BEKEM METALS INC
Form 10QSB
August 14, 2006

United States
Securities and Exchange Commission
Washington, DC 20549

FORM 10-QSB

Quarterly Report under Section 13 or 15(d) of
the Securities Exchange Act of 1934

For the Six Months Ended	Commission File Number
June 30, 2006	**0-50218**

BEKEM METALS, INC.
(Exact name of registrant as specified in its charter)

UTAH
(State or other jurisdiction of incorporation or organization

87-0669131
(I.R.S. Employer Identification No.)

170 Tchaikovsky Street, 4th Floor, Almaty, Kazakhstan 050000
(Address of principal executive offices)

+7 3272 582 386
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12 (b) of the Act: None.

Securities registered pursuant to section 12(g) of the Exchange Act:
Common, $0.001 par value

Check whether the Issuer (1) filed all reports required to be filed by section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such report(s), and (2) has been subject to such filing requirements for the past 90 days. (1) Yes [X] No [ ]

Check whether the Issuer is a shell company (as defined by Rule 12b-2 of the Exchange Act) Yes [ ] No [X]

As of August 7, 2006, the issuer had 124,088,888 shares of its $0.001 par value common stock outstanding.

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PART I. FINANCIAL INFORMATION Item 1. Financial Statements BEKEM METALS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED) June 30, December 31, 2006 2005 -- -------------------- --------------------- **ASSETS Current Assets** Cash $ 280,735 $ 89,366 Trade accounts receivable 5,673 18,657 Prepaid expenses and other current assets 322,874 - Related party receivables 26,866 42,393 Inventories 390,634 337,030 VAT recoverable 184,542 61,936 -- -------------------- --------------------- **Total Current Assets** 1,211,324 549,382 -- -------------------- --------------------- Long-term deferred expenses 21,320 37,606 Property, plant and equipment (net of accumulated depreciation of $48,342 and $25,436) 5,466,534 3,061,290 Other assets 35,039 1,635 Mineral property rights - net 8,843,574 7,877,078 -- -------------------- --------------------- **Total Assets** $ 15,577,791 $ 11,526,991 == ==================== ===================== **LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT) Current Liabilities** Accounts payable $ 444,192 $ 424,306 Accrued expenses 811,848 276,291 Due to related party 5,310 5,518 Current portion of long-term notes payable 6,823,076 3,660,230 Current portion of long-term notes payable - related parties 772,000 - -- -------------------- --------------------- **Total Current Liabilities** 8,856,428 4,366,345 -- -------------------- --------------------- Deferred tax liabilities 2,715,440 2,304,285 Long-term notes payable, net of discount 103,605 797,178 Long-term notes payable - related parties 5,174,943 4,075,012 Asset retirement obligation 979,260 833,840 -- -------------------- --------------------- **Total Liabilities** 17,696,751 12,376,660 -- -------------------- --------------------- **Shareholders' Equity (Deficit)** Preferred stock; $0.001 par value, 20,000,000 shares authorized, no shares outstanding - - Common stock; $0.001 par value, 150,000,000 shares authorized, 100,088,888 shares outstanding 100,089 100,089 Additional paid-in capital 515,879 515,879 Accumulated deficit (2,615,308) (1,448,344) Cumulative translation adjustment (119,620) (17,293) -- -------------------- --------------------- **Total Shareholders' Equity (Deficit)** (2,118,960) (849,669) -- -------------------- --------------------- **Total Liabilities and Shareholders' Equity (Deficit)** $ 15,577,791 $ 11,526,991 == ==================== ===================== The accompanying notes are an integral part of these financial statements. 3

BEKEM METALS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED) For the three months ended For the six months ended June 30, June 30, --------------------------------------- --------------------------------------- **2006 2005 2006 2005** -- --------------------- ------------------ -------------------- ------------------ **Revenue** $ 4,885 $ - $ 69,527 $ - -- --------------------- ------------------ -------------------- ------------------ **Operational Expenses** Cost of product sold 36,461 - 65,871 - General and administrative expenses 564,550 120,862 922,088 194,816 Research and development costs 93,402 - 386,411 - Exploratory costs 57,336 81,759 118,265 187,566 Accretion expense 18,599 18,048 36,143 35,073 Depreciation expense 17,570 2,012 35,728 4,038 -- --------------------- ------------------ -------------------- ------------------ **Total Expenses** 787,918 222,681 1,564,506 421,493 -- --------------------- ------------------ -------------------- ------------------ **Loss From Operations** (783,033) (222,681) (1,494,979) (421,493) **Other Income (Expense)** Other income (35,764) 2,258 (71,711) 3,108 Interest expense (300,314) (2,258) (365,212) (3,108) Translation adjustment (81,748) - (125,210) - Exchange rate gain 650,093 2,517 890,148 3,085 -- --------------------- ------------------ -------------------- ------------------ **Net Other Income** 232,267 2,517 328,015 3,085 -- --------------------- ------------------

-------------------- ----------------- **Net Loss Before Taxes** (550,766) (220,164) (1,166,964) (418,408) Deferred tax benefit - - - - --- -------------------- ------------------ ------------------- -----------------
Net Loss $ (550,766) $ (220,164) $ (1,166,964) $ (418,408) **Basic and Diluted Loss per Common Share** $ (0.01) $ (0.01) $ (0.01) $ (0.01) == ================== ==================== ================== **Weighted-Average Shares used in Basic and Diluted Loss per Common Share** 100,088,888 38,300,000 100,088,888 38,300,000 == ================== ==================== ================== The accompanying notes are an integral part of these financial statements. 4

BEKEM METALS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED) *For the six months ended June 30* **2006 2005** -- -------------------- -------------------- **Cash Flows from Operating Activities** Net loss $ (1,166,964) $ (418,408) Adjustments to reconcile net loss to net cash provided by operating activities: Depreciation and amortization 23,216 4,038 Accretion expense on asset retirement obligations 36,143 40,597 Interest expense from debt discount 5,020 - Foreign currency exchange gain (890,148) 3,085 Loss on disposal of property and equipment 40,166 - Change in operating assets and liabilities: Accounts receivable 14,298 - Inventories (10,108) (5,134) Prepaid expenses and other current assets (357,687) 13,326 Accounts payable and accrued liabilities 229,263 52,687 Deferred grant revenue 2,415 (2,565) -- -------------------- -------------------- **Net Cash From Operating Activities** (2,074,386) (312,374) -- -------------------- -------------------- **Cash Flows from Investing Activities** Purchase of property and equipment, net (1,940,755) (1,487) Cash acquired in acquisitions 2,648 Increase in related party payables (416,880) -- -------------------- -------------------- Net Cash From Investing Activities (2,357,635) 1,161 -- -------------------- -------------------- Cash Flows from Financing Activities Proceeds from notes payable 3,968,114 362,639 Payments on notes payable (481,558) - Proceeds from notes payable related parties 1,005,031 - Proceeds from accrued liabilities to related parties 3,000 81,427 -- -------------------- -------------------- **Net Cash From Financing Activities** 4,494,587 444,066 -- -------------------- -------------------- **Effect of Exchange Rate Changes on Cash** 128,803 (12,389) -- -------------------- -------------------- **Net Increase in Cash** 191,369 120,464 **Cash at Beginning of Period** 89,366 4,190 == ==================== ==================== Cash at End of Period $ 280,735 $ 124,654 == ==================== ==================== **Supplemental Cash Flow Information Non Cash Investing and Financing Activities:** Fair value of assets acquired $ - $ 4,471 Fair value of shares issued for acquisitions $ - $ 11,706 -- -------------------- -------------------- **Liabilities Assumed** $ - $ 16,177 -- -------------------- -------------------- The accompanying notes are an integral part of these financial statements. 5

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) NOTE 1 - BASIS OF PRESENTATION AND NATURE OF BUSINESS ***Interim Financial Information*** - The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they are condensed and do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments and reclassifications considered necessary for a fair and comparable presentation have been included and are of a normal recurring nature. The accompanying financial statements should be read in conjunction with the

Company's most recent audited financial statements included in the Company's annual report on Form 10-KSB filed for the year ended December 31, 2005. Operating results for the six-month period ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. **Basis of Presentation** On October 24, 2005, Bekem Metals, Inc. ("BMI") entered into an Acquisition Agreement with Kazakh Metals, Inc., a British Virgin Islands international business company ("KMI"), under which Bekem acquired 100% of the outstanding common shares of KMI in exchange for the issuance of 61,200,000 common shares. The KMI shareholders received 61.1% of the BMI common stock outstanding after the transaction and therefore KMI was considered the acquirer for financial reporting purposes. Accordingly, the accompanying financial statements include financial statements of KMI for all periods presented. Brisa Equities Corporation, a British Virgin Islands holding company, together with other entities its owners control, is the controlling shareholder of KMI and was also the principal shareholder of BMI. Accordingly, the transaction was considered to be between entities under common control and did not result in a change in control of BMI. Following the transaction, entities over which shareholder maintains voting and investment control held 51,600,000 BMI common shares, which represent 51.5% of the 100,088,888 outstanding common shares. The acquisition of the portion of the net liabilities of BMI relating to the common shares owned by the controlling shareholder was recorded at historical cost of $(161,998). The acquisition of the common shares of BMI purchased from the minority shareholders of BMI were recorded at their estimated fair value on the transaction date of $345,000. KMI accounted for the purchase of BMI similar to a pooling. 6

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) The accompanying consolidated financial statements include the accounts of Bekem Metals, Inc. ("BMI", "Bekem," or the "Company") and its wholly owned subsidiaries, Kazakh Metals, Inc. ("KMI"), Kyzyl Kain Mamyt LLP ("KKM"), Condesa Pacific, S.A. ("Condesa"), and Kaznickel, LLP ("Kaznickel"). Intercompany accounts and transactions have been eliminated in consolidation. The results of operations of the previously separate KMI and BMI were combined for all periods prior to the acquisition, with recognition of the minority interest in BMI, and the operations of BMI and KMI are consolidated from October 24, 2005. ***Bekem Metals, Inc.*** - The combined financial statements include the accounts of Condesa and Kaznickel, since the date of its acquisition by Condesa, and the accounts of Bekem Metals, Inc. since its acquisition by Condesa. Condesa was incorporated under the laws of the British Virgin Islands on March 5, 2004. Condesa acquired Bekem Metals, Inc. in a reverse acquisition, on January 28, 2005. ***Kazakh Metals, Inc.*** - The combined financial statements also include the accounts of KMI and its wholly-owned subsidiary, KKM, which it acquired on June 1, 2005 in a purchase business combination. ***Name Change*** - On February 9, 2005, the Board of Directors of EMPS Research Corporation approved, and the stockholders holding a majority of the outstanding shares of the company approved and ratified by written consent, a change in the company's name from EMPS Research Corporation to Bekem Metals, Inc. On March 16, 2005, the company filed an amendment to its Articles of Incorporation to affect the change. **Nature of Business** The Company is engaged in the acquisition, exploration, and production of mineral resource properties. Kaznickel owns the right to the Gornostayevskoye ("Gornostai") nickel and cobalt deposit located in the East Kazakhstan Oblast in northeast Kazakhstan. KKM holds exploration and production licenses from the government of Kazakhstan to a 163,770 hectare (404,682 acres) parcel, in the Aktobe Oblast located in northwestern Kazakhstan. This deposit is referred to as the Kempirsai deposit. The licenses grant KKM the right to explore for and produce nickel and cobalt from deposits located within the territory through October 12, 2011, which may be extended upon agreement between KKM and the Geology and Minerals Resources Committee of the Ministry of Energy and Minerals Resources (MEMR) of the Republic of Kazakhstan. KKM also holds a license to explore for and produce Mamyt brown coal from a deposit located within 40 kilometers of its cobalt and nickel deposit. This license expires on December 11, 2018 with further possible extensions. 7

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) ***Business Condition*** - The Company has no proven mineral reserves that conform to U.S. accounting standards and has had only limited ore and Mamyt brown coal production from its Kempirsai deposit since its acquisition on May 31, 2005. The Gornostai deposit has not yet entered the development stage with respect to its mineral interests and has no production. There has been only limited revenue from the Kempirsai operations, and the Company has incurred a net loss of $1,166,964 and $418,408 for the six-month periods ended June 30, 2006 and 2005, respectively. In addition, current liabilities exceeded current assets by $7,645,102 and $3,816,963 at June 30, 2006 and December 31, 2005, respectively. Management expects to generate sufficient cash to fund construction of a processing plant in 2006-2008 by issuing equity securities and receiving financial assistance, if needed, from its shareholders. Certain shareholders, however, have provided the Company with a $10,000,000 line of credit. See Note 7. In addition, subsequent to June 30, 2006, the Company raised $28,000,000 from the sale of equity securities. See Note 9. ***Kempirsai Production Stage*** - The Kempirsai, or KKM, operations are considered to be in the production stage. ***Gornostai Exploration Stage*** - The Gornostai, or Kaznickel, operations are considered to be in the exploration stage. Since its inception on March 5, 2004, the Company has devoted a substantial amount of effort in raising capital and acquiring Kaznickel, and then exploring for mineral property under its exploration contract. The mineral property has not reached a development or production stage and accordingly, no revenues from production of the property have been recorded. Therefore, these operations are considered to be in the development stage. ***Currency Translation*** - The consolidated financial statements are presented in U.S. dollars. The functional currency of the Company's subsidiaries operating in Kazakhstan is U.S. dollars for Kaznickel and Kazakh tenge for KKM. Results of operations are translated into U.S. dollars at the average exchange rates during the reporting period. Non-monetary assets and liabilities of Kaznickel are translated into U.S. dollars, using historical exchange rates and monetary assets and liabilities are translated into U.S. dollars using exchange rates on the date of the financial statements. Translation differences are included in results of operations. All balance sheet accounts of KKM are translated at exchange rates on the date of the financial statements and translation differences are included in stockholders' equity as cumulative translation adjustments. **NOTE 2 - ACQUISITIONS** ***Purchase of Minority Interest in Bekem Metals, Inc.*** - On October 24, 2005 the Company issued 17,888,888 shares of common stock to acquire the minority shareholders' interests of BMI. Acquisition of the minority interests was accounted for under the purchase method. The incremental increase in the assets acquired and liabilities assumed related to the Kaznickel property, and were recorded at their estimated fair values as follows: 8

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) --- ------------------ Mineral interest rights $ 132,432 Purchased exploration costs 251,286 Deferred tax liability (38,718) --- ------------------ Minority Shareholders' Interests Acquired $ 345,000 --- ------------------ The value assigned to the intangible purchased exploration costs was written off and charged to operations on the date of the acquisition as exploration costs. Intangible mineral interest rights assets acquired include the mineral property rights, which are capitalized until the production phase begins, subject to impairment considerations. ***Acquisition of Kyzyl Kain Mamyt, LLC*** - On June 1, 2005, Kazakh Metals acquired 100% of the equity interests of Kyzyl Kain Mamyt, LLC (KKM) for the cash purchase price of $100,000. The former equity holders of KKM were not related parties. KKM operates in the Aktyubinsk region of northwestern Kazakhstan and has licenses to explore for, and is engaged in the production and sale of nickel and cobalt ore and Mamyt brown coal. KKM has been actively involved in mining cobalt and nickel ore since its inception and operating in the Soviet Union since 1938. The height of production occurred in the late 1980's. Limited production has occurred since that time. KKM's primary assets are its rights to exploit unproved reserves and its infrastructure of buildings, machinery and equipment, including a rail spur. Kazakh Metals accounted for the acquisition of KKM as a purchase business combination with a purchase price of $100,000. The purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values. The Company has estimated a fair value of $40,000,000 for the mineral interests and obtained an independent appraisal of the buildings and equipment of $17,693,795 on the acquisition date, and is in the process of obtaining third-party valuations of the mineral assets; accordingly, the allocation of the purchase price is subject to refinement. Negative goodwill was not recognized in connection with the acquisition of KKM. Instead, the excess of the fair value of the net assets over the purchase price was allocated as a pro rata reduction of the amounts that otherwise would have been assigned to the long-term assets. Notes payable assumed in the acquisition with a stated value of $7,445,197 are due to third parties generally within three years, including $4,432,290 to a bank, and were recorded based upon their fair values on the acquisition date, resulting in a discount to the notes that will be recognized as interest expense through maturity. The operations and cash flows of KKM are included in the Company's consolidated financial statements since the date of the acquisition. 9

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. --- ---------------- Current Assets $ 469,379 Unproved mineral property rights 7,034,321 Asset retirement costs of the mineral rights 86,852 Buildings, constructions machinery and equipment 3,068,786 --- ---------------- Total assets acquired 10,659,338 --- ---------------- Current 717,527 Asset retirement obligation 97,223 Notes Payable, net of discount of $917,737 6,541,670 Deferred tax liability 3,202,918 --- ---------------- Total assumed 10,559,338 --- ---------------- Net Assets Acquired $ 100,000 --- ---------------- Intangible assets acquired include the mineral property rights, which are capitalized and amortized on a units-of-production method, subject to impairment considerations. Other intangible assets include the asset retirement costs of the mineral rights, which have a 20-year estimated life and are subject to amortization at a planned rate of $4,311 per year, and the asset retirement obligation, which is accreted over its 20-year life, with a current estimated expense of $7,680 per year. ***Acquisition of EMPS Research, Inc.*** - On January 28, 2005, EMPS Research, Inc. ("EMPS") completed a Plan and Agreement of Reorganization with Condesa, wherein EMPS acquired 100% of the outstanding capital stock of Condesa in exchange for the issuance of 35,000,000 common shares of which 21,000,000 were held by the controlling shareholder of KMI and 14,000,000 were issued to minority shareholders in Condesa. EMPS then changed its name to Bekem Metals, Inc. As a result of that reorganization, the shareholders of Condesa owned 91% of the outstanding common stock of EMPS at that reorganization date. The combined entities were referred to after that reorganization as Bekem. EMPS had 3,300,000 shares of common stock outstanding prior to that transaction that remained outstanding, were classified as minority interests, and were valued at $0. The transaction resulted in a change of control of EMPS. For financial reporting purposes, Condesa was considered the acquirer. The acquisition was recognized as a forward stock split of Condesa's 30,000 shares of capital stock held by the controlling shareholder of KMI that were outstanding prior to the reorganization into 21,000,000 common shares, or a 700-for-1 stock split. The accompanying financial statements have been restated for the effects of the stock split for all periods presented. Condesa's assets, liabilities and minority interests were recorded at their historical cost and the effect of the stock split was reflected retroactively since the inception of Condesa. The assets of EMPS were considered to have been acquired by Condesa in exchange for the assumption of EMPS's net liabilities. The net assets consisted 10

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) of cash of $2,648 and intangible assets of $1,823 and current liabilities of $15,077. The operations of Condesa are included for all periods presented and the operations of EMPS are included from the acquisition of EMPS. ***Purchase of Kaznickel LLP*** - On July 9, 2004 Condesa, which was owned 60% by Brisa holding 8,400,000 of 14,000,000 shares of outstanding common stock, entered into an investment agreement under which Condesa provided a $300,000 convertible loan to Kaznickel LLP, which was immediately converted into a new 40 percent equity interests in Kaznickel. On September 22, 2004, Brisa acquired an interest in Kaznickel by purchasing 60 percent of the equity interest of the founding partners' remaining 60 percent interests. As consideration for the purchase, the original partners obtained a commitment from Brisa to facilitate a reverse merger with a U.S. public company, and a commitment to obtain funding enabling Kaznickel to further develop its mineral property rights. The value of the commitment was estimated to be $270,000 based on the percent of Kaznickel obtained for Condesa's original cash investment of $300,000. On November 19, 2004, Brisa and the remaining Kaznickel partners exchanged their combined 60% interest in Kaznickel for a new 60% interest, equal to 21,000,000 shares of Condesa, thereby making Kaznickel a wholly-owned subsidiary of Condesa. Brisa received 12,600,000 shares of Condesa in the transaction. The remaining 8,400,000 common shares issued in the acquisition were recognized as minority shareholders' interests. The acquisition of a controlling interest in Kaznickel by Brisa and Condesa was considered the purchase of Kaznickel with a measurement date of September 22, 2004, the date Brisa and Condesa obtained control from the original Kaznickel partners. Condesa accounted for the acquisition of Kaznickel as a purchase business combination with a purchase price of $304,456. The purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair values. Negative goodwill was not recognized in connection with the acquisition of Kaznickel. Instead, the excess of the fair value of the net assets over the purchase price was allocated as a pro rata reduction of the amounts that otherwise would have been assigned to the long-term assets. The Company is in the process of obtaining an independent valuation of the net assets acquired. Accordingly the allocation of the purchase price is subject to refinement. At September 22, 2004, the purchase price was allocated to the assets acquired and the liabilities assumed as follows: 11

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) --- ---------------- Current assets $ 231,674 Mineral property rights 267,660 Asset retirement costs of the mineral rights 474,936 Property and equipment 21,573 --- ---------------- Total assets acquired 995,843 --- ---------------- Current liabilities (25,468) Asset retirement obligation (665,919) --- ---------------- Total liabilities assumed (691,387) Minority Shareholders' interests (121,782) --- ---------------- Net Assets Acquired $ 182,674 --- ---------------- Intangible assets acquired include the mineral property rights, which are capitalized until the production phase begins, subject to impairment considerations. Other intangible assets include the asset retirement costs of the mineral rights, which have a 20-year estimated life and are subject to amortization at a planned rate of $24,291 per year, and the asset retirement obligation, which is accreted over its 20-year life, with a current estimated expense of $43,274 per year. **NOTE 3 - MINERAL PROPERTY RIGHTS** The government of Kazakhstan retains the title to the property upon which the Company's mineral rights pertain; accordingly, the Company's mineral interests are considered to be intangible assets. The Company capitalized the acquisition costs of its mineral interests upon the purchase business combinations with Kaznickel and with KKM. **Gornostai Deposit** Kaznickel acquired its interest in the Contract on Exploration and Development of Gornostai Cobalt and Nickel Deposit (the "Contract") issued by the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan (the "Ministry") dated February 26, 2004. By virtue of the Contract, Kaznickel acquired the right to exploit the mineral property including the right to explore, develop and produce the cobalt and nickel mineral resources on the Deposit through February 26, 2026. The Company has the right to re-negotiate the contract at that time for an additional 30 years. The government of Kazakhstan retains the title to the property; accordingly, the Company's mineral interest is considered to be an intangible asset. The Company capitalized the acquisition costs of its mineral interest upon the purchase business combination with Kaznickel. The allocated purchase price included a capitalized amount of an acquired asset retirement obligation. While the property is not in production, the asset retirement cost is depleted over the life of the contract from the date of acquisition. 12

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) The Contract provides the Company certain rights and also imposes certain obligations and commitments. The rights include exploration through February 2006, and development and production of minerals through February 26, 2026. The Company may transfer its right to third parties in accordance with Kazakh laws and regulations and has a right to renegotiate an extension of the Contract. Significant rights and obligations and commitments of the Contract include monetary commitments for exploration of $200,000 in 2005 and 2006, and expenditures to support social projects amounting to $300,000 during the production stage. In addition, the Company was required to pay a fee of $2,000 upon award of the Contract, and a fee for the use of Kazakh owned technical data of $835,759 of which $4,179 was paid on award of the Contract and $831,580 will be due upon a finding of commercial deposits. Royalties of 0.5% of ores extracted and sold will be required. The Contract subjects the Company to pay regular income tax of 30 percent and requires an excess profits tax of 15 to 60 percent if its net profits exceed 20 percent of gross profit. Obligations also include the establishment and funding of a reclamation fund that includes the cost of removing buildings and equipment used in the Deposit area. The Company is also required to comply with Kazakh environmental laws and regulations. **Kempirsai Deposit** Bekem acquired two contracts to explore for and extract minerals in connection with the purchase of KKM. One contract is for the exploration and extraction of nickel and cobalt ore from deposits located in an approximately 575,756 acre site in the northwest area of the Republic of Kazakhstan approximately 130 kilometers northwest of the city of Aktobe, Kazakhstan, near the town of Badamsha, referred to as the "Kimpersai" deposit through October 12, 2011. The other contract is for the exploration and extraction of Mamyt brown coal at a site located within 40 kilometers of the Kimpersai deposit through December 11, 2018. The contracts may be extended upon agreement between KKM and the Geology and Minerals Resources Committee of the Ministry of Energy and Minerals Resources of the Republic of Kazakhstan. The Kimpersai contract requires the Company to pay royalty payments equal to 2.21% of gross ore sales. The Mamyt brown coal contract requires a royalty payment equal to nine tenths of one percent of gross coal sales. Both contracts require the Company to pay an excess profits tax ranging from 4 to 30 percent based upon the reaching of an internal rate of return (as defined in the contracts) ranging from 22 to 30 percent. The allocated purchase price of the mineral interest included a capitalized amount of an acquired asset retirement obligation. The asset retirement cost is depleted over the life of the contract from the date of acquisition. 13

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) NOTE 4 - PROPERTY, PLANT AND EQUIPMENT, NET Property, plant and equipment, net, were as follows: **June 30, December 31, 2006 2005** ---------------------------- ------------- -------------- Buildings $2,330,108 $2,062,865 Machinery and equipment 3,102,293 970,005 Other fixed assets 82,475 53,856 ---------------------------- ------------- -------------- 5,514,876 3,086,726 Accumulated depreciation (48,342) (25,436) ---------------------------- ------------- -------------- Net Property and Equipment $5,466,534 $3,061,290 ---------------------------- ------------- -------------- The increase in PP&E substantially represents the equipment that the Company purchased in May 2006 from a third party for $2,000,000, which is used in KKM's pilot plant. The equipment was capitalized since it was in service on June 15, 2006. In connection with the equipment acquisition, the Company issued the third party a note payable for $2,000,000. **NOTE 5 - RELATED PARTY TRANSACTIONS** On December 2, 2004 the Company borrowed $92,308 from CJSC Kazmorgeophysica, a Kazakh company related by virtue of several common shareholders. The short-term loan is denominated in Kazakh Tenge, interest free and was due on its original terms by December 31, 2004. During March 2005 the Company borrowed an additional $99,798 from CJSC Kazmorgeophysica, as a Kazakh Tenge denominated, interest-free, due on demand note. In addition, during the six months ended June 30, 2005, the Company received advances in the amount of $26,866 from certain owners, which are short-term in nature and payable upon demand. On January 18, 2006, the Company signed the financial aid agreement with Balmont Trading S.A (see Note 7). Because the notes are denominated in Tenge, the balance reported on the financial statements fluctuates based upon ending exchange rates. 14

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) NOTE 6 - LONG-TERM DEBT Long-term debt consists of the following: **June 30, December 31, 2006 2005** -- ------------------- --------------------- Note payable to a company bearing interest at 0%; imputed interest of 22%; denominated in U.S. dollars; due April 2009; unsecured; $ 497,818 $ 497,818 Note payable to a company bearing interest at 3%; imputed interest of 22%; denominated in U.S. dollars; due April 2010; unsecured; 700,000 550,000 Note payable to a company bearing interest at 0%; imputed interest of 22%; denominated in U.S. dollars; due August 2008; unsecured; 485,951 485,951 Note payable to a company bearing interest at LIBOR plus 2% (6.39% at December 31, 2005); imputed interest of 22%; denominated in U.S. dollars; due March 2010; unsecured; 180,000 60,000 Notes payable to companies bearing interest at 0%; imputed interest of 22%; due on demand; unsecured; 4,063,007 3,018,032 Note payable to a company bearing interest at 14%; due on demand; unsecured; - 29,709 Note payable to a company bearing interest at 16%; due on demand; unsecured; - 52,286 Note payable to a company bearing interest at 5%; due on demand; unsecured; 754,908 560,203 Note payable to a company bearing interest at 0%; due on demand; unsecured; 777,169 - Note payable to a company bearing interest at 0%; due on demand; unsecured; (See Note 4) 2,000,000 - -- ------------------- --------------------- Total Long-term Debt 9,458,853 5,253,999 Less: Current Portion (7,595,084) (3,660,230) Less: Debt discount (893,164) (796,591) -- ------------------- --------------------- Long-term Debt - Net of Current Portion $ 970,605 $ 797,178 -- ------------------- --------------------- 15

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) NOTE 7 - LONG-TERM DEBT - RELATED PARTIES Long-term debt to related parties consists of the following: **June 30, December 31, 2006 2005** --- ------------------- ------------------- Notes payable to related companies bearing interest at 6.29%; due August 2008; unsecured; $ 1,845,600 $ 1,710,012 Note payable to related company bearing interest at 6.29%; due August 2010; unsecured; 2,385,343 2,288,000 Notes payable to related companies bearing interest at 6.29%; due May 2008; unsecured; 77,000 77,000 Notes payable to related companies bearing interest at 0%; due May 2007; unsecured; 100,000 - --- ------------------- ------------------- Total Long-term Debt 4,407,943 4,075,012 Less: Current Portion (100,000) - --- ------------------- ------------------- Long-term Debt - Net of Current Portion $ 4,307,943 $ 4,075,012 --- ------------------- ------------------- The above amounts have been loaned to the Company per an agreement dated August 8, 2005, between Kazakh Metals, Inc. and its wholly owned subsidiary, Kyzyl Kain Mamyt ("KKM"), for up to $10,000,000 for the purpose of assisting KKM in funding its work requirements, including generation of geological data, under the mineral extraction contract with the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan. Funds borrowed on this agreement bear interest at the rate of 6.29% (the August 8, 2005 LIBOR plus 2%) per annum. Terms currently range from three to five years with no prepayment penalties. The notes are not collateralized. At December 31, 2005 $3,998,012 had been borrowed. The former owners of Kazakh Metals, Inc. are funding this agreement. On 18 January 2006, the Company signed the financial aid agreement with Balmont Trading S.A. Under this agreement the Company borrowed $100,000 for the period of 16 months from the date of signing the agreement which may be reduced or extended. The Company has agreed to repay these loans out of the first funds raised by BMI. **NOTE 8 - COMMITMENTS AND CONTINGENCIES** ***Concentration of Risk Relating to Foreign Mining Operations*** - All of the Company's properties are located within the Republic of Kazakhstan in Central Asia. In addition to general industry risks of nickel and cobalt price fluctuations, and potential lack of economic viability of the claims, the Company has a concentration of risk related to its foreign properties and interests which are subject to political uncertainty, changes in government, unilateral renegotiation of licenses, claims or contracts, and nationalization, or other uncertainties. In addition, the validity of mining claims which 16

BEKEM METALS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS June 30, 2006 (UNAUDITED) constitute the Company's property holdings in Kazakhstan, may, in certain cases, be uncertain and are subject to being contested. ***Kazakhstan Business Environment*** - Kazakhstan, as an emerging market, has a legal and regulatory infrastructure that is not as mature and stable as those usually existing in more developed free market economies. As a result, operations carried out in Kazakhstan can involve risks and uncertainties that are not typically associated with those in developed markets. The instability associated with the ongoing transformation process to a market economy can lead to changes in the business conditions in which the Company currently operates. Changes in the political, legal, tax or regulatory environment could adversely impact the Company's operations. ***Tax Matters*** - The local and national tax environment in the Republic of Kazakhstan is subject to change and inconsistent application, interpretation and enforcement. Non-compliance with Kazakhstan laws and regulations, as interpreted by the Kazakh authorities, can lead to the imposition of fines, penalties and interest. ***Environmental Matters*** - Extensive national, regional and local environmental laws and regulations in Kazakhstan affect the Company's operations. These laws and regulations set various standards regulating certain aspects of health and environmental quality provide for user fees, penalties and other liabilities for the violation of these standards and establish, in some circumstances, obligations to remediate current and former facilities and off-site locations. The Company believes it is currently in compliance with all existing Republic of Kazakhstan environmental laws and regulations. However, as new environmental laws and legislation are enacted and the old laws are repealed, interpretation, application and enforcement of the laws may become inconsistent. Compliance in the future could require significant expenditures, which may adversely affect the Company's operations. **NOTE 9 -SUBSEQUENT EVENT** On July 14, 2006, the Company closed a private placement of 8,000,000 Units of our securities to two non-U.S. investors for $28,000,000. Each Unit consisted of three shares of restricted common stock and one warrant to purchase an additional share of common stock for two years from the closing at a price of $2.00 per share. The warrants are immediately exercisable. The price per Unit was $3.50. The Company issued a total of 24,000,000 common shares and warrants to purchase 8,000,000 common shares. These issuances did not result in a change in control of the Company. The Company also issued to the placement agent a warrant to purchase up to 2,400,000 shares of our restricted common stock. The exercise price of this warrant is $1.17 per share. The warrant is immediately exercisable and will expire eighteen months from the date they were granted. 17

Item 2. Management's Discussion and Analysis For a complete understanding, this Plan of Operations should be read in conjunction with the *Financial Statements and Notes to the Financial Statements* contained in this Form 10-QSB and our Form 10-KSB for the year ended December 31, 2005, as amended. **Forward Looking Information and Cautionary Statement** Certain statements in this quarterly report may be deemed to be forward-looking statements. Forward-looking statements regarding economic conditions, effects of corporate initiatives, future profitability, projections, future revenue opportunities, and their impact on us are forward-looking statements and not historical facts. These statements are estimates or projections involving numerous risks or uncertainties, including but not limited to, consumer demand, acceptance of products and services offered by us, our ability to control expenses, actions by competitors, changes in market needs and technology, political or regulatory matters, litigation, general economic conditions and changes in management strategy. Actual results or events could differ materially from those discussed in the forward-looking statements. See our annual report on Form 10-KSB as filed with the Securities and Exchange Commission for further information. We disclaim any obligation to publicly update, revise or correct any forward-looking statements, whether as a result of new information, future events or otherwise. The information contained in this analysis should be read in conjunction with the financial statements contained herein and related disclosures. **Overview** Bekem Metals, Inc., (hereinafter referred to as "us," "we," the "Company" or "Bekem") is engaged in the exploration, extraction, refining and marketing of nickel, cobalt and brown coal in the Republic of Kazakhstan. We incorporated in the state of Utah under the name EMPS Research Corporation on January 30, 2001. We changed our name to Bekem Metals, Inc., on March 16, 2005 following our acquisition of Condesa Pacific, S.A., a British Virgin Islands international business company, and its wholly owned subsidiary Kaznickel, LLP ("Kaznickel") in January of 2005. On July 24, 2006, Condesa transferred its interest in Kaznickel to Bekem, making Kaznickel a wholly-owned subsidiary of Bekem. The primary asset of Kaznickel is an exploration and production concession issued by the government of the Republic of Kazakhstan which grants Kaznickel the exclusive right, through February 2026, to explore for and engage in test production of nickel, cobalt and other minerals in a 4,950 hectare (12,232 acre) area in northeastern Kazakhstan known as the Gornostai deposit. On October 24, 2005, we entered into an agreement whereby we acquired Kazakh Metals, Inc., a British Virgin Islands international business company ("KMI"), in exchange for 61,200,000 of our common shares. KMI has a wholly owned 18

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subsidiary Kyzyl Kain Mamyt LLP, a Kazakhstani limited liability partnership ("KKM"), which holds the exclusive licenses to extract and process nickel and cobalt ore from its Kempirsai deposit and brown coal from its Mamyt deposit in northwestern Kazakhstan. Under the applicable accounting reporting rules, KMI was considered the accounting acquirer.

Results of Operations

Since inception we have generated only limited revenue from operations. We do not anticipate generating significant revenues until we begin commercial production, which, if necessary funding can be obtained, is estimated to occur in 2007. Moreover, in reaching commercial production stage, we anticipate incurring millions of dollars in costs. Because we are not currently generating significant revenues we will be completely dependent on investment funds to support our operations until such time as production generates sufficient revenues to cover our operating expenses. We do not expect to begin production until the fourth quarter 2007, and we do not anticipate generating sufficient revenue to cover operating expenses until 2008. Subsequent to the quarter end, in July we raised $28,000,000 through the private placement of our equity securities. These funds will be used in the further development of our properties and technology, for repayment of loans, acquisitions and as working capital. The funds raised in July, however, represent only a portion of the funds we will need to begin commercial production. We anticipate the need to

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seek additional funding in the future. There is no assurance that we will be able to obtain additional funding in the future on favorable terms, or at all. As you read this Results of Operations section it is important to keep in mind that in October 2005 we acquired KMI and its operating subsidiary KKM. KMI acquired KKM on May 31, 2005. As a result of common ownership between Bekem and KMI prior to the October 2005 acquisition, the operations of KKM have been included in our financial statements from the time KKM was acquired by KMI on May 31, 2005. While KKM has not engaged in significant operations in recent years, it has engaged in significantly greater operations than Bekem or Kaznickel. Prior to the acquisition of KMI, we were engaged in exploration of our Gornostai deposit. However, because of a lack of funds our exploration activities were limited. The increases in revenue and expenses during the six months ended June 30, 2006 compared to the six months ended June 30, 2005 is the result of acquisition of KKM and not the result of increased operations of Bekem or Kaznickel. *Three months ended June 30, 2006 compared to the three months ended June 30, 2005* Revenue During second quarter 2006 we earned revenue of $4,885 primarily from providing different services by using existing machinery and equipment. By comparison, in second quarter 2005 we realized no revenue. While we anticipate revenue during the first three quarter of 2006 to be higher than in the comparable 2005 periods, we expect revenue by the end of the 2006 fiscal year will be lower as compared to the 2005 fiscal year because we do not expect to sell any significant quantities of ore or coal in 2006. Cost of Product Sold We realized cost of product sold of $36,461 during the three months ended June 30, 2006 and no cost of product sold during the comparable 2005 period. This increase in cost of product sold is the direct result of our acquisition of KKM and its operations. We anticipate cost of product sold during the third quarter fiscal quarter of 2006 to be higher than the comparable period 2005, but we expect cost of product sold by the end of the 2006 fiscal year to be lower than during the 2005 fiscal year because we do not expect to sell any significant quantities of ore or coal during the 2006 fiscal year. General and Administrative Expenses With the acquisition of KKM, our general and administrative expenses during the three months ended June 30, 2006 increased to $564,550 from $120,862 during the second quarter 2005. This significant increase in general and administrative expenses in the second quarter 2006 is attributable to the significant increase in employees and employee-related costs due to the acquisition of KKM, as well as costs associated with having operations in both northeastern and northwestern Kazakhstan, including increased office rents and travel expenses. During the remainder of the 2006 fiscal year we expect general 20

and administrative expenses will continue to increase at about the same or a more accelerated rate as we continue our efforts to ramp up mining and processing operations. Accretion Expense Accretion expense was nearly unchanged during the three months ended June 30, 2006 compared to the three months ended June 30, 2005 increasing 3%. We believe accretion expense will continue to remain fairly constant in upcoming fiscal quarters. Depreciation Expenses During the second quarter 2006 we realized depreciation expense of $17,570 compared to $2,012 during the second quarter 2005. With the acquisition of KKM, we also acquired the assets of KKM, which includes equipment, buildings, machinery, etc. that we did not own during the first quarter 2005. We expect increases in depreciation expense during the third and fourth quarters of fiscal 2006 to remain at levels more or less consistent with the increases experienced during the second quarter 2006. Research and development costs We realized research and development costs of $93,402 related to the development of our pilot processing plant during the second quarter 2006. By comparison, we realized no research and development costs during the second quarter 2005. We expect our research and development costs during the remainder of the current fiscal year to increase by more than $500,000 due to testing the pilot processing plant. Total Expenses For the reasons discussed in the preceding paragraphs, our total expenses increased from $222,681 during the three months ended June 30, 2005 to $787,918 during three months ended June 30, 2006. We expect total expenses during the rest of 2006 to increase at even greater rates as we ramp up our business. Loss from Operations During the three months ended June 30, 2006 we experienced a loss from operations of $783,033 compared to a loss of $220,164 during the three months ended June 30, 2005. This dramatic increase in loss from operations during the second quarter 2006 is the result of our acquisition of KKM and its active operations since May 31, 2005. By comparison, during the first quarter 2005 we engaged in limited operations and incurred few expenses. We expect we will continue to generate losses from operations until such time as we begin significant ore production. 21

Net Loss For all of the foregoing reasons, during the three months ended June 30, 2006 we experienced a net loss of $550,766 compared to a net loss of $220,164 during the three months ended June 30, 2005. We anticipate we will continue to experience increasing net losses until we are able to engage in significant nickel and cobalt ore extraction, processing and sales. We do not expect to be engaged in significant ore extraction and processing prior to the 2008 fiscal year. *Six months ended June 30, 2006 compared to the six months ended June 30, 2005* Revenue During the six month period ended June 30, 2006, we earned revenue of $69,527 primarily from the sale of brown coal and providing various services by using existing machinery and equipment. By comparison, in the first two quarters of 2005 we realized no revenue. During the six-month period ended June 30, 2005 we acquired the Gornostai deposit. Our operations during the period were limited to exploratory drilling. The KKM operations were limited immediately after our acquisition on May 31, 2005 and no revenue was produced until later in 2005. We anticipate revenue during the first three quarters of fiscal 2006 to be higher than the comparable period of fiscal 2005, however, by the end of the 2006 fiscal year we expect revenue to be lower as compared to the 2005 fiscal year because we do not expect to sell any significant quantities of ore or coal in 2006. Cost of Product Sold We realized cost of product sold of $65,871 during the six months period ended June 30, 2006 and no cost of product sold during the comparable 2005 period. This increase in cost of product sold is the direct result of our acquisition of KKM and its active operations. As discussed above, during the first six months of 2005 we engaged in very limited mining operations. We anticipate cost of product sold during the third quarter of the 2006 fiscal year will be higher than the comparable period of the 2005 fiscal year. We expect, however, by the end of the 2006 fiscal year that cost of product sold will be lower when compared to the 2005 fiscal year because we do not expect to sell any significant quantities of ore or coal during the 2006 fiscal year. General and Administrative Expenses General and administrative expenses during the six-month period ended June 30, 2006 increased to $922,088 from $194,816 during the six-month period ended June 30, 2005. This significant increase in general and administrative expense is attributable to the significant increase in employees and employee-related costs due to the acquisition of KKM, as well as costs associated with having operations in both northeastern and northwestern Kazakhstan, including increased office rents and travel expenses. During the remainder of the 2006 fiscal year we expect general and administrative expense will continue to increase at about the same or a more accelerated rate as we continue our efforts to ramp up mining and processing operations. 22

Accretion Expense Accretion expense was nearly unchanged during the six months ended June 30, 2006 compared to the six months ended June 30, 2005 increasing 3%. We believe accretion expense will continue to remain fairly constant in upcoming fiscal quarters. Depreciation Expenses During the six months ended June 30, 2006 we realized depreciation expense of $35,728 compared to $4,038 during the six month ended June 30, 2005. With the acquisition of KKM, we also acquired the assets of KKM, which includes equipment, buildings, machinery, etc. that we did not own during the first quarter 2005. We expect increases in depreciation expense during the remainder of the year to remain at levels more or less consistent with the increase experienced during the first six months of the year. Research and development costs We realized research and development costs of $386,411 related to the development of our pilot processing plant during the six months ended June 30, 2006, compared to $0 during the six months ended June 30, 2005. We expect our research and development costs will increase by more than $500,000 by the end of current fiscal year as we start testing our pilot processing plant. Total Expenses As a result of our acquisition of KKM our total expenses increased from $421,493 during the six months ended June 30, 2005 to $1,564,506 during six months ended June 30, 2006. We expect our total expenses during the rest of 2006 will continue to increase at even greater rates as we ramp up our business. Loss from Operations During the six months ended June 30, 2006 we experienced a loss from operations of $1,494,979 compared to a loss of $421,493 during the six months ended June 30, 2005. This dramatic increase in loss from operations during the six months ended June 30, 2006 is the result of our acquisition of KKM and its active operations during the fourth quarter 2005. By comparison, during the six month ended June 30, 2005 we engaged in limited operations and incurred fewer expenses. We expect we will continue to generate losses from operations until such time as we engage in significant ore production. Net Loss For all of the foregoing reasons, during the six months ended June 30, 2006 we experienced a net loss of $1,166,964 compared to a net loss of $418,408 during the six months ended June 30, 2005. We anticipate we will continue to experience increasing net losses until we are able to engage in significant 23

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nickel and cobalt ore extraction, processing and sales. We do not expect to be engaged in significant ore extraction and processing prior to the 2008 fiscal year. **Liquidity and Capital Resources** Our capital resources have consisted primarily of funds we have borrowed from related and non-related parties. As discussed above, subsequent to the quarter end we raised $28,000,000 through the private placement of our equity securities. These funds, however, represent only a portion of the funds we will need to move to commercial production. We anticipate the need for substantial additional capital resources in the upcoming twelve months, which will likewise consist primarily of funds raised in financing activities and debt. During the six months ended June 30, 2006 and June 30, 2005, cash was primarily used to fund operations. See below for additional discussion and analysis of cash flow. **Six months ended Six months ended June 30, 2006 June 30, 2005** ---------------- ---------------- Net cash used in operating activities $ (2,074,386) $ (312,374) Net cash provided by/(used) in investing activities (2,357,635) 1,161 Net cash provided by financing activities 4,494,587 444,066 Effect of exchange rate changes on cash 128,803 (12,389) ------------ ------------ NET INCREASE IN CASH $ 191,369 $ 120,464 ============ ============ During the six months ended June 30, 2006 net cash used in operating activities was $2,074,386 compared to net cash used in operating activities of $312,374 during the six months ended June 30, 2005. This increase in net cash used in operating activities is primarily attributable to increases in general and administrative expenses and research and development costs, which are largely the result of our acquisition of KMI and its operating subsidiary KKM. During the six months ended June 30, 2006 we used $2,357,635 in investing activities, most of which was used to acquire property and equipment. By comparison, during the six months ended June 30, 2005 we realized net cash from operating activities of $1,161. This change in net cash provided by investing activities is again related to our acquisition of KKM in 2005. Net cash provided by financing activities during the six months ended June 30, 2006 was $4,494,587 compared to net cash provided by financing activities of $444,066 during the six months ended June 30, 2005. During the six months ended June 30, 2006 borrowing from related and non-related parties increased significantly as we sought loans to fund the development of our pilot processing plant. 24

Plan of Operations *Operations* Drilling We plan to drill approximately 34,500 meters of the left and right banks of the Gornostai deposit. Estimated drilling costs is $3,500,000 which include both direct and indirect drilling costs, including geologist fees and costs for site supervisors, geological data processors, core sample takers, topographers, site procurement specialists, etc. Core Analysis We anticipate spending approximately $250,000 for core analysis during the next twelve months. *Design and Engineering* Over the next twelve months we anticipate to spend approximately $3,500,000 for pre-feasibility and feasibility studies and to develop a commercial processing plant design for ore processing at the Kempirsai deposit. We will also perform an independent resource and reserves estimate and valuation. Independent Resource and Reserve Estimate We will allocate $1,000,000 to hire an independent mining consulting firm to provide us with a resource and reserve reclassification and estimate for the Gornostai deposit and the Kempirsai deposits. Feasibility Study We anticipate spending approximately $1,000,000 for the preparation of pre-feasibility and feasibility studies. Detailed Design Detailed design costs of $1,500,000 represent the prospective costs of detailed engineering and design contract for construction of a commercial processing plant on the territory of Kempirsai deposit. This includes flow sheet design and its pilot testing. This is a rough estimate, which will be subject to future revision following completion of feasibility studies. 25

Professional Fees We expect to incur approximately $300,000 in expenses to our financial auditors and securities attorneys during the next twelve months. *Administrative Expenses* We plan to allocate approximately $3,000,000 for administrative expenses during the next twelve months, which include expenses of maintaining offices in the United States and Kazakhstan, for salaries and taxes. *Working Capital* We plan to allocate $2,800,000 for working capital for the next twelve months. This will be used to finance our operations at the Kempirsai and Gornostai deposits.

Summary of Material Contractual Commitments The following table lists our significant commitments as of December 31, 2005: Payments Due by Fiscal Year -- Less than 1-3 3-5 Contractual Commitments Total 1 year years years Thereafter -- Notes Payable $ 5,253,999 3,660,230 983,769 610,000 -0- Notes Payable - Related Party $ 4,075,012 -0- 1,787,012 2,288,000 -0- Due to the Government of the Republic of Kazakhstan(1) $ 831,580 -0- 831,580 -0- -0- Operating Leases $ 103,160 96,660 6,500 -0- -0- ----------- ---------- ---------- ---------- ------ Total $10,263,751 $3,756,890 $3,602,361 $2,898,000 -0- =========== ========== ========== ========== ====== (1) In connection with our acquisition of the exploration contract covering the Gornostai deposit, we are required to repay the Republic of Kazakhstan for historical costs incurred by it in undertaking geological and geophysical studies and infrastructure improvements. The repayment terms of this obligation will not be determined until such time as we apply for and are granted a contract to engage in commercial production by the Republic of Kazakhstan. Under our current contract once we determine the property contains commercially producible reserves, if we wish to commence commercial production, we must apply for such right prior to the expiration of our exploration and development rights in February 2026. We anticipate that we will apply for a commercial production contract within the next 1-3 years. Of course, there is no guarantee when or if we will discover commercially producible reserves within the Gornostai deposit. Should we decide not to pursue a commercial production contract, we can relinquish the Gornostai deposit to the Republic of Kazakhstan in satisfaction of this obligation. For us to maintain our rights under the exploration license held by Kaznickel and the production license held by KKM, we must satisfy the work program requirements of the Ministry of Energy and Mineral Resources of the Republic of Kazakhstan ("MEMR"). Each year we must submit a proposed annual work program under each license to the MEMR. This annual work program must be 26

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reviewed and approved by the MEMR. If we fail to meet the minimum work program requirements, we could lose our licenses. Under the current work program for Kaznickel, we must drill at least 17,498 meters in 2006. The current work program under the KKM licenses calls for KKM to extract the following amounts of ore for processing and brown coal through 2011. Tons of Ore Tons of Brown Coal -------------- ----------------- 2006 -0- 20,000 2007 175,000 60,000 2008 350,000 200,000 2009 1,000,000 200,000 2010 1,000,000 200,000 2011 1,000,000 200,000 To date, we have met the minimum obligations under the minimum work programs of our subsidiaries. Should we fail to complete the minimum work program in some year, the MEMR could review the work program, request an update and amendment to the work program or even recall our license. We are confident of our ability to satisfy the obligations of the minimum work programs of our subsidiaries in the future. We plan to retire loans provided to us through notes payable by related and non-related parties to finance operation and construction of the pilot plant during 2006. **Off-Balance Sheet Financing Arrangements** As of June 30, 2006 we had no off-balance sheet financing arrangements. **Critical Accounting Policies** The preparation of financial statements in accordance with accounting standards generally accepted in the United States requires management to make estimates and assumptions that affect both the recorded values of assets and liabilities at the date of the financial statements and the revenues recognized and expenses incurred during the reporting period. Our estimates and assumptions affect our recognition of deferred expenses, bad debts, income taxes, the carrying value of our long-lived assets and our provision for certain contingencies. We evaluate the reasonableness of these estimates and assumptions continually based on a combination of historical information and other information that comes to our attention that may vary our outlook for the future. Actual results may differ from these estimates under different assumptions. We suggest that our Summary of Significant Accounting Policies, as described in Note 1 of Notes to Consolidated Financial Statements on Form 10-KSB for December 31, 2005, be read in conjunction with this Management's Discussion 27

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and Analysis of Financial Condition and Results of Operations. We believe the critical accounting policies that most impact our consolidated financial statements are described below. ***Use of Estimates*** - The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates. The more significant areas requiring the use of management estimates and assumptions relate to mineral reserves that are the basis for future cash flow estimates and units-of-production depreciation, depletion and amortization calculations; environmental, reclamation and closure obligations; asset impairments; write-down of inventory to net realizable value; valuation allowances for deferred tax assets; reserves for contingencies and litigation; and the fair value and accounting treatment of financial instruments. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Accordingly, actual results may differ significantly from these estimates under different assumptions or conditions. ***Currency Translation*** - The consolidated financial statements are presented in U.S. dollars. The functional currency of the Company's subsidiaries operating in Kazakhstan is U.S. dollars for Kaznickel and Kazakh tenge for KKM. Results of operations are translated into U.S. dollars at the average exchange rates during the reporting period. Non-monetary assets and liabilities of Kaznickel are translated into U.S. dollars, using historical exchange rates and monetary assets and liabilities are translated into U.S. dollars using exchange rates on the date of the financial statements. Translation differences are included in results of operations. All balance sheet accounts of KKM are translated at exchange rates on the date of the financial statements and translation differences are included in stockholders' equity as cumulative translation adjustments. ***Revenue Recognition*** - For its operating mine, revenues currently arise from the limited sale of ore and Mamyt brown coal. Revenue is recorded when persuasive evidence of an arrangement exists, title to product transfers to the customer, and collectibility is reasonably assured. Produced, but unsold minerals or ore are recorded as inventory until sold. ***Trade Receivables*** - In the normal course of business, the company extends credit to its customers on a short-term basis. The principal customers are local companies and government agencies. Although credit risks associated with these customers are considered minimal, the company routinely reviews its accounts receivable balances and makes provisions for doubtful accounts. ***Related Party Receivables*** - Related party receivables consists of short-term advances to employees. No allowance has been provided due to the historic short-term nature and recoverability of such advances. ***Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of*** - Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the 28

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impairment to be recognized is measured by the amount that the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. At December 31, 2005, we reviewed our long-lived assets as disclosed above and determined no impairment was necessary. ***Income taxes*** - Income taxes are calculated using the liability method of tax accounting. Under this method, future income tax assets and liabilities are computed based on temporary differences between the tax basis and carrying amount on the balance sheet for assets and liabilities. Future income tax assets and liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. ***Depreciation, Depletion and Amortization*** - Expenditures for new facilities or equipment and expenditures that extend the useful lives of existing facilities or equipment are capitalized and depreciated using the straight-line method at rates sufficient to depreciate such costs over the estimated future lives of such facilities or equipment. These lives do not exceed the estimated mine life based on proven and probable reserves as the useful lives of these assets are considered to be limited to the life of the relevant mine. Costs incurred to develop new properties are capitalized as incurred, where it has been determined that the property can be economically developed based on the existence of proven and probable reserves. At our surface mines, these costs include costs to further delineate the ore body and remove overburden to initially expose the ore body. All such costs are amortized using the units-of-production ("UOP") method over the estimated life of the ore body based on recoverable minerals to be mined from proven and probable reserves. Major development costs incurred after the commencement of production are amortized using the UOP method based on estimated recoverable minerals to be mined from proven and probable reserves. Depending upon whether the development is expected to benefit the entire remaining ore body, or specific ore blocks or areas only, the UOP basis is either the life of the entire ore body, or the life of the specific ore block or area. The calculation of the UOP rate of amortization, and therefore the annual amortization charge to operations, could be materially impacted to the extent that actual production in the future is different from current forecasts of production based on proven and probable reserves. This would generally occur to the extent that there were significant changes in any of the factors or assumptions used in determining reserves. These factors could include: (i) an expansion of proven and probable reserves through exploration activities; (ii) differences between estimated and actual cash costs of mining, due to differences in grade, mineral recovery rates and foreign currency exchange rates; and (iii) differences between actual commodity prices and commodity price assumptions used in the estimation of reserves. Such changes in reserves could similarly impact the useful lives of assets depreciated on a straight-line basis, where those lives are limited to the life of the mine, which in turn is limited to the life of the proven and probable reserves. 29

The expected useful lives used in depreciation, depletion and amortization calculations are determined based on applicable facts and circumstances, as described above. Significant judgment is involved in the determination of useful lives, and no assurance can be given that actual useful lives will not differ significantly from the useful lives assumed for purpose of depreciation, depletion and amortization calculations. ***Stripping Costs*** - In general, mining costs are allocated to production costs, stockpiles, and inventories, and are charged to costs applicable to sales when minerals are sold. However, the mining industry, generally, defers and amortizes certain mining costs on a units-of-production basis over the life of the mine. These mining costs, which are commonly referred to as "deferred stripping" costs, are incurred in mining activities that are normally associated with the removal of waste rock. The deferred stripping accounting method is generally accepted in the mining industry where mining operations have diverse grades and waste-to-ore ratios; however, industry practice does vary. Deferred stripping matches the costs of production with the sale of minerals, where this procedure is employed, by assigning each quantity of mineral with an equivalent amount of waste removal cost. When stripping costs are expensed as incurred, there might be greater volatility in a company's period-to-period results of operations. We did not acquire any deferred stripping costs in the acquisition of KKM. In March 2005, the FASB ratified Emerging Issues Task Force Issue No. 04-6, "Accounting for Stripping Costs Incurred during Production in the Mining Industry," (EITF 04-6) which addresses the accounting for stripping costs incurred during the production phase of a mine and refers to these costs as variable production costs that should be included as a component of inventory to be recognized in costs applicable to sales in the same period as the revenue from the sale of inventory. As a result, capitalization of stripping costs is appropriate only to the extent product inventory exists at the end of a reporting period and the carrying value is less than the net realizable value. We will adopt the provisions of EITF 04-6 on January 1, 2006. We have had very limited production activity in the recent period, so the full effect of this adoption will be felt as production increases in the future periods. ***Mineral Property Rights*** - Mineral property acquisition costs, site restoration costs and development costs on mineral properties with proven and probable reserves are capitalized and will be depleted using the units-of-production method over the estimated life of the reserves. If there are insufficient reserves to use as a basis for depleting such costs, they are written off as a mineral property or mineral interest impairment in the period in which the determination is made. Site restoration costs are depleted over the term of their expected life. Interest costs are capitalized on mineral properties and mineral interests in development. The development potential of mining properties is established by the existence of proven and probable reserves, reasonable assurance that the property can be permitted as an operating mine and evidence that there are no metallurgical or other impediments to the production of saleable metals. Exploration costs incurred on mineral interests, other than acquisition costs, prior to the establishment of proven and probable reserves are charged to operations as incurred. Development costs incurred on mineral interests with proven and probable reserves will be capitalized as mineral properties. We regularly perform evaluations of our investment in mineral interests to assess the recoverability and / or the residual value of its investments in these 30

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assets. All mineral interests and mineral properties are reviewed for impairment whenever events or circumstances change which indicate the carrying amount of an asset may not be recoverable, utilizing established guidelines based upon undiscounted future net cash flows from the asset or upon the determination that certain exploration properties do not have sufficient potential for economic mineralization. Our estimates of mineral prices, recoverable probable reserves, and operating, capital and reclamation costs, when available, are subject to certain risks and uncertainties, which may affect the recoverability of mineral property costs. Although we have made our best estimate of these factors, it is possible that changes could occur in the near term, which could adversely affect the future net cash flows to be generated from the properties. **Item 3. Controls and Procedures** Our principal executive officer and our principal financial officer (the "*Certifying Officers*") are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Such officers have concluded (based upon their evaluations of these controls and procedures as of the end of the period covered by this report) that our disclosure controls and procedures are effective to ensure that information required to be disclosed by it in this report is accumulated and communicated to management, including the Certifying Officers as appropriate, to allow timely decisions regarding required disclosure. The Certifying Officers have also indicated that there were no significant changes in our internal controls over financial reporting or other factors that could significantly affect such controls subsequent to the date of their evaluation, and there were no significant deficiencies and material weaknesses. Management, including our Certifying Officers, do not expect that our disclosure controls or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any systems of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of these inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected. 31

PART II - OTHER INFORMATION Item 2. Unregistered Sales of Equity Securities and Use of Proceeds On July 14, 2006, we closed a private placement of 8,000,000 Units of our securities to two non-U.S. investors for $28,000,000. Each Unit consisted of three shares of restricted common stock and one warrant to purchase an additional share of common stock for two years from the closing at a price of $2.00 per share. The warrants are immediately exercisable. The price per Unit was $3.50. We issued a total of 24,000,000 common shares and warrants to purchase 8,000,000 common shares. These issuances did not result in a change in control of the Company. From the total proceeds, we paid the placement agent, Aton Securities, Inc., a cash fee totaling 5% of the total proceeds raised, or $1,400,000. We also issued to the placement agent a warrant to purchase up to 2,400,000 shares of our restricted common stock. The exercise price of this warrant is $1.17 per share. The warrant is immediately exercisable and will expire eighteen months from the date they are granted. The placement agent is not an officer, director or greater than 10% shareholder of the Company. None of the fees paid or warrants granted to the placement agent were directly or indirectly be paid to any officer, director or greater than 10% shareholder of the Company. Investors in this offering were granted the right to request that we file a registration statement on their behalf registering for resale the shares they purchased in this private placement. The Registration Rights Agreement requires that at least 51% of the shares purchased in this private placement request registration before we must undertake efforts to register the shares for resale. The investors in this private placement may not request registration for at least 90 days from the closing of the private placement. The securities were issued without registration under the Securities Act of 1933 in reliance upon exemptions from registration pursuant to Regulation S of the rules and regulations promulgated by the Securities and Exchange Commission under the Securities Act of 1933. *Sales Pursuant to Regulation S* All offers and sales were made to non-U.S. persons in offshore transactions. No directed selling efforts were made in the United States by the issuer, placement agent or any person acting on their behalf. The shares sold are subject to the offering restrictions set forth in Rule 903(b)(3), including a one-year distribution compliance period. **Item 6. Exhibits** Exhibits. The following exhibits are included as part of this report: Exhibit No. Exhibit Exhibit 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Exhibit 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 Exhibit 32.1 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 Exhibit 32.2 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 **SIGNATURES** Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized. **BEKEM METALS, INC.** August 14, 2006 By: /s/ Marat Cherdabayev Marat Cherdabayev, Principal Executive Officer August 14, 2006 By: /s/ Yermek Kudabayev Yermek Kudabayev, Principal

Financial Officer 32