL”) enacted in March 2007 removed the tax incentives offered to foreign invested enterprises since wholly domestically owned companies did not receive such incentives. Established Migao operating subsidiaries may enjoy certain “grandfathering” provisions under the EITL, however there can be no certainty in this regard until each subsidiary applies for, and if available to it, receives, approval. Any increase in the tax rate to which the Company or its subsidiaries are subject, pursuant to the EITL or otherwise, will reduce the net profitability of the Company. Such reduction could be material and historical financial results may thus not be indicative of results for future periods.

Under current Chinese laws, any dividends H.K. Migao Industry Limited (a wholly-owned subsidiary directly held by the Company) may receive from the Migao operating subsidiaries are not subject to Chinese tax. There can be no assurance that these dividends will continue not to be subject to tax in the future.

### ***Shareholders’ Rights and Enforcement of Judgements***

As Chinese legal entities, Migao’s operating subsidiaries are subject to Chinese company law and regulations. Chinese company law, in general, and provisions for the protection of shareholders’ rights and access to information, in particular, are less developed than those applicable to companies in other countries. Substantially all of the Company’s assets, through its subsidiaries, are located in China. China does not have a treaty with Canada providing for the reciprocal recognition and enforcement of judgements of courts and, as such, recognition and enforcement in China of judgements of a Canadian court in relation to any matter not subject to a binding arbitration provision may be difficult or impossible. Although the rights of minority shareholders in the Company would be protected in Canada, judgements rendered against the Company and/or its subsidiaries would likely not be enforceable in China.

***Developing Legal System***

The Chinese legal system is a system based on written statutes that are often incomplete or drafted ambiguously. They are interpreted by the Supreme Peoples’ Court and prior court decisions may be cited for reference but have limited precedential value. Since 1979, the Chinese government has been developing a comprehensive system of commercial laws, and considerable progress has been made in introducing laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade.

However, because these laws and regulations are relatively new, and because of the limited volume of published cases and their non-binding nature, interpretation and enforcement of these laws and regulations involve uncertainties. In addition, many judges in the PRC take a pragmatic view of the law and seek to resolve problems without necessarily enforcing the legal rights of the aggrieved parties. As the Chinese legal system develops, changes in such laws and regulations, their interpretation or their enforcement may have a material effect on the Company.

***Protection of Intellectual Property Rights***

Intellectual property rights in China are still developing and there are uncertainties involved in intellectual property rights protection and the enforcement of such protection. The Company will need to pay special attention to protecting its intellectual property and trade secrets. Failure to do so could lead to the loss of a competitive advantage that could not be compensated for by a damages award.

***Permits and Business Licenses***

Migao’s operating subsidiaries hold various permits, business licenses and approvals authorizing their operations and activities which are subject to periodic review and re-assessment by the Chinese authorities. Standards of compliance necessary to pass such reviews change from time to time and differ from jurisdiction to jurisdiction, leading to a degree of uncertainty. If renewals, or new permits, business licenses or approvals required in connection with existing or new facilities or activities, are not granted or are delayed, or if existing permits, business licenses or approvals are revoked or substantially modified, the Company may suffer a material adverse effect. If new standards are applied to renewals or new applications, it could prove costly to the Company to meet any new level of compliance.

***Appropriation***

Migao’s operating subsidiaries have purchased certain land use rights in China. Under Chinese law, land use rights can be revoked in the public interest, although holders of such appropriated land use rights typically receive compensation. Events in China have shown that the public interest rationale is interpreted quite broadly and the process of land appropriation may be less than transparent.

*Availability of Land*

Land in China is divided into agricultural land, construction land and unused land. In October 2007, a new policy was issued by the Chinese government restricting the use or conversion of agricultural land for non-agricultural purposes (which would include the Company’s purposes). While the policy does not prohibit the use of agricultural land for non-agricultural purposes, it may make it more difficult for Migao to secure new land and/or increase the price of available properties.