



**Audited Consolidated Financial Statements  
For the Year Ended July 31, 2011**

# Independent Auditor's Report

## To the Shareholders of MBAC Fertilizer Corp.

We have audited the accompanying consolidated financial statements of MBAC Fertilizer Corp. (the Company), which comprise the consolidated balance sheets as at July 31, 2011 and 2010 and the consolidated statements of operations, comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies.

### Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes valuating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of MBAC Fertilizer Corp. as at July 31, 2011 and 2010 and the results of operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants, Licensed Public Accountants  
Toronto, Canada

October 28, 2011

**MBAC FERTILIZER CORP.****Consolidated Balance Sheets**

As at July 31, 2011 and 2010 (In thousands of Canadian dollars)

|  | 2011              | 2010              |
|--|-------------------|-------------------|
| <b>ASSETS</b>                                      |                   |                   |
| <b>Current</b>                                     |                   |                   |
| Cash   | \$ 73,060         | \$ 63,349         |
| Accounts receivable                                | 2,814             | 773               |
| Inventories (Note 4)                               | 1,334             | 1,450             |
| Other current assets                               | 627               | 576               |
|  | <b>77,835</b>     | 66,148            |
| Investments (Note 5)                               | -                 | 564               |
| Long-term accounts receivable                      | 573               | -                 |
| Property, plant and equipment (Note 6)             | 27,222            | 9,898             |
| Mineral properties and exploration assets (Note 7) | 68,789            | 60,704            |
|  | <b>\$ 174,419</b> | <b>\$ 137,314</b> |
| <b>LIABILITIES</b>                                 |                   |                   |
| <b>Current</b>                                     |                   |                   |
| Accounts payable and accrued liabilities           | \$ 9,106          | \$ 3,363          |
| Future income taxes (Note 8)                       | 2,366             | 15,254            |
| Asset retirement obligation                        | 154               | 51                |
|  | <b>11,626</b>     | 18,668            |
| <b>SHAREHOLDERS' EQUITY</b>                        |                   |                   |
| Share capital (Note 9)                             | 179,632           | 139,731           |
| Contributed surplus                                | 17,759            | 14,264            |
| Accumulated other comprehensive income             | 5,437             | 2,176             |
| Deficit  | (40,035)          | (37,525)          |
|  | <b>162,793</b>    | 118,646           |
|  | <b>\$ 174,419</b> | <b>\$ 137,314</b> |

**Commitments** (Note 11)

ON BEHALF OF THE BOARD:

Signed: "Peter Marrone"

**Peter Marrone**  
Director

Signed: "Antenor Silva Jr."

**Antenor Silva Jr.**  
Director

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

**MBAC FERTILIZER CORP.****Consolidated Statements of Operations**

For the years ended July 31, 2011 and 2010 (In thousands of Canadian dollars except for per share amounts)

|  | <b>2011</b>       | 2010        |
|--|-------------------|-------------|
| Sales  | \$ <b>6,564</b>   | \$ 2,342    |
| Cost of sales  | <b>4,904</b>      | 2,090       |
| Gross profit   | <b>1,660</b>      | 252         |
| Operating expenses   |                   |             |
| Selling, general and administrative expenses                               | <b>13,520</b>     | 11,915      |
| Stock-based compensation (Note 10)   | <b>3,495</b>      | 12,285      |
|  | <b>17,015</b>     | 24,200      |
| Operating loss   | <b>(15,355)</b>   | (23,948)    |
| Foreign exchange loss  | <b>(21)</b>       | (383)       |
| Interest income  | <b>758</b>        | 212         |
| Other income, net (Note 5)   | <b>622</b>        | 344         |
| Write-off of exploration assets and property, plant and equipment (Note 7) | <b>(1,388)</b>    | (13,257)    |
| Loss before income taxes   | <b>(15,384)</b>   | (37,032)    |
| Current income taxes (Note 8)  | <b>289</b>        | 54          |
| Future income tax recovery (Note 8)  | <b>(13,163)</b>   | (956)       |
|  | <b>(12,874)</b>   | (902)       |
| Net loss   | \$ <b>(2,510)</b> | \$ (36,130) |
| Basic loss per share (Note 9(b))   | \$ <b>(0.03)</b>  | \$ (0.57)   |
| Diluted loss per share (Note 9(b))   | \$ <b>(0.03)</b>  | \$ (0.57)   |

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

**Consolidated Statements of Comprehensive Income**

For the years ended July 31, 2011 and 2010 (In thousands of Canadian dollars)

|  | <b>2011</b>       | 2010        |
|--|-------------------|-------------|
| Net loss   | \$ <b>(2,510)</b> | \$ (36,130) |
| Other comprehensive income   |                   |             |
| Unrealized gain on available-for-sale investment, net of taxes<br>(Note 5) | <b>-</b>          | 343         |
| Realization of gain on available-for-sale investment (Note 5)              | <b>(343)</b>      | -           |
| Unrealized gain on translation of self-sustaining foreign<br>operations    | <b>3,604</b>      | 565         |
|  | <b>3,261</b>      | 908         |
| Comprehensive income (loss)  | \$ <b>751</b>     | \$ (35,222) |

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

**MBAC FERTILIZER CORP.**
**Consolidated Statements of Shareholders' Equity**

For the years ended July 31, 2011 and 2010 (In thousands of Canadian dollars except for number of shares)

|  | 2011              | 2010            |
|--|-------------------|-----------------|
| <b>Common shares (in shares)</b>                                       |                   |                 |
| Balance, beginning   | <b>72,689,336</b> | 11,856,256      |
| Shares issued as equity financing <i>(Note 9(c))</i>                   | <b>13,685,000</b> | 4,538,500       |
| Conversion of Founders' special warrants                               | -                 | 462,375         |
| Shares issued as compensation  | -                 | 65,000          |
| Balance, FinCO prior to reverse takeover <i>(Note 1)</i>               | <b>86,374,336</b> | 16,922,131      |
| Pursuant to the acquisition of FinCO <i>(Note 1)</i>                   | -                 | (16,922,131)    |
| Outstanding shares of the Company prior to acquisition <i>(Note 1)</i> | -                 | 31,607,361      |
| Exchange of shares on reverse takeover <i>(Note 1)</i>                 | -                 | 1,057,633,188   |
| Share consolidation under amalgamation agreement <i>(Note 1)</i>       | -                 | (1,016,624,546) |
| Stock options exercised  | -                 | 73,333          |
|  | <b>86,374,336</b> | 72,689,336      |
| <b>Common shares</b>   |                   |                 |
| Balance, beginning   | <b>\$ 139,731</b> | \$ 86,226       |
| Shares issued as equity financing, net of costs <i>(Note 9(c))</i>     | <b>39,901</b>     | 53,442          |
| Reverse takeover transaction costs                                     | -                 | (356)           |
| Shares issued as compensation  | -                 | 261             |
| Stock options exercised  | -                 | 158             |
|  | <b>179,632</b>    | 139,731         |
| <b>Contributed surplus</b>   |                   |                 |
| Balance, beginning   | <b>14,264</b>     | 1,979           |
| Stock-based compensation expense for the period <i>(Note 10)</i>       | <b>3,495</b>      | 12,285          |
| Options assumed on reverse takeover <i>(Note 1)</i>                    | -                 | 48              |
| Transfer on the exercise of stock options                              | -                 | (48)            |
|  | <b>17,759</b>     | 14,264          |
| <b>Deficit</b>   |                   |                 |
| Balance, beginning   | <b>(37,525)</b>   | (1,939)         |
| Net loss   | <b>(2,510)</b>    | (36,130)        |
| Reverse takeover transfer of legal parent share capital                | -                 | 544             |
| Balance, ending  | <b>(40,035)</b>   | (37,525)        |
| Accumulated other comprehensive income                                 | <b>5,437</b>      | 2,176           |
|  | <b>(34,598)</b>   | (35,349)        |
| Total shareholders' equity   | <b>\$ 162,793</b> | \$ 118,646      |

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

**MBAC FERTILIZER CORP.**
**Consolidated Statements of Cash Flows**

For the years ended July 31, 2011 and 2010 (In thousands of Canadian dollars)

|  | 2011             | 2010             |
|--|------------------|------------------|
| <b>Cash provided by (used in):</b>   |                  |                  |
| <b>Operating activities</b>  |                  |                  |
| Net loss   | \$ (2,510)       | \$ (36,130)      |
| Add (deduct) items not affecting cash:                                     |                  |                  |
| Depreciation and depletion   | 837              | 271              |
| Shares issued as compensation, including stock options                     | 3,495            | 12,546           |
| Future income tax recovery   | (13,163)         | (956)            |
| Gain on disposal of property, plant and equipment                          | (6)              | (122)            |
| Foreign exchange loss  | 21               | 383              |
| Gain on sale of available-for-sale securities (Note 5)                     | (754)            | -                |
| Provisions and other write-offs  | 132              | -                |
| Write-off of exploration assets and property, plant and equipment (Note 7) | 1,388            | 13,257           |
|  | <b>(10,560)</b>  | <b>(10,751)</b>  |
| Net change in non-cash working capital (Note 15(a))                        | <b>1</b>         | <b>196</b>       |
|  | <b>(10,559)</b>  | <b>(10,555)</b>  |
| <b>Investing activities</b>  |                  |                  |
| Acquisition of property, plant and equipment                               | (14,232)         | (6,695)          |
| Exploration, evaluation and mine development expenditures                  | (6,287)          | (14,173)         |
| Proceeds of disposition of property, plant and equipment                   | 35               | 281              |
| Investments (Note 5)   | (263)            | -                |
| Proceeds on sale of available-for-sale securities (Note 5)                 | 1,175            | -                |
|  | <b>(19,572)</b>  | <b>(20,587)</b>  |
| <b>Financing activities</b>  |                  |                  |
| Issuance of common shares, net of transaction costs (Note 9(c))            | 39,901           | 53,442           |
| Cash acquired from reverse takeover transaction (Note 1)                   | -                | 346              |
| Cash received on stock options exercised                                   | -                | 110              |
|  | <b>39,901</b>    | <b>53,898</b>    |
| Foreign currency effect on cash  | (59)             | (110)            |
| Increase in cash   | <b>9,711</b>     | <b>22,646</b>    |
| Cash, beginning  | <b>63,349</b>    | <b>40,703</b>    |
| Cash, ending   | <b>\$ 73,060</b> | <b>\$ 63,349</b> |

**Supplementary cash flow information** (Note 15(a), (b))

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

## **Notes to Consolidated Financial Statements**

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

### **1. BASIS OF CONSOLIDATION AND PRESENTATION**

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) and include the assets, liabilities and operations of MBAC Fertilizer Corp. (“MBAC” or the “Company”) and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated.

MBAC is a Toronto-based company engaged in the mining, production and exploration of phosphate and potash fertilizer in Brazil. In October 2008, MBAC indirectly acquired 100% interest in Itafós Mineração Ltda. (“Itafós”), which wholly owns all interests in the Itafós phosphate mine and related infrastructure in Brazil.

The Company's sales are subject to quarterly variances due to the seasonality of the Company's production cycle and customers' purchasing cycles impacted by the seasonal nature of the fertilizer business in Brazil. The first and last quarter of each fiscal year for the Company historically generate substantially more sales than during the second and third quarters of the fiscal year.

On December 24, 2009, the Company completed the acquisition of all of the outstanding common shares of MBAC Opportunities and Financing Inc. (“FinCO”) in exchange for common shares of the Company. Pursuant to the terms of an amalgamation agreement (the “Amalgamation Agreement”) dated November 26, 2009, the Company issued 1,057,633,188 common shares to acquire the 16,922,131 outstanding common shares of FinCO (“FinCO Shares”). The transaction constituted a reverse takeover transaction (“RTO”) of Sandwell Mining Ltd. (“Sandwell”) by FinCO for accounting purposes with FinCO as the acquirer. These consolidated financial statements reflect the continuation of the financial statements of FinCO, while the capital structure is that of the Company. Upon completion of the RTO, Sandwell changed its name to MBAC Fertilizer Corp., consolidated its issued and outstanding shares on the basis of one (1) post-consolidation share for every 15 pre-consolidation shares held and continued out of the province of British Columbia pursuant to the Canada Business Corporation Act.

### **2. SIGNIFICANT ACCOUNTING POLICIES**

#### **Cash and cash equivalents**

Cash and cash equivalents consist of cash on deposit with banks and highly liquid short term investments with terms of less than 90 days.

#### **Measurement uncertainty**

Management has made estimates and assumptions that affect the carrying value of assets and liabilities, the disclosure of contingent assets and liabilities at each financial statement date, and the reported amounts of revenues and expenses in the preparation of the consolidated financial statements. Such estimates primarily relate to the fair value of assets acquired and liabilities assumed in business combinations, accounting for income taxes, unsettled transactions and events as of the date of the consolidated financial statements. Accordingly, actual results may differ from estimated amounts.

The recovery of both the costs of acquiring mineral properties and the related exploration and development expenditures which depend on the existence of economically recoverable reserves and resources, the ability of the Company to obtain the financing necessary to complete exploration and development activities, and the future profitable production of phosphate and related products are all subject to significant risks and uncertainties.

Depletion and depreciation and amounts used for impairment calculations are based on estimates of phosphate reserves and resources and commodity prices, production expenses and capital costs required to develop and produce those reserves and resources. By their nature, estimates of reserves and resources and the related future cash flows are subject to measurement uncertainty, and the impact of differences between actual and estimated amounts on the consolidated financial statements of future periods could be material.

## **Notes to Consolidated Financial Statements**

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

### **Mineral properties and related depletion and depreciation**

The costs of acquiring land and mineral rights are capitalized based on the estimated fair value of reserves and resources at the date of acquisition. When production begins, capitalized acquisition costs are amortized using the unit-of-production method. On acquisition of mineral properties, an estimate of the fair value of the exploration potential of the property is recorded, which is not subject to amortization. At the time mineralized material is converted into reserves, the associated cost is reclassified to an asset subject to amortization.

Costs incurred in exploring for and developing reserves and resources are capitalized. Such expenditures include geological and geophysical expenses, costs of drilling and general and administrative costs directly related to exploration and development activities. For those properties that are still in the development stage, related costs are capitalized until either commercial production commences or it is determined that the invested amounts will not be recovered. Capitalized costs are not amortized until transferred to mineral properties.

The Company reviews the carrying amount of mineral property assets on an ongoing basis. This review is generally made by reference to the timing of exploration and/or development work, work programs proposed and the exploration results achieved. If there is an indication that impairment may have occurred, an impairment test is performed whereby the net capitalized costs of a particular operation or project is compared to the sum of the undiscounted cash flows expected to result from the particular operation or project. If the undiscounted cash flows are less than the carrying amount, an impairment loss, based on the excess carrying amount above the net present value of future cash flows is recorded in the consolidated statements of operations.

Buildings, plant and equipment are recorded at cost, which includes all expenditures incurred to prepare the asset for its intended use. Costs are also capitalized to the extent they improve productive capacity or extend the useful economic life of an asset. The cost, less any residual value, is amortized over its estimated useful economic life using the straight-line method. The lives of these assets range from 2 years to 25 years.

### **Foreign currency translation**

The Brazilian subsidiaries of the Company are considered self-sustaining operations and exist in a business environment where the Brazilian Real is their functional currency. The financial statements of self-sustaining operations are translated into Canadian dollars from their functional currency using the current rate method. Under this method, assets and liabilities are translated into Canadian dollars using the exchange rate in effect at the consolidated balance sheet date. Revenues and expenses are translated into Canadian dollars at the average exchange rate for the period. All resulting exchange gains and losses are recorded in shareholders' equity in the accumulated other comprehensive income (loss) account ("AOCI").

### **Inventory valuation**

The phosphate inventory is valued at the lower of cost and net realizable value. Phosphate is extracted from open pits and accumulated in stockpiles. Costs are allocated to the stockpiles based on current mining costs incurred up to the point of stockpiling the phosphate. Overhead costs are allocated based on normal levels of production. In periods where we produce at less than a normal capacity due to the seasonality of the operations, unallocated overheads are recognised as an expense in cost of sales in the period in which they are incurred. As phosphate is processed and sold, costs are removed on a weighted average basis. Inventory stockpiles are reduced by provisions required to reduce inventory to net realizable value. Reversal of previous write-downs is made when there is a subsequent increase in the value of inventories. Mine operating supplies are recorded at the lower of purchase cost and market value.

## **Notes to Consolidated Financial Statements**

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

### **Asset retirement obligation**

The Company recognizes the fair value of an asset retirement obligation (“ARO”) in the period in which it is incurred when a reasonable estimate of fair value can be made. The fair value of the estimated ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is amortized to expense through depletion over the life of the asset. The liability amount is increased each reporting period due to the passage of time and the amount of this accretion is charged to earnings in the period. Revisions, if any, to the estimated timing of cash flows or to the original estimated undiscounted cost, if any, also result in an increase or decrease to the ARO and the related asset. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the liability recorded. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized as a gain or loss in the Company’s earnings in the period in which the settlement occurs.

### **Financial instruments**

All financial instruments have been classified into one of the following five categories: held-for-trading assets or liabilities, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in AOCI until the instruments are derecognized or impaired. Available-for-sale securities are reviewed periodically for possible other than temporary impairment and more frequently when economic or market concerns warrant such evaluation. Loans and receivables, investments held to maturity and other financial liabilities are measured at cost.

The Company's financial instruments consist of cash, accounts receivable, investment in securities and accounts payable and accrued liabilities. The Company has elected the following classifications:

|   |                                    |
|---|------------------------------------|
| <i>Short and Long-term Accounts receivable</i>  | <i>Loans and receivables</i>       |
| <i>Investments in securities</i>                | <i>Available for sale</i>          |
| <i>Accounts payable and accrued liabilities</i> | <i>Other financial liabilities</i> |

### **Revenue recognition**

Revenue from the sale of phosphate is recognized when the product is shipped to the customer and title has transferred, the price can be estimated or determined, and collection is reasonably assured. Revenue is recorded net of Brazilian sales taxes which amounted to \$331 (2010 - \$136).

### **Comprehensive income**

Comprehensive income is the change in the Company’s net assets that results from transactions, events and circumstances from sources other than the Company's shareholders and includes items that would not normally be included in net earnings such as unrealized gains or losses on available-for-sale investments and cumulative translation adjustments arising from the consolidation of self-sustaining operations denominated in foreign currencies.

### **Loss per share**

Basic loss per share is calculated using the weighted average number of shares outstanding. Diluted loss per share is calculated using the treasury stock method. In order to determine diluted loss per share, the treasury stock method assumes that any proceeds from the exercise of dilutive stock options and warrants and the unrecognized portion of the related fair value would be applied to repurchase common shares at the average market price during the period, with the incremental number of shares being included in the denominator of the diluted loss per share calculation. The diluted loss per share calculation excludes any potential conversion of options and warrants that would increase earnings per share or decrease loss per share.

## **Notes to Consolidated Financial Statements**

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

### **Share issue costs**

Costs incurred in connection with the issuance of capital stock are netted against the proceeds received.

### **Income taxes**

The Company follows the liability method of accounting for income taxes. Under this method current income taxes are recorded at the estimated income tax rates payable for the current period. Future tax assets and liabilities are recognized for temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future tax liabilities and assets are measured using substantively enacted statutory tax rates in effect when the timing differences are expected to reverse. The effect on future tax liabilities and assets of a change in tax rates is recognized in the period that the change occurs. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

### **Stock-based compensation**

The Company accounts for stock-based compensation that settle through the issuance of equity using a fair value based method, whereby the fair value of the stock based award is determined at the date of grant using a market-based option valuation model. The fair value of the award is recorded as compensation expense and is accrued on a graded vesting basis with a corresponding increase to contributed surplus. No adjustment for subsequent changes in the price of the Company's shares will be recorded. On exercise of the award, the proceeds together with the amount recorded in contributed surplus are recorded as share capital.

### **Operating segments**

The Company operates in a single operating segment, consisting of mining activities in the Brazilian phosphate market. All of the Company's assets and revenues are attributable to this single segment.

### **Economic dependence**

The Company earns significant sales revenue from two (2) customers in Brazil. During the year \$2,363 (36%) and \$1,772 (27%) of revenue was earned from each of these two (2) customers (2010 - \$1,106 (46%) and \$1,036 (44%)) respectively.

## **3. CHANGES IN SIGNIFICANT ACCOUNTING POLICIES**

Canadian public companies will be required to prepare their financial statements in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), for financial years beginning on or after January 1, 2011 ("Changeover Date"). Effective August 1, 2011, the Company adopted IFRS as the basis for preparing its consolidated financial statements. The Company will issue its financial results for the quarter ending October 31, 2011 prepared on an IFRS basis and provide comparative data on an IFRS basis as required.

## **4. INVENTORIES**

|   | <b>2011</b>     | 2010            |
|---|-----------------|-----------------|
| Raw materials   | \$ 248          | \$ 12           |
| Processed phosphate held in finished goods stockpiles | 911             | 1,359           |
| Spare parts and supplies                              | 175             | 79              |
|   | <b>\$ 1,334</b> | <b>\$ 1,450</b> |

**MBAC FERTILIZER CORP.**
**Notes to Consolidated Financial Statements**

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

**5. INVESTMENTS**

| Available-for-sale investments | 2011        |            |   | 2010          |            |   |
|--------------------------------|-------------|------------|---|---------------|------------|---|
|                                | Cost        | Fair value | Cumulative amount in other comprehensive income | Cost          | Fair value | Cumulative amount in other comprehensive income |
| Redstone Resources Ltd.        |             |            |   |               |            |   |
| Common shares                  | \$ -        | -          | \$ -  | \$ 144        | 485        | \$ 341  |
| Warrants                       | -           | -          | -   | 14            | 79         | 65  |
|                                | <b>\$ -</b> | <b>-</b>   | <b>\$ -</b>                                     | <b>\$ 158</b> | <b>564</b> | <b>\$ 406</b>                                   |

During the year the Company sold its entire investment in Redstone Resources Ltd. for proceeds of \$1,175 and a realized gain of \$754 (July 31, 2010 – \$NIL) recorded as Other Income.

The financial instruments presented above were classified as Level 1 instruments as their fair value was obtained from unadjusted quoted prices from an active market.

**6. PROPERTY, PLANT AND EQUIPMENT**

|                                | 2011             |                          |                  | 2010             |                          |                 |
|--------------------------------|------------------|--------------------------|------------------|------------------|--------------------------|-----------------|
|                                | Cost             | Accumulated amortization | Net book value   | Cost             | Accumulated amortization | Net book value  |
| Property, plant and equipment  | \$ 7,680         | (1,087)                  | \$ 6,593         | \$ 4,506         | (444)                    | \$ 4,062        |
| Cost of non-depreciable items: |                  |                          |                  |                  |                          |                 |
| Land                           | 4,045            | -                        | 4,045            | 3,367            | -                        | 3,367           |
| Assets under construction      | 16,584           | -                        | 16,584           | 2,469            | -                        | 2,469           |
|                                | <b>\$ 28,309</b> | <b>(1,087)</b>           | <b>\$ 27,222</b> | <b>\$ 10,342</b> | <b>(444)</b>             | <b>\$ 9,898</b> |

**7. MINERAL PROPERTIES AND EXPLORATION ASSETS**

|                               | 2011             |                       |                  | 2010             |                       |                  |
|-------------------------------|------------------|-----------------------|------------------|------------------|-----------------------|------------------|
|                               | Cost             | Accumulated depletion | Net book value   | Cost             | Accumulated depletion | Net book value   |
| Depletable producing property |                  |                       |                  |                  |                       |                  |
| Itafós Arraias SSP project    | \$ 64,484        | (290)                 | \$ 64,194        | \$ 59,716        | (88)                  | \$ 59,628        |
| Exploration properties        |                  |                       |                  |                  |                       |                  |
| Coastal potash project        | 137              | -                     | 137              | 710              | -                     | 710              |
| Santana phosphate project     | 3,218            | -                     | 3,218            | 88               | -                     | 88               |
| Carmo phosphate project       | 833              | -                     | 833              | 59               | -                     | 59               |
| Regional phosphate project    | 213              | -                     | 213              | 171              | -                     | 171              |
| Other projects                | 194              | -                     | 194              | 48               | -                     | 48               |
|                               | <b>\$ 69,078</b> | <b>(290)</b>          | <b>\$ 68,789</b> | <b>\$ 60,792</b> | <b>(88)</b>           | <b>\$ 60,704</b> |

During the year the Company decided to relinquish some of its exploration properties in connection with its Coastal potash project, Regional phosphate project, Carmo phosphate project, and Other projects and wrote off a total of \$1,249 of deferred costs.

## Notes to Consolidated Financial Statements

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

During the prior year, the Company determined that it was unlikely to exercise the Pyrite supply agreement option and accordingly recorded \$11,910 as impairment. Furthermore, during the prior year, the Company wrote off \$1,347 in deferred costs with regards to abandonment of further exploration efforts with the Apuí and Anebá projects, as well as relinquishment of approximately one (1) million hectares of its coastal potash project exploration permits.

### 8. INCOME TAXES

The following table reconciles the statutory tax rate with the effective income tax rate:

|   | 2011        |        | 2010        |        |
|---|-------------|--------|-------------|--------|
| Combined Canadian federal and provincial statutory tax rate | \$ (4,474)  | 29.1 % | \$ (11,791) | 31.8 % |
| Changes in future tax rates                                 | 247         | (1.6)  | 2,015       | (5.4)  |
| Difference in foreign tax rates                             | (1,879)     | 12.2   | (152)       | 0.4    |
| Permanent differences                                       | 1,664       | (10.8) | 4,766       | (12.9) |
| Future tax assets not previously recognized                 | (8,913)     | 57.9   | -           | -      |
| Expired losses  | 989         | (6.4)  | -           | -      |
| Change in valuation allowance                               | (508)       | 3.3    | 4,260       | (11.5) |
| Effective tax rate  | \$ (12,874) | 83.7 % | \$ (902)    | 2.4 %  |

Income tax recovery is represented by:

|         | 2011                       |                                      |             | 2010                       |                            |          |
|---------|----------------------------|--------------------------------------|-------------|----------------------------|----------------------------|----------|
|         | Current income tax expense | Future income tax expense (recovery) | Total       | Current income tax expense | Future income tax recovery | Total    |
| Canada  | \$ -                       | 63                                   | \$ 63       | \$ -                       | (61)                       | \$ (61)  |
| Foreign | 289                        | (13,226)                             | (12,937)    | 54                         | (895)                      | (841)    |
|         | \$ 289                     | (13,163)                             | \$ (12,874) | \$ 54                      | (956)                      | \$ (902) |

Significant components of future income tax liabilities and assets are as follows:

|  | 2011      | 2010      |
|--|-----------|-----------|
| Future income tax liabilities                                  |           |           |
| Fair value increments on acquisition of Itafós Mineração Ltda. | \$ 16,579 | \$ 16,285 |
| Other  | 22        | 44        |
|  | 16,601    | 16,329    |
| Future income tax assets                                       |           |           |
| Share issue costs  | 1,639     | 1,442     |
| Non-capital losses carry-forward                               | 7,210     | 4,122     |
| Write-off of pyrite supply agreement                           | 1,489     | 1,489     |
| Investments  | 10,125    | -         |
| Other  | 51        | 85        |
|  | 20,514    | 7,138     |
| Valuation allowance  | (6,279)   | (6,063)   |
|  | 14,235    | 1,075     |
| Net future income tax liability                                | \$ 2,366  | \$ 15,254 |

**MBAC FERTILIZER CORP.****Notes to Consolidated Financial Statements**

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

As at July 31, 2011, the Company has Canadian non-capital losses that expire as follows:

|              |    |               |
|--------------|----|---------------|
| 2026 to 2028 | \$ | 171           |
| 2029         |    | 3,310         |
| 2030         |    | 2,979         |
| 2031         |    | 6,087         |
|              | \$ | <u>12,547</u> |

No tax benefit has been recognized on the financial statements for the Canadian and Dutch tax losses in the amount of \$12,547 and \$118 respectively. As at July 31, 2011 the Company has Brazilian non-capital losses of \$11,892 that may be carried forward indefinitely to offset up to 30% of taxable income in any given period. The amount of \$4,043 related to these Brazilian tax losses has been recognized in the financial statements.

During 2011, the Company completed an internal reorganization that resulted in a future tax benefit of \$8,913 in Brazil.

The interpretation of tax regulations and legislation and their application to MBAC's business is complex and subject to change. Accordingly, the Company's ability to realize future income tax assets, could significantly affect net income or cash flow in future periods.

**9. SHARE CAPITAL****(a) Authorized capital**

The Company is authorized to issue unlimited number of common shares without par value and an unlimited number of preferred shares issuable in series.

**(b) Weighted average number of common shares and dilutive common share equivalents**

|  | 2011              | 2010       |
|--|-------------------|------------|
| Weighted average number of common shares                   | <b>78,575,761</b> | 63,425,174 |
| Weighted average number of dilutive share purchase options | -                 | -          |
| Diluted weighted average number of common shares           | <b>78,575,761</b> | 63,425,174 |

The dilutive effect of share purchase options has not been included in the calculation of the weighted average number of common shares of the prior and current fiscal years as their impact would be anti-dilutive.

**(c) Bought deal equity financing**

On February 24, 2011 the Company completed a bought deal equity financing and issued 13,685,000 common shares of the Company for aggregate gross proceeds of \$42,424 less transaction costs of approximately \$2,523.

During the prior year, the Company completed a private placement of 4,538,500 subscription receipts at a price of Cdn\$12.50 per subscription receipt for proceeds, net of transaction costs, of \$53,442.

## Notes to Consolidated Financial Statements

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

### 10. STOCK-BASED COMPENSATION

The Company has established a stock option plan (the "Stock Option Plan") designed to provide a long-term incentive to employees, officers, directors and consultants of the Company. The maximum number of options that may be issued under the Stock Option Plan cannot exceed the number that is equal to 10% of the issued and outstanding common shares at the date of grant. The vesting period of the awards under the plan are determined by the Board of Directors. Also, share purchase options granted under the Stock Option Plan cannot have an exercise price that is less than the trading price of the common shares on the day immediately preceding the grant date, and are exercisable for a period to be determined by the Board but not to exceed ten years.

During the year ended July 31, 2011, the Company issued 890,758 share purchase options. The fair value of these options has been determined to be \$821. During the year, the Company recognized a total of \$3,495 (2010 - \$12,285) in compensation expense and a corresponding increase in contributed surplus. During the year, no share purchase options were exercised under the Stock Option Plan. Under the Company's Stock Option Plan, 400,000 stock options to purchase common shares were available for issuance as at July 31, 2011.

The following is a summary of the issued share purchase options to acquire common shares as at the year end and the changes thereof during the year:

|                             | 2011              |   | 2010              |   |
|-----------------------------|-------------------|---|-------------------|---|
|                             | Number of options | Weighted average exercise price (Cdn\$) | Number of options | Weighted average exercise price (Cdn\$) |
| Outstanding, beginning      | 7,123,550         | \$ 2.69                                 | -                 | \$ -                                    |
| Assumed on reverse takeover | -                 | -                                       | 73,333            | 1.50                                    |
| Granted                     | 890,758           | 2.46                                    | 7,123,550         | 2.69                                    |
| Exercised                   | -                 | -                                       | (73,333)          | 1.50                                    |
| Outstanding, ending         | 8,014,308         | \$ 2.67                                 | 7,123,550         | \$ 2.69                                 |
| Exercisable, ending         | 6,887,417         | \$ 2.57                                 | 3,489,085         | \$ 2.57                                 |

Stock options outstanding and exercisable as at July 31, 2011 are as follows:

| Range (Cdn\$)   | Outstanding and exercisable | Remaining vested contractual life | Weighted average exercise price (Cdn\$) |
|-----------------|-----------------------------|-----------------------------------|---|
| \$2.00 - \$2.49 | 4,947,054                   | 3.17                              | \$ 2.40                                 |
| \$2.50 - \$3.00 | 1,940,363                   | 3.33                              | \$ 3.00                                 |

The share purchase options issued during the year ended July 31, 2011 were recorded using the fair value based method of accounting whereby the fair value of the share purchase options were estimated at the time of grant using the Black-Scholes option pricing model with the following assumptions:

|                                      |           |
|--------------------------------------|-----------|
| Dividend yield                       | - %       |
| Annualized expected price volatility | 44.61%    |
| Risk-free interest rate              | 2.21%     |
| Expected life                        | 3.8 years |

## **Notes to Consolidated Financial Statements**

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

### **11. COMMITMENTS**

In addition to commitments otherwise reported in these consolidated financial statements the Company is contractually committed to the following:

|                     |                  |
|---------------------|------------------|
| 2012                | <b>\$ 30,394</b> |
| 2013                | <b>2,723</b>     |
| 2014                | <b>165</b>       |
| 2015                | <b>81</b>        |
| 2016 and thereafter | <b>11</b>        |
|                     | <hr/>            |
|                     | <b>\$ 33,374</b> |

### **12. CONTINGENCIES**

The Company does not have any material liabilities not recorded in these financial statements that will arise from contingent liabilities.

### **13. CAPITAL MANAGEMENT**

The Company manages its capital to ensure that the Company and its subsidiaries will be able to continue as a going concern while attempting to maximize the return to shareholders through the optimization of equity and debt financing. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the Company. The capital structure consists of raised capital net of transaction costs of \$179,632 through the issuance of common shares. MBAC monitors its capital through its net cash position. The Company maintains this structure by managing working capital and capital spending programs and reviews its capital management approach on an ongoing basis.

### **14. FINANCIAL INSTRUMENTS**

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

#### **Credit risk**

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to accounts receivable. At July 31, 2011 the Company had a provision for credit losses of \$36 which represents 1% of total accounts receivable (July 31, 2010 - \$37). Cash consists of funds that have been invested with reputable financial institutions and management believes the risk of loss to be remote.

#### **Liquidity risk**

The Company's approach to managing liquidity risk is to ensure that it will have sufficient funds to meet liabilities as they come due and to execute on its business plan. As at July 31, 2011 the Company had a cash balance of \$73,060 (July 31, 2010 - \$63,349).

## **Notes to Consolidated Financial Statements**

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### **Interest rate risk**

The Company holds significant cash balances following the equity issues that have occurred during the year. Changes in interest rates will result in a change in the amount of interest earned on the Company's cash. Given the current levels of cash and the anticipated period of holding this cash while the Company executes its business plan, management believes that the risk of material changes to interest rate in the short to medium term is remote and therefore does not hedge its interest rate risk. As at July 31, 2011, the Company has no outstanding debt.

### **Foreign currency risk**

The Company's reporting and functional currency is the Canadian dollar. The functional currency of the Brazilian operations is the Brazilian Real (R\$). Management does not hedge its foreign exchange risk. The R\$ exchange rate strengthened by 5.0% (2010 - 1.1%) against the Canadian dollar over the course of the year, resulting in a cumulative translation gain of \$3,604 on translation of the Brazilian entities (July 31, 2010 - \$565).

### **Commodity price risk**

The Company is exposed to commodity price risk with respect to phosphate. The price of phosphate is dependent on general economic conditions such as local market supply and demand considerations. Future price declines could cause reported accounting losses and future exploration and development to be uneconomical. The Company does not manage any exposure to commodity price risk. As of July 31, 2011, management estimates that if the price of phosphate had changed by 10% with all other variables being constant, revenue would have changed by \$656 (2010 - \$234).

## **15. SUPPLEMENTARY CASH FLOW INFORMATION**

### **(a) Net change in non-cash working capital items**

|  | <b>2011</b> | 2010          |
|--|-------------|---------------|
| Accounts receivable                      | \$ (2,500)  | \$ (652)      |
| Inventories                              | 206         | (62)          |
| Other current assets                     | (15)        | (364)         |
| Accounts payable and accrued liabilities | 2,310       | 1,274         |
|  | <b>\$ 1</b> | <b>\$ 196</b> |

### **(b) Interest and income taxes paid**

|                                     | <b>2011</b> | 2010  |
|-------------------------------------|-------------|-------|
| Interest paid during the period     | \$ 52       | \$ 43 |
| Income taxes paid during the period | \$ -        | \$ 75 |

## **Notes to Consolidated Financial Statements**

For the years ended July 31, 2011 and 2010

(In thousands of Canadian Dollars unless otherwise noted)

### **16. SUBSEQUENT EVENTS**

Subsequent to year end:

- a) the Company issued 10,829,900 common shares to the IFC (a member of the World Bank Group) for aggregate proceeds of approximately \$33,573;
- b) the Company executed a loan agreement and other transaction documents in connection with a R\$193.5 million project financing facility with Itaú BBA S.A., with funding from the Banco Nacional de Desenvolvimento Econômico e Social (“BNDES”); and
- c) the IFC received Board approval to provide the Company a US\$40 million project financing facility in connection with the Itafós Arraias SSP Project, subject to customary conditions.

### **17. COMPARATIVE FIGURES**

Certain of the prior year’s figures have been reclassified to conform to the current year’s presentation.