

# **Grizzly Diamonds Ltd.**

Financial Statements

**For the years ended July 31, 2006 and 2005**



STOUT & COMPANY LLP

CHARTERED ACCOUNTANTS EDMONTON, CANADA

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AUDITORS' REPORT

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

We have audited the balance sheets of **Grizzly Diamonds Ltd.** as at July 31, 2006 and 2005 and the statements of net loss and deficit and cash flows for the years then ended. 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, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Edmonton, Canada  
October 11, 2006

Chartered Accountants

# Grizzly Diamonds Ltd.

## Balance Sheets

As at July 31, 2006 and 2005

	2006	2005
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	1,685,381	635,947
Accounts receivable	149,169	47,470
	<b>1,834,550</b>	683,417
Mineral properties (Note 4)	2,243,912	573,265
	<b>4,078,462</b>	1,256,682
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	123,513	166,149
Future income taxes (Note 6)	41,814	-
	<b>165,327</b>	166,149
<b>Shareholders' equity</b>		
Share capital (Note 7)	4,081,362	1,104,440
Contributed surplus (Note 8)	363,136	94,000
Deficit	(531,363)	(107,907)
	<b>3,913,135</b>	1,090,533
	<b>4,078,462</b>	1,256,682

Approved by the Board of Directors

Signed "Brian Testo" \_\_\_\_\_ Director

Signed "Pam Strand" \_\_\_\_\_ Director

See accompanying notes to financial statements

**Grizzly Diamonds Ltd.**  
**Statements of Net Loss and Deficit**  
**For the years ended July 31, 2006 and 2005**

	2006 \$	2005 \$
<b>Revenue</b>		
Interest	37,921	8,068
<b>Expenses</b>		
Advertising and promotion	29,412	11,181
Office	25,260	7,561
Conferences and corporate travel	33,600	12,904
Corporate filing and transfer fees	20,131	24,772
Professional fees	40,444	43,625
Consulting fees	125,805	31,700
	<u>274,652</u>	<u>131,743</u>
	<u>(236,731)</u>	<u>(123,675)</u>
<b>Other expenses</b>		
Stock-based compensation (Note 7(b))	(310,545)	(59,000)
Write-down of mineral properties (Note 4(k))	-	(56,243)
	<u>(310,545)</u>	<u>(115,243)</u>
Loss before income taxes	(547,276)	(238,918)
Future income tax benefit (Note 6)	123,820	141,213
<b>Net loss for the year</b>	(423,456)	(97,705)
<b>Deficit - beginning of year</b>	(107,907)	(10,202)
<b>Deficit - end of year</b>	<u>(531,363)</u>	<u>(107,907)</u>
<b>Basic and diluted net loss per common share</b>	<u>(0.03)</u>	<u>(0.01)</u>
<b>Weighted average number of common shares outstanding</b>	<u>12,538,255</u>	<u>8,242,193</u>

See accompanying notes to financial statements

**Grizzly Diamonds Ltd.**  
**Statements of Cash Flows**  
**For the years ended July 31, 2006 and 2005**

	2006 \$	2005 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net loss for the year	(423,456)	(97,705)
Items not affecting cash and cash equivalents		
Stock-based compensation	310,545	59,000
Write down of mineral properties	-	56,243
Future income tax benefit	(123,820)	(141,213)
	(236,731)	(123,675)
Net change in non-cash working capital items	(144,335)	128,298
	(381,066)	4,623
<b>Investing activities</b>		
Mineral properties		
Acquisition costs	(95,027)	(129,562)
Exploration costs	(1,377,770)	(283,305)
	(1,472,797)	(412,867)
<b>Financing activities</b>		
Issuance of shares	2,992,311	1,200,000
Share issuance costs	(89,014)	(237,847)
	2,903,297	962,153
<b>Increase in cash and cash equivalents</b>	<b>1,049,434</b>	<b>553,909</b>
<b>Cash and cash equivalents - beginning of year</b>	<b>635,947</b>	<b>82,038</b>
<b>Cash and cash equivalents - end of year</b>	<b>1,685,381</b>	<b>635,947</b>
<b>Cash and cash equivalents consist of:</b>		
Cash on deposit with bank	1,085,381	35,947
Guaranteed investment certificates	600,000	600,000
	1,685,381	635,947

See accompanying notes to financial statements

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2006 and 2005**

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#### **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 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. 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 value of mineral properties and the assumptions used in determining stock based compensation. 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, the acquisition and exploration expenditures will be depleted using the units of production basis 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 fair value.

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2006 and 2005**

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## **2. Accounting Policies, cont.**

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**

Future income taxes relate to the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax values. Future tax assets are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment.

### **Mineral exploration tax credits**

Federal, provincial and territorial taxation authorities provide companies with tax incentives for undertaking mineral exploration directives in certain areas. Mineral exploration tax credits on eligible mineral exploration expenditures incurred in the Province of British Columbia are treated as a reduction of the deferred exploration costs of the respective mineral properties.

### **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. Where at the time of renouncement the Company has unrecorded net tax assets exceeding the income tax effect of the deduction renounced, a corresponding future tax asset will be recognized.

### **Stock-based compensation**

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

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2006 and 2005**

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## **2. Accounting Policies, cont.**

### **Net loss per share**

Net loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the year. Diluted net loss per share reflects the assumed conversion of all dilutive securities using the treasury stock method. When the Company is in a net loss position, options and warrants are anti-dilutive.

### **Asset retirement obligation**

The Company recognizes liabilities for retirement obligations associated with long-lived assets, which includes abandonment of mineral properties and returning property to its original condition. The Company recognizes the fair value of the liability for an asset retirement obligation in the period in which it is incurred and records a corresponding increase in the carrying value of the related long-lived asset. The fair value of the liability is estimated using the present value of the estimated future cash outflows to abandon the asset at the Company's credit adjusted risk free interest rate. The liability is subsequently adjusted for the passage of time, and is recognized as an accretion expense in the statement of loss and deficit. 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 policy was adopted effective August 1, 2004, and to date has no effect on the Company's prior or current year financial statements.

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

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 policy was adopted effective August 1, 2004, and to date has no effect on the Company's prior or current year financial statements.

# Grizzly Diamonds Ltd.

## Notes to Financial Statements

For the years ended July 31, 2006 and 2005

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### 3. Cash and cash equivalents

Cash and cash equivalents includes \$600,000 in Guaranteed Investment Certificates (“GIC’s”) which bear interest at 2.40% maturing on October 7, 2006. The repayment of monies on deposit, GIC’s and interest payable on those monies is guaranteed by the Crown in right of Alberta.

### 4. Mineral Properties

	Ownership interest	2006			July 31, 2006 balance
		July 31, 2005 balance	Acquisition costs	Exploration costs	
	%	\$	\$	\$	\$
<b>Alberta</b>					
White Bear (a)	90-100	161,666	6,875	11,910	180,451
Smoky the Bear (a)	90	105,030	9,350	147,169	261,549
Grand Cub Aidan (a)	90-100	9,365	6,383	239,900	255,648
Legend (b)	*	26,088	101,837	318,047	445,972
New Buffalo Head Hills (c)	90	51,833	(51,833)	-	-
Call of the Wild (d)	100	10,400	30,968	14,852	56,220
Preston upon the Wolverine (e)	90	-	26,850	451,544	478,394
Kodiak (f)	90-100	-	14,650	1,567	16,217
Bear Paw (f)	90-100	-	4,350	895	5,245
Grand Cub Parker (f)	90-100	-	15,250	2,238	17,488
<b>British Columbia</b>					
Goat Mine (g)	100	56,793	53,885	11,366	122,044
Peak (h)	100	87,215	5,910	146,847	239,972
French (i)	100	40,034	411	14,913	55,358
Silver Bear (j)	100	24,841	67,991	16,522	109,354
		573,265	292,877	1,377,770	2,243,912

\* See Legend property note below

**Grizzly Diamonds Ltd.**  
**Notes to Financial Statements**  
**For the years ended July 31, 2006 and 2005**

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

\* See Legend property note below

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

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 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.

During the year ended July 31, 2006, the Company staked additional townships in the White Bear property (100% interest). Additionally, townships from the New Buffalo Head Hills property (90% interest) were reallocated to the White Bear and Grand Cub Aidan properties (Note 4(c)).

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2006 and 2005**

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#### **4. Mineral Properties, cont.**

##### **b) Legend**

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. To acquire these interests, the Company was required to incur \$100,000 of exploration expenditures on the property by August 23, 2006 (all of which has been incurred as of July 31, 2006).

On February 27, 2006, the Company signed an agreement with Blue Diamond Mining Corporation (“Blue”) and certain individuals from whom Blue acquired its mineral interests, resulting in the Company acquiring a 100% interest in the Legend property and an 85% interest in the Little Legend property (collectively “Legend Property”).

To acquire these properties, the Company paid Blue \$12,500 and issued 50,000 common shares of the Company, and issued to certain individuals related to Blue 35,000 common shares and will issue an additional 15,000 common shares if kimberlite or related rock is discovered on the Legend Property. The 85,000 common shares issued in the period were recorded at a weighted average value of \$1.01 per share, for total consideration of \$85,850. Blue will retain a 2% Gross Overriding Royalty on all diamonds produced on the properties. The Company is carrying the remaining 15% interest in the Little Legend Property, held by Grizzly Gold Inc., a company controlled by a director and officer of the Company.

##### **c) New Buffalo Head Hills**

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. 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.

During the year ended July 31, 2006, the townships that comprised the New Buffalo Head Hills property block were re-allocated into new and existing properties. As a result, the original acquisition costs were re-allocated into new properties as follows: \$23,100 for Preston Upon the Wolverine, \$11,500 for Grand Cub Parker, \$8,400 for Kodiak, and \$3,100 for Bear Paw. The remainder of the acquisition costs were re-allocated into existing properties as follows: \$3,100 for White Bear and \$2,633 for Grand Cub Aidan.

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2006 and 2005**

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#### **4. Mineral Properties, cont.**

##### **d) Call of the Wild**

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. This transaction has been recorded at the exchange amount of \$10,000.

On July 24, 2006, the Company announced that it has entered into an option agreement with Stornoway Diamond Corporation ("Stornoway") whereby Stornoway has the right to earn up to a 70% interest in the Company's 820,000 acre Call of the Wild property.

Under the terms of the agreement, Stornoway may earn an initial 51% interest in the property by flying the entire property with an airborne fixed wing magnetic survey and collecting twenty five (25) diamond indicator samples within one year. Stornoway can earn an additional 9% by incurring \$5 Million in exploration expenditures within five years. Finally, Stornoway can earn an additional 10% (totalling 70%) by providing the Company with a bankable feasibility study.

##### **e) Preston Upon the Wolverine**

The Preston Upon the Wolverine Property was originally part of the property block called the New Buffalo Head Hills. During the year ended July 31, 2006 the Company separated the townships that comprise the Preston Upon the Wolverine area into a new property. As a result, \$23,100 in acquisition costs were reclassified from the New Buffalo Head Hills Property to the Preston Upon the Wolverine Property.

##### **f) Kodiak, Bear Paw, and Grand Cub Parker**

During the year ended July 31, 2006, the company staked mineral claims in ten townships constituting the Kodiak property; two townships constituting the Bear Paw property; and six townships constituting the Grand Cub Parker property. These properties are composed of townships originally belonging to the Company's New Buffalo Head Hills property, which claims were allowed to lapse and then were re-staked, along with additional adjacent townships.

##### **g) Goat Mine**

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 had initially made a cash payment of \$10,000 and issued 100,000 common shares for a deemed value of \$30,500.

During the year ended July 31, 2006, as per the agreement, the Company made an additional cash payment of \$5,000 and issued an additional 50,000 common shares with a deemed value of \$47,500.

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2006 and 2005**

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#### **4. Mineral Properties, cont.**

To satisfy the terms of the agreement, the Company will have to make a final cash payment of \$25,000, and issue an additional 100,000 common shares by January 10, 2007. At that date, exploration expenditures on the property must meet or exceed \$100,000, and by January 10, 2008, must meet or exceed \$250,000. 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.

##### **h) 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 three years ending February 3, 2008, and pay rental fees on the property for the same period. 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.

##### **i) 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 \$30,000 to Matador Exploration Inc. In addition, the Company must complete sufficient exploration expenditures on the property to satisfy assessment requirements for three years ending February 3, 2008, and pay rental fees on the property for the same period. 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.

##### **j) Silver Bear**

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.

During the year ended July 31, 2006, as per the agreement, the Company has issued an additional 50,000 common shares for a deemed value of \$64,500, resulting in total payments made to date totalling \$6,500 and 100,000 common shares with a deemed value of \$79,500 issued to two individuals.

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

**For the years ended July 31, 2006 and 2005**

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### **4. Mineral Properties, cont.**

The Company will have to issue an additional 50,000 common shares by each of February 3, 2007 and 2008 for a total of an additional 100,000 common shares. Furthermore, the Company must complete sufficient exploration expenditures on the property to satisfy assessment requirements for the next two years, and pay rental fees on the property for the next two 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%).

#### **k) 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. Commitments**

The Company has pledged \$25,000 (2005 – nil) to its bank as security for corporate credit card liabilities. The Company has provided two letters of guarantee \$28,200 in aggregate on reclamation work in order to facilitate exploration in certain mineral property areas.

**Grizzly Diamonds Ltd.**  
**Notes to Financial Statements**  
**For the years ended July 31, 2006 and 2005**

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**6. 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:

	<u>2006</u>	<u>2005</u>
	\$	\$
Expected tax recovery at a rate of 33.13% (2005 – 39.03%)	181,295	93,250
Increase (decrease) resulting from:		
Stock based compensation	(102,874)	(23,028)
Write down of mineral property	-	(21,952)
Other expenses not deductible for tax purposes	(426)	(265)
Share issuance costs deducted	24,339	21,739
Changes in income tax rates	(3,045)	(630)
Change in valuation allowance	21,851	-
Deductible temporary differences	2,680	72,099
	<hr/>	<hr/>
Income tax benefit	123,820	141,213
	<hr/>	<hr/>

The future income tax liability is comprised of the following tax effected temporary differences:

	<u>2006</u>	<u>2005</u>
	\$	\$
Mineral properties	(281,157)	(121,601)
Non-capital losses carried forward	161,990	67,448
Share issuance costs	77,353	76,004
Valuation allowance	-	(21,851)
	<hr/>	<hr/>
Net recognized future income tax liability	(41,814)	-
	<hr/>	<hr/>

The Company has incurred the following non-capital losses for tax purposes, the benefit of which has been recognized, and expire as follows:

<u>Year of origin</u>	<u>Non-capital loss</u>	<u>Year of expiry</u>
	\$	
2004	14,000	2014
2005	179,000	2015
2006	309,000	2026
	<hr/>	
	502,000	
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**Grizzly Diamonds Ltd.**  
**Notes to Financial Statements**  
**For the years ended July 31, 2006 and 2005**

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**7. Share capital**

**a) Shares**

Authorized:

Unlimited number of common shares

Unlimited number of preferred shares

Issued:

	2006		2005	
	Common Shares #	Amount \$	Common Shares #	Amount \$
Balance – beginning of year	10,010,001	1,104,440	5,710,001	268,500
Shares issued for cash	3,561,875	2,992,311	4,000,000	1,200,000
Shares issued for other consideration	185,000	197,850	300,000	90,500
Reclassified from contributed surplus	-	41,409	-	-
Share issuance costs	-	(89,014)	-	(313,347)
Future income taxes	-	(165,634)	-	(141,213)
Balance – end of year	13,756,876	4,081,362	10,010,001	1,104,440

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 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 was required to incur \$404,970, (all of which has been incurred as of July 31, 2006), of qualifying expenditures to renounce to the purchasers of the 1,349,900 flow-through shares. In connection with the offering, agents 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 had recorded \$35,000 in stock based compensation as a share issuance cost in 2005.

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 (Note 4(g)(h)(i)(j)).

On October 24, 2005, the Company closed a non-brokered private placement for an aggregate of 1,588,155 units and 500,000 flow-through common shares at a price of \$1.00 per unit or flow-through share, for aggregate proceeds of \$2,088,155. Each unit consisted of one common share of the Company and one-half of a non-transferable share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at a price of \$1.50 per common share by October 24, 2006. The Company was required to incur \$500,000 of qualifying expenditures to be renounced to the holders of the 500,000 flow-through shares, all of which has been incurred as of July 31, 2006. Related to this private placement, the Company paid an aggregate of \$47,415 in finder’s fees included in share issuance costs.

# Grizzly Diamonds Ltd.

## Notes to Financial Statements

For the years ended July 31, 2006 and 2005

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### 7. Share capital, cont.

On May 10, 2006 the Company closed a non-brokered private placement for an aggregate of 500,000 flow-through common shares at a price of \$1.00 per flow-through share for aggregate proceeds of \$500,000. The Company will be required to incur \$500,000 (\$73,965 has been incurred as of July 31, 2006) of qualifying expenditures to be renounced to the holders of the 500,000 flow-through shares. Insiders of the corporation purchased an aggregate of 430,000 flow-through shares.

During the year ended July 31, 2006, the Company issued 522,700 common shares from the exercise of warrants for gross proceeds of \$261,350 and 451,020 common shares from the exercise of options for gross proceeds of \$142,806.

During the year ended July 31, 2006, the Company issued 185,000 common shares at a deemed value of \$197,850 as consideration for mineral property acquisitions (Note 4(b)(g)(j)).

Subsequent to July 31, 2006, the Company issued 58,980 common shares from the exercise of options for gross proceeds of \$17,694.

#### b) 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. Occasionally, the Company issues stock options to agent's which do not fall under the plan.

The following table summarizes activity related to stock options:

	2006		2005	
	Number of options #	Weighted average exercise price \$	Number of options #	Weighted average exercise price \$
Balance – beginning of year	1,085,000	0.33	-	-
Granted	475,000	1.06	1,085,000	0.33
Exercised	(451,020)	0.32	-	-
Balance – end of year	1,108,980	0.65	1,085,000	0.33

**Grizzly Diamonds Ltd.**  
**Notes to Financial Statements**  
**For the years ended July 31, 2006 and 2005**

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**7. Share capital, cont.**

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

			<b>2006</b>			<b>2005</b>		
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			
58,980	0.30	0.4	360,000	0.30	1.4			
575,000	0.35	3.4	725,000	0.35	4.4			
150,000	0.70	4.1	-	-	-			
325,000	1.22	4.5	-	-	-			
1,108,980	0.65	3.7	1,085,000	0.33	3.4			

All of the Company's outstanding stock options as at July 31, 2006 were exercisable.

The Company accounts for options granted under this plan and the stock 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.

The Company recorded stock-based compensation expense in the amount of \$310,545 (2005 – \$59,000) in the statement of loss and deficit for options granted in the year ended July 31, 2006 (July 31, 2005). The stock-based compensation expense has been determined based on the fair value of 475,000 (2005 – 1,085,000) options at the grant date, with a weighted average fair value of \$0.654 per option (2005 – \$0.086 per option). All of the Company's options were issued with an exercise price equal to the market price on the grant date. The fair value of each option granted is estimated on the date of grant, using the Black-Scholes option-pricing model with the following weighted average assumptions:

	<b>2006</b>	<b>2005</b>
Risk-free interest rate	3.67%	2.50%
Expected volatility	91.3%	81.0%
Annual dividend yield	0.0%	0.0%
Expected life of options	4 years	1 year

**Grizzly Diamonds Ltd.**  
**Notes to Financial Statements**  
**For the years ended July 31, 2006 and 2005**

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**7. Share capital, cont.**

**c) Warrants**

The following table summarizes activity related to warrants:

	<b>2006</b>		<b>2005</b>	
	<b>Number of warrants</b>	<b>Weighted average exercise price</b>	<b>Number of warrants</b>	<b>Weighted average exercise price</b>
	<b>#</b>	<b>\$</b>	<b>#</b>	<b>\$</b>
Balance – beginning of year	1,325,050	0.50	-	-
Issued	794,077	1.50	1,325,050	0.50
Exercised	(522,700)	0.50	-	-
Balance – end of year	1,596,427	1.00	1,325,050	0.50

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

<b>2006</b>			<b>2005</b>		
<b>Number of warrants outstanding</b>	<b>Weighted average exercise price</b>	<b>Weighted average remaining contractual life</b>	<b>Number of warrants outstanding</b>	<b>Weighted average exercise price</b>	<b>Weighted average remaining contractual life</b>
<b>#</b>	<b>\$</b>	<b>Years</b>	<b>#</b>	<b>\$</b>	<b>Years</b>
802,350	0.50	0.4	1,325,050	0.50	1.4
794,077	1.50	0.2	-	-	-
1,596,427	1.00	0.3	1,325,050	0.50	1.4

Subsequent to July 31, 2006, the expiry date of the 794,077 warrants outstanding was extended by an additional year to October 24, 2007.

# Grizzly Diamonds Ltd.

## Notes to Financial Statements

### For the years ended July 31, 2006 and 2005

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#### 8. Contributed Surplus

Contributed surplus arises from the recognition of estimated fair value of stock options and agents options as follows:

	<u>2006</u>	<u>2005</u>
	\$	\$
Balance – beginning of year	94,000	-
Stock options granted	310,545	59,000
Agent options granted	-	35,000
Exercise of options	<u>(41,409)</u>	<u>-</u>
Balance – end of year	<u>363,136</u>	<u>94,000</u>

#### 9. Related party transactions

During the year ended July 31, 2006, consulting fees of \$30,250 (2005 - \$31,200) were paid to a former officer and a company controlled by a current officer of the Company; consulting fees of \$4,750 (2005 – nil) were paid to a company controlled by a director. Of these amounts, \$750 (2005 – nil) is included in accounts payable. In the prior year, the Company paid \$500 in consulting fees to a company controlled by an officer and director; and \$4,321 in geological consulting fees capitalized to mineral interests were paid to a company controlled by a director.

These transactions were in the normal course of operations and were measured at the exchange amount which is the amount of consideration established and agreed to by the related parties.

#### 10. Financial instruments

The Company's financial instruments consist of cash and cash equivalents, accounts 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.

#### 11. Comparative amounts

Certain comparative amounts have been reclassified to conform to current year presentation.