

Grizzly Diamonds Ltd.

Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

AUDITORS' REPORT

To the Shareholders of **Grizzly Diamonds Ltd.**

We have audited the balance sheets of **Grizzly Diamonds Ltd.** as at July 31, 2005 and 2004 and the statements of loss and deficit and cash flows for the year ended July 31, 2005 and the seven months ended July 31, 2004. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at July 31, 2005 and 2004, and the results of its operations and its cash flows for the year ended July 31, 2005 and seven months ended July 31, 2004 in accordance with Canadian generally accepted accounting principles.

Edmonton, Canada
October 12, 2005

Signed "Stout & Company LLP"
Chartered Accountants

Grizzly Diamonds Ltd.

Balance Sheets

July 31, 2005 and 2004

| | 2005 \$ | 2004 \$ |
|--|------------|------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | 635,947 | 82,038 |
| Goods and services tax receivable | 41,175 | 9,619 |
| Accrued interest receivable | 6,295 | - |
| | <hr/> | <hr/> |
| | 683,417 | 91,657 |
| Deferred share issuance costs | - | 40,500 |
| Mineral properties (Note 4) | 573,265 | 126,141 |
| | <hr/> | <hr/> |
| | 1,256,682 | 258,298 |
| | <hr/> | <hr/> |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 166,149 | - |
| | <hr/> | <hr/> |
| Shareholders' Equity | | |
| Share capital (Note 6) | 1,104,440 | 268,500 |
| Contributed surplus | 94,000 | - |
| Deficit | (107,907) | (10,202) |
| | <hr/> | <hr/> |
| | 1,090,533 | 258,298 |
| | <hr/> | <hr/> |
| | 1,256,682 | 258,298 |
| | <hr/> | <hr/> |

Approved by the Board of Directors

Signed "Brian Testo" Director

Signed "Pamela Strand" Director

See accompanying notes to financial statements

Grizzly Diamonds Ltd.

Statements of Loss and Deficit

For the year ended July 31, 2005 and seven months ended July 31, 2004

| | 2005 \$ | 2004 \$ |
|---|------------|------------|
| Revenue | | |
| Interest | 8,068 | - |
| | <hr/> | <hr/> |
| Expenses | | |
| General and administrative | 56,418 | 202 |
| Professional fees | 43,625 | - |
| Consulting fees | 31,700 | 10,000 |
| | <hr/> | <hr/> |
| | 131,743 | 10,202 |
| | <hr/> | <hr/> |
| | (123,675) | (10,202) |
| | <hr/> | <hr/> |
| Other expenses | | |
| Stock-based compensation | (59,000) | - |
| Write-down of mineral properties | (56,243) | - |
| | <hr/> | <hr/> |
| | (115,243) | - |
| | <hr/> | <hr/> |
| Loss before income taxes | (238,918) | - |
| Future income tax benefit | 141,213 | - |
| | <hr/> | <hr/> |
| Net loss for the period | (97,705) | (10,202) |
| Deficit – beginning of period | (10,202) | - |
| | <hr/> | <hr/> |
| Deficit – end of period | (107,907) | (10,202) |
| | <hr/> | <hr/> |
| Basic and diluted net loss per common share | (0.012) | (0.003) |
| | <hr/> | <hr/> |
| | # | # |
| Weighted average number of common shares outstanding | 8,242,193 | 3,562,442 |
| | <hr/> | <hr/> |

See accompanying notes to financial statements

Grizzly Diamonds Ltd.

Statements of Cash Flows

For the year ended July 31, 2005 and seven months ended July 31, 2004

| | 2005 \$ | 2004 \$ |
|--|------------------|------------------|
| Cash provided by (used in) | | |
| Operating activities | | |
| Net loss for the period | (97,705) | (10,202) |
| Items not affecting cash | | |
| Stock-based compensation | 59,000 | - |
| Write-down of mineral properties | 56,243 | - |
| Future income tax benefit | (141,213) | - |
| | <u>(123,675)</u> | <u>(10,202)</u> |
| Net change in non-cash working capital items | <u>128,298</u> | <u>(9,619)</u> |
| | <u>4,623</u> | <u>(19,821)</u> |
| Investing activities | | |
| Mineral properties | | |
| Acquisition costs | (129,562) | (20,000) |
| Exploration costs | (283,305) | (106,141) |
| | <u>(412,867)</u> | <u>(126,141)</u> |
| Financing activities | | |
| Issuance of shares | 1,200,000 | 268,500 |
| Share issuance costs | (237,847) | - |
| Deferred share issuance costs | - | (40,500) |
| | <u>962,153</u> | <u>228,000</u> |
| Increase in cash and cash equivalents | 553,909 | 82,038 |
| Cash and cash equivalents – beginning of period | 82,038 | - |
| Cash and cash equivalents – end of period | 635,947 | 82,038 |
| Cash and cash equivalents consist of: | | |
| Cash on deposit with bank | 35,947 | 42,038 |
| Guaranteed investment certificates | 600,000 | 40,000 |
| | <u>635,947</u> | <u>82,038</u> |

See accompanying notes to financial statements

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

1 Nature of operations

Grizzly Diamonds Ltd. (the “Company” or “Grizzly”) was incorporated in Alberta on May 31, 2002 and commenced operations on January 1, 2004.

Grizzly is in the business of acquiring and exploring mineral properties located primarily in Canada. The Company has not yet determined whether these properties contain precious mineral reserves that are economically recoverable and the Company is not presently carrying on active exploration efforts on certain of its mineral properties. To date, the Company has not earned significant revenues and is considered to be in the development stage. The recoverability of the amounts shown for mineral properties is dependent upon the existence of economically recoverable reserves, securing and maintaining title and beneficial interest in the properties, the ability of the Company to obtain necessary financing to complete the development, and ultimately upon future profitable production or proceeds from disposition of the mineral properties. These financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets should the Company be unable to continue as a going concern.

2 Change in accounting policies

Effective August 1, 2004, the Company retroactively adopted the new Canadian Institute of Chartered Accountants’ Handbook Section 3110 “Asset Retirement Obligations.” This standard requires liability recognition for retirement obligations associated with long-lived assets, which includes abandonment of mineral properties and returning property to its original condition. The standard requires the Company to recognize the fair value of the liability for an asset retirement obligation in the period in which it is incurred and record a corresponding increase in the carrying value of the related long-lived asset. Fair value is estimated using the present value of the estimated future cash outflows to abandon the asset at the company’s credit adjusted risk free rate. The liability is subsequently adjusted for the passage of time, and is recognized as an accretion expense in the statement of loss. The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. The increase in the carrying value of the asset is amortized on the same basis as mineral properties and deferred exploration costs. This change in accounting policy has no effect on the Company’s prior or current financial statements.

Effective August 1, 2004, the Company retroactively adopted the new Canadian Institute of Chartered Accountants’ Handbook section 3063 “Impairment of Long-lived Assets”. This standard requires that in the event that facts and circumstances indicate that the carrying value of long-lived assets may be impaired, the company performs a recoverability evaluation. If the evaluation indicates that the carrying value of the asset is not recoverable from undiscounted cash flows attributable to the asset, then an impairment loss is measured by comparing the carrying amount of the asset to its fair value. This accounting policy has no effect on the Company’s prior or current financial statements.

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Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

3 Accounting policies

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The significant areas requiring the use of management estimates relates to the assessment of impairment of the value of mineral properties. Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents are defined as amounts on deposit with banks and readily convertible guaranteed investment certificates.

Mineral properties

Mineral property acquisition costs and exploration costs directly related to specific properties are deferred until the properties are brought into production, sold or abandoned. All other costs, including administrative overhead are expensed as incurred. If the properties are put into commercial production, these expenditures will be depleted based upon the proven reserves available. If the properties are sold or abandoned, these expenditures will be written off.

Mineral properties are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Where there is evidence of impairment, the net carrying amount of the asset will be written down to its net recoverable amount which is the estimated undiscounted future net cash flows expected to result from the asset and its eventual disposition. The loss on impairment written off is not reversed even if circumstances change and the net recoverable amount subsequently increases.

The amounts shown as mineral properties represent unamortized costs to date and do not necessarily reflect present or future values.

Income taxes

Income taxes are accounted for by the asset and liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

3 Accounting policies (continued)

Flow-through shares

The proceeds of flow-through shares issued pursuant to certain provisions of the Income Tax Act (Canada) ("Act") are included in share capital. The Act provides that, where the share issuance proceeds are used for exploration and development expenditures, the related income tax deductions may be renounced to subscribers. Accordingly these expenditures provide no income tax deduction to the Company. Share capital is reduced and a future tax liability is recorded equal to the amount of future income taxes payable by the Company when the expenditures are renounced to the holders of these shares.

Stock-based compensation

Share-based compensation of employees, directors, officers and consultants is recorded in accordance with the fair value based method.

Net loss per share

Net loss per share is calculated based on the weighted average number of shares outstanding during the year. Diluted net loss per share reflects the assumed conversion of all dilutive securities using the treasury stock method.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

4 Mineral properties

| 2005 | | | | | | |
|-------------------------|--------------------|---------------|-------------------|-------------------|----------------------|---------------|
| | Ownership interest | July 31, 2004 | Acquisition costs | Exploration costs | Property write-downs | July 31, 2005 |
| | % | \$ | \$ | \$ | \$ | \$ |
| Alberta | | | | | | |
| White Bear | 90 | 113,141 | 2,500 | 46,025 | - | 161,666 |
| Smoky the Bear | 90 | 5,500 | - | 99,530 | - | 105,030 |
| Grand Cub Aidan | 90 | 7,500 | 500 | 1,365 | - | 9,365 |
| Legend | 51-60 | - | - | 26,088 | - | 26,088 |
| New Buffalo Head Hills | 90 | - | 51,833 | - | - | 51,833 |
| Call of the Wild | 100 | - | 10,000 | 400 | - | 10,400 |
| Other | - | - | - | 56,243 | (56,243) | - |
| British Columbia | | | | | | |
| Goat Mine | 100 | - | 45,880 | 10,913 | - | 56,793 |
| Peak | 100 | - | 52,849 | 34,366 | - | 87,215 |
| French | 100 | - | 35,000 | 5,034 | - | 40,034 |
| Silver Bear | 100 | - | 21,500 | 3,341 | - | 24,841 |
| | | 126,141 | 220,062 | 283,305 | (56,243) | 573,265 |

| 2004 | | | | | | |
|-----------------|--------------------|-----------------|-------------------|-------------------|----------------------|---------------|
| | Ownership interest | January 1, 2004 | Acquisition costs | Exploration costs | Property write-downs | July 31, 2004 |
| | % | \$ | \$ | \$ | \$ | \$ |
| Alberta | | | | | | |
| White Bear | 90 | - | 7,000 | 106,141 | - | 113,141 |
| Smoky the Bear | 90 | - | 5,500 | - | - | 5,500 |
| Grand Cub Aidan | 90 | - | 7,500 | - | - | 7,500 |
| | | - | 20,000 | 106,141 | - | 126,141 |

a) White Bear, Smoky the Bear and Grand Cub Aidan Properties

Pursuant to a Rollover agreement dated January 8, 2004 between the Company and Grizzly Gold Inc. (a company controlled by a director and shareholder), the Company acquired an undivided 90% interest in 40 Metallic and Industrial Mineral Permits that constitute three separate mineral properties - White Bear, Smoky the Bear, and Grand Cub Aidan. The properties total 337,921 hectares and are situated in the Buffalo Head Hills in northern Alberta. The Company paid \$20,000, representing Grizzly Gold Inc.'s out of pocket staking

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

4 Mineral properties (continued)

and acquisition costs, and issued 2,710,000 common shares. This transaction has been recorded at the carrying amount of \$20,000.

Pursuant to the rollover agreement, the Company agreed to carry Grizzly Gold Inc.'s remaining 10% interest to commercial production.

Pursuant to an Option agreement dated January 8, 2004, the Company has the option, for a period of 60 days following the completion of a positive feasibility study, to acquire up to an additional 5% interest in the properties upon payment of \$1,000,000 for each additional 1% interest in the properties.

b) Legend Properties

On February 23, 2005, the Company signed an option agreement to acquire an undivided 60% mineral interest in the Legend Property and an undivided 51% mineral interest in the Little Legend Property, both located in the Birch Mountains of northeast Alberta. In order to acquire these interests, the Company must complete exploration expenditures of \$100,000 on the property by August 23, 2006.

c) New Buffalo Head Hills Property

On April 21, 2005 the Company signed a purchase agreement with Grizzly Gold Inc. (a company controlled by a director and shareholder) to acquire an undivided 90% interest in a number of mineral claims situated in the Buffalo Head Hills area of northern Alberta. In order to acquire the interest in the New Buffalo Head Hills Property, the Company reimbursed Grizzly Gold Inc. for the staking costs of the property in the amount of \$51,833. This transaction has been recorded at the exchange amount of \$51,833. In addition, the Company will have the right, for a period of sixty (60) days following completion of a positive feasibility study, to acquire up to an additional 5% interest in the New Buffalo Head Hills Property upon payment of \$1,000,000 for each additional 1% interest in the property.

d) Call of the Wild Property

On April 21, 2005 the Company signed a purchase agreement with Grizzly Gold Inc. (a company controlled by a director and shareholder) to acquire a 100% interest in a number of mineral claims located in the Calling Lake area of north-central Alberta. In order to acquire the interest in the Call of the Wild Property, the Company reimbursed Grizzly Gold Inc. for the staking costs of the property in the amount of \$10,000. This transaction has been recorded at the exchange amount of \$10,000.

e) Goat Mine Property

On January 10, 2005, the Company signed an option agreement with a prospector to acquire a 100% mineral interest in the Goat Mine Property located northwest of the town of Stewart, British Columbia. In order to acquire the interest in the property, the Company has made cash payments of \$10,000 and issued 100,000 common shares for a deemed value of \$30,500. In addition, the Company must complete the following:

- cash payment of \$5,000, \$25,000 in exploration expenditures, and issue 50,000 common shares by January 10, 2006.

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Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

4 Mineral properties (continued)

- cash payment of \$25,000, \$100,000 in exploration expenditures, and issue 100,000 common shares by January 10, 2007.
- \$250,000 in exploration expenditures by January 10, 2008.

The prospector will retain a one and a half percent (1.5%) industry standard net smelter royalty (NSR) on the property. The Company may purchase a one percent (1%) NSR from the prospector for the sum of \$500,000.

f) Peak Property

On February 3, 2005, the Company signed an option agreement to acquire a 100% mineral interest in the Peak Property located northeast of the town of Smithers, British Columbia. In order to acquire the interest in the property, the Company has made payments totalling \$20,000 to Valley Gold Inc. ("Valley") and an individual and issued 100,000 common shares for a deemed value of \$30,000 to Matador Exploration Inc. In addition, the Company must complete sufficient exploration expenditures on the property to satisfy assessment requirements for the next three years, and pay rental fees on the property for the next three years. Valley and an individual will retain a combined three percent (3%) industry standard net smelter royalty (NSR) on the property. The Company has a first right of refusal to purchase the NSR.

g) French Property

On February 3, 2005, the Company signed an option agreement to acquire a 100% mineral interest in the French Property located northeast of the town of Smithers, British Columbia. In order to acquire the interest in the property, the Company has made payments totalling \$20,000 to Valley Gold Inc. ("Valley") and an individual and issued 50,000 common shares for a deemed value of \$15,000 to Matador Exploration Inc. In addition, the Company must complete sufficient exploration expenditures on the property to satisfy assessment requirements for the next three years, and pay rental fees on the property for the next three years. Valley and an individual will retain a combined two percent (2%) industry standard net smelter royalty (NSR) on the property. The Company has a first right of refusal to purchase the NSR.

h) Silver Bear Property

On February 3, 2005, the Company signed an option agreement to acquire a 100% mineral interest in the Silver Bear Property located east of Slocan Lake, British Columbia. In order to acquire the interest in the property, the Company has made payments totalling \$6,500 and issued 50,000 common shares for a deemed value of \$15,000 to two individuals. The Company will have to issue an additional 50,000 common shares by each of February 3, 2006, 2007 and 2008 for a total of 150,000 common shares. In addition, the Company must complete sufficient exploration expenditures on the property to satisfy assessment requirements for the next three years, and pay rental fees on the property for the next three years. The two individuals will retain a combined three percent (3%) industry standard net smelter royalty (NSR) on the property. The Company has the right to purchase up to two percent (2%) of the NSR for \$500,000 for each one percent (1%).

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

4 Mineral properties (continued)

i) Other

During the year ended July 31, 2005 the company pursued exploration on a property which was subsequently not acquired. As a result management has written down all costs related to the property as at July 31, 2005.

5 Income taxes

The income tax provision differs from the amount computed by applying the statutory rates to pre-tax income as a result of the following:

| | 2005 \$ | 2004 \$ |
|--|------------|------------|
| Income tax recovery expected based on a combined federal and provincial tax rate of 39.03% (2004 – 39.04%) | 93,250 | 3,983 |
| Increase (decrease) in recovery resulting from | | |
| Expenses not deductible for income tax purposes | (45,245) | - |
| Share issuance costs deductible for income tax purposes | 21,739 | 1,612 |
| Non-capital losses not utilized | (69,744) | (5,595) |
| Changes in income tax rates | (630) | - |
| Deductible temporary differences | 141,843 | - |
| | <hr/> | <hr/> |
| Income tax benefit | 141,213 | - |

The future income tax assets and liabilities are comprised of the following tax effected temporary differences:

| | 2005 \$ | 2004 \$ |
|--|------------|------------|
| Mineral properties | 19,612 | - |
| Non-capital losses carried forward | 67,448 | 5,186 |
| Share issuance costs | 76,004 | 12,568 |
| Valuation allowance | (21,851) | (17,754) |
| | <hr/> | <hr/> |
| Recognized future income tax assets | 141,213 | - |
| Recognized future income tax liability on renounced expenditures | (141,213) | - |
| | <hr/> | <hr/> |
| Net recognized future income tax asset | - | - |

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

6 Share capital

Shares

Authorized:

Unlimited number of common shares

Unlimited number of preferred shares

Issued:

| | 2005 | | 2004 | |
|--|-----------------------|--------------|-----------------------|--------------|
| | Common shares # | Amount \$ | Common shares # | Amount \$ |
| Balance – beginning of period | 5,710,001 | 268,500 | - | - |
| Shares issued for cash | 4,000,000 | 1,200,000 | 3,000,001 | 268,500 |
| Shares issued for other consideration | 300,000 | 90,500 | 2,710,000 | - |
| Share issuance costs | - | (313,347) | - | - |
| Future income taxes | - | (141,213) | - | - |
| Balance – end of period | 10,010,001 | 1,104,440 | 5,710,001 | 268,500 |

On December 24, 2004, the Company closed its initial public offering and issued 1,349,900 flow-through common shares and 2,650,100 units (“Units”) at a price of \$0.30 per Unit or flow-through common share for gross proceeds of \$1,200,000. Each Unit consisted of one common share and one-half of a non-transferable share purchase warrant. Each whole warrant is exercisable at \$0.50 for a period of two years after closing. The Company will be required to incur \$404,970 (\$283,305 has been incurred as of July 31, 2005) of qualifying expenditures to renounce to the holders of the 1,349,900 flow-through shares. In connection with the offering, the agent received a cash commission of \$96,000 and 360,000 options at an exercise price of \$0.30 per common share, which expire in December 2006. Related to this, the Company has recorded \$35,000 in stock-based compensation as a share issuance cost.

During the year ended July 31, 2005, the Company issued 300,000 common shares at a deemed value of \$90,500 as consideration for property acquisitions (see Note 4(e)(f)(g)(h)).

During the seven months ended July 31, 2004, the Company issued 3,000,001 common shares for aggregate cash proceeds of \$268,500.

During the seven months ended July 31, 2004, the Company issued 2,710,000 shares as consideration for the acquisition of mineral properties (see Note 4(a)).

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

6 Share capital (continued)

Stock options

The Company has a stock option plan under which directors, officers, employees or consultants of the Company and its affiliates are eligible to receive stock options. The maximum number of shares issuable pursuant to the exercise of outstanding options granted under the plan shall be 10% of the issued shares of the Company at the time of granting the options. The maximum number of common shares optioned to any one optionee in a 12 month period shall not exceed 5% of the outstanding common shares of the company (2% in the case of a consultant or investor relations person). Options granted under the plan may not exceed 5 years and vest at terms to be determined by the board of directors at the time of grant, but shall not be less than the price permitted by the policy or policies of the stock exchange(s) on which the Company's common shares are then listed, or \$0.10 per share.

The following table summarizes activity related to stock options:

| | 2005 | | 2004 | |
|-------------------------------|--|---|--|---|
| | Number of options outstanding # | Weighted average exercise price \$ | Number of options outstanding # | Weighted average exercise price \$ |
| Balance – beginning of period | - | - | - | - |
| Granted | 1,085,000 | 0.33 | - | - |
| Balance – end of period | 1,085,000 | 0.33 | - | - |

The following table summarizes information about the Company's stock options outstanding:

| | 2005 | | | 2004 | | |
|--|--|--|--|--|--|--|
| Number of options outstanding # | Weighted average exercise price \$ | Weighted average remaining contractual life Years | Number of options outstanding # | Weighted average exercise price \$ | Weighted average remaining contractual life Years | |
| 1,085,000 | 0.33 | 3.4 | - | - | - | |

All of the Company's outstanding stock options as at July 31, 2005 were exercisable.

The company accounts for options granted under this plan and the share option agreement with the agent in accordance with the fair value based method of accounting for stock-based compensation. The application of the fair value based method requires the use of certain assumptions regarding the risk-free market interest rate, expected volatility of the underlying stock and the life of the options.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

6 Share capital (continued)

The Company recorded stock-based compensation expense and contributed surplus in the amount of \$59,000 in the statement of loss and deficit for options granted to directors, officers and consultants in the year ended July 31, 2005. The stock-based compensation expense has been determined based on the fair value of 725,000 options at the grant date (\$0.081 per option). The fair value of each option granted is estimated on the date of grant, using the Black-Scholes option-pricing model with the following assumptions:

| | |
|--------------------------|--------|
| Risk-free interest rate | 2.5% |
| Expected volatility | 81.0% |
| Annual dividend yield | 0.0% |
| Expected life of options | 1 year |

The market price of the Company's shares at grant date is less than option exercise price. The weighted average exercise price is \$0.35 and the weighted average fair value of the options on the grant date was \$0.081 per option.

The Company has recognized stock-based compensation expense in the amount of \$35,000 which has been recorded as a share issuance cost and contributed surplus relating to 360,000 options issued to the agent on the Company's initial public offering on December 24, 2004. The fair value of \$0.097 per option granted was estimated on the date of grant, using the Black-Scholes option-pricing model with the following assumptions:

| | |
|--------------------------|--------|
| Risk-free interest rate | 2.5% |
| Expected volatility | 81.0% |
| Annual dividend yield | 0.0% |
| Expected life of options | 1 year |

The market price of the Company's shares at grant date equalled the option exercise price. The weighted average exercise price is \$0.30 and the weighted average fair value of the options on the grant date was \$0.097 per option.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

6 Share capital (continued)

Warrants

The following table summarizes activity related to warrants:

| | 2005 | | 2004 | |
|-------------------------------|----------------------|------------------------------------|----------------------|------------------------------------|
| | Number of warrants # | Weighted average exercise price \$ | Number of warrants # | Weighted average exercise price \$ |
| Balance – beginning of period | - | - | - | - |
| Issued | 1,325,050 | 0.50 | - | - |
| Balance – end of period | 1,325,050 | 0.50 | - | - |

The following table summarizes information about the Company's warrants outstanding:

| | 2005 | | | 2004 | | |
|----------------------------------|------------------------------------|---|----------------------------------|------------------------------------|---|--|
| Number of warrants outstanding # | Weighted average exercise price \$ | Weighted average remaining contractual life Years | Number of warrants outstanding # | Weighted average exercise price \$ | Weighted average remaining contractual life Years | |
| 1,325,050 | 0.50 | 1.4 | - | - | - | |

7 Related party transactions

During the year ended July 31, 2005, consulting fees of \$31,200 (2004 - \$10,000) were paid to an officer of the company, consulting fees of \$500 (2004 – nil) were paid to Grizzly Gold Inc., a company controlled by a director and shareholder, and \$4,321 (2004 – nil) geological consulting fees capitalized to mineral properties were paid to a company controlled by a director. These transactions were in the normal course of operations and are measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

Related party transactions related to property acquisitions are disclosed in Note 4(a)(c)(d) of these financial statements.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the year ended July 31, 2005 and seven months ended July 31, 2004

8 Financial instruments

The Company's financial instruments consist of cash and cash equivalents, accrued interest receivable, and accounts payable and accrued liabilities. The carrying value of these assets and liabilities approximate their fair values due to the short term maturity of these instruments.

It is management's opinion that the Company is not exposed to significant interest, currency or credit risk arising from these financial instruments.

9 Subsequent events

On September 12, 2005, the Company granted 150,000 stock options at an exercise price of \$0.70 per share to a consultant. The options will expire in September 2010 and will result in additional stock-based compensation expense and contributed surplus of \$47,295 in 2005.

Subsequent to July 31, 2005, the Company issued 279,100 common shares from the exercise of warrants for gross proceeds of \$139,550 and 281,020 common shares from the exercise of the agent's options for gross proceeds of \$84,306.