

# **Grizzly Diamonds Ltd.**

Financial Statements

**For the years ended July 31, 2007 and 2006**



**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, 2007 and 2006 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, 2007 and 2006, 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  
September 19, 2007

Chartered Accountants

# Grizzly Diamonds Ltd.

## Balance Sheets

As at July 31, 2007 and 2006

	2007	2006
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	1,451,409	1,632,181
Restricted cash (note 5)	25,000	25,000
Prepaid expenses	20,843	-
Accounts receivable	44,556	149,169
	<u>1,541,808</u>	1,806,350
<b>Restricted cash (note 5)</b>	28,200	28,200
<b>Mineral properties (note 4)</b>	<u>3,800,668</u>	2,243,912
	<u>5,370,676</u>	4,078,462
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	152,198	123,513
<b>Future income taxes (note 6)</b>	<u>437,166</u>	41,814
	<u>589,364</u>	165,327
<b>Shareholders' equity</b>		
Share capital (note 7)	5,096,356	4,081,362
Contributed surplus (note 8)	536,353	363,136
Deficit	<u>(851,397)</u>	(531,363)
	<u>4,781,312</u>	3,913,135
	<u>5,370,676</u>	4,078,462

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, 2007 and 2006**

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	2007	2006
	\$	\$
<b>Revenue</b>		
Interest	68,538	37,921
<b>Expenses</b>		
Advertising and promotion	40,580	29,412
Office	25,302	25,260
Conferences and corporate travel	38,480	33,600
Corporate filing and transfer fees	16,533	20,131
Professional fees	60,944	40,444
Consulting fees	47,199	125,805
	229,038	274,652
	(160,500)	(236,731)
<b>Other expenses</b>		
Stock-based compensation (note 7)	(131,250)	(310,545)
Write down of mineral properties (note 4)	(122,122)	-
<b>Loss before income taxes</b>	(413,872)	(547,276)
<b>Future income tax benefit (note 6)</b>	93,838	123,820
<b>Net loss for the year</b>	(320,034)	(423,456)
<b>Deficit - beginning of year</b>	(531,363)	(107,907)
<b>Deficit - end of year</b>	(851,397)	(531,363)
<b>Basic and diluted net loss per common share</b>	(0.02)	(0.03)
<b>Weighted average number of common shares outstanding</b>	15,051,255	12,538,255

See accompanying notes to financial statements

**Grizzly Diamonds Ltd.**  
**Statements of Cash Flows**  
**For the years ended July 31, 2007 and 2006**

	2007	2006
	\$	\$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net loss for the year	(320,034)	(423,456)
Items not affecting cash and cash equivalents		
Stock-based compensation	131,250	310,545
Write down of mineral properties	122,122	-
Future income tax benefit	(93,838)	(123,820)
	<u>(160,500)</u>	<u>(236,731)</u>
Net change in non-cash working capital items	30,402	(22,620)
Restricted cash (note 5)	-	(25,000)
	<u>(130,098)</u>	<u>(284,351)</u>
<b>Investing activities</b>		
Mineral properties	(1,626,378)	(1,472,797)
Net change in non-cash working capital items	82,053	(121,715)
Restricted cash (note 5)	-	(28,200)
	<u>(1,544,325)</u>	<u>(1,622,712)</u>
<b>Financing activities</b>		
Issuance of shares	1,605,619	2,992,311
Share issuance costs	(111,968)	(89,014)
	<u>1,493,651</u>	<u>2,903,297</u>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(180,772)</b>	<b>996,234</b>
<b>Cash and cash equivalents - beginning of year</b>	<b>1,632,181</b>	<b>635,947</b>
<b>Cash and cash equivalents - end of year</b>	<b>1,451,409</b>	<b>1,632,181</b>
<b>Cash and cash equivalents consist of:</b>		
Cash on deposit with financial institutions	1,451,409	1,032,181
Guaranteed investment certificates	-	600,000
	<u>1,451,409</u>	<u>1,632,181</u>

The non-cash transactions described in notes 4 and 7 have been excluded from the statements of cash flows.

See accompanying notes to financial statements

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

**For the years ended July 31, 2007 and 2006**

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### **1. Nature of operations**

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.

#### **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. Impairment losses are 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.

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2007 and 2006**

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## **2. Accounting policies, cont.**

### **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. The amount of the net tax asset recognized is limited to the amount that is more likely than not to be realized.

### **Cash and cash equivalents**

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

### **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.

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2007 and 2006**

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## **2. Accounting policies, cont.**

### **Stock based compensation**

Stock based compensation is accounted for using the fair value method whereby compensation expense related to these programs is recorded in the statement of net loss and deficit with a corresponding increase to contributed surplus. The fair value of options granted is determined at the date of grant and expensed over the vesting period. The fair value of warrants issued to agents is recorded as share issue costs with a corresponding increase to contributed surplus.

Consideration paid on the exercise of stock options and warrants is credited to share capital. Upon the exercise of the stock options and warrants, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. The Company does not incorporate an estimated forfeiture rate for stock options and agents warrants that may not vest, but accounts for forfeitures as they occur.

### **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.

### **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.

## **3. Cash and cash equivalents**

Cash and cash equivalents consists of cash on deposit with financial institutions (2006 – cash on deposit with financial institutions and \$600,000 in Guaranteed Investment Certificates). The repayment of monies on deposit, Guaranteed Investment Certificates and interest payable on those monies is guaranteed by the Crown in right of Alberta.

**Grizzly Diamonds Ltd.**  
**Notes to Financial Statements**  
**For the years ended July 31, 2007 and 2006**

**4. Mineral properties**

	<b>Ownership interest %</b>	<b>July 31, 2006 balance \$</b>	<b>Acquisition costs \$</b>	<b>Exploration costs \$</b>	<b>Write-downs \$</b>	<b>July 31, 2007 balance \$</b>
<b>Alberta</b>						
White Bear (a)	90-100	180,451	150	5,334	-	185,935
Smoky the Bear (a)	90-100	261,549	20,767	361,930	-	644,246
Grand Cub Aidan (a)	90	255,648	206	39,965	-	295,819
Legend (b)	85-100	445,972	169	570,308	-	1,016,449
Call of the Wild (d)	49	56,220	375	7,019	-	63,614
Preston upon the Wolverine (e)	90	478,394	281	44,417	-	523,092
Bear Paw (f)	90-100	5,245	13,815	3,035	-	22,095
Kodiak (f)	90-100	16,217	131	2,283	-	18,631
Grand Cub Parker (f)	90-100	17,488	169	3,035	-	20,692
<b>British Columbia</b>						
Goat Mine (g)	-	122,044	-	78	(122,122)	-
Ant (h)	51	-	13,159	16,792	-	29,951
Peak (i)	100	239,972	100	494,741	-	734,813
French (j)	100	55,358	-	3,988	-	59,346
Silver Bear (k)	100	109,354	54,166	22,465	-	185,985
		<b>2,243,912</b>	<b>103,488</b>	<b>1,575,390</b>	<b>(122,122)</b>	<b>3,800,668</b>
	<b>Ownership interest %</b>	<b>July 31, 2005 balance \$</b>	<b>Acquisition costs \$</b>	<b>Exploration costs \$</b>	<b>Property write offs \$</b>	<b>July 31, 2006 balance \$</b>
<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	9,365	6,383	239,900	-	255,648
Legend (b)	85-100	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
Bear Paw (f)	90-100	-	4,350	895	-	5,245
Kodiak (f)	90-100	-	14,650	1,567	-	16,217
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 (i)	100	87,215	5,910	146,847	-	239,972
French (j)	100	40,034	411	14,913	-	55,358
Silver Bear (k)	100	24,841	67,991	16,522	-	109,354
		<b>573,265</b>	<b>292,877</b>	<b>1,377,770</b>	<b>-</b>	<b>2,243,912</b>

# Grizzly Diamonds Ltd.

## Notes to Financial Statements

For the years ended July 31, 2007 and 2006

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### 4. Mineral Properties, cont.

#### 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.

During the year ended July 31, 2007, Grizzly was successful in acquiring by bid process additional townships adjacent to the existing Smoky the Bear and Bear Paw properties in the Province of Alberta (100% interest). The townships were previously held by the Buffalo Head Hills joint venture comprised of Ashton Mining of Canada Inc., Encana Corp. and Pure Gold Minerals Ltd.

#### b) Legend

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 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.

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2007 and 2006**

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

##### **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.

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

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 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.

During the year ended July 31, 2007, Stornoway completed its initial earn-in to a 51% interest in the property.

##### **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.

# Grizzly Diamonds Ltd.

## Notes to Financial Statements

For the years ended July 31, 2007 and 2006

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### 4. Mineral Properties, cont.

#### 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.

During the year ended July 31, 2007, Grizzly was successful in acquiring by bid process additional townships adjacent to the existing Smoky the Bear and Bear Paw properties in the Province of Alberta. The townships were previously held by the Buffalo Head Hills joint venture comprised of Ashton Mining of Canada Inc., Encana Corp. and Pure Gold Minerals Ltd.

#### g) Goat Mine

During the year ended July 31, 2006, pursuant to an option agreement dated January 10, 2005, the Company made a cash payment of \$5,000 and issued 50,000 common shares with a deemed value of \$47,500.

During the year ended July 31, 2007, management determined that the Goat Mine property lacked merit relative to other opportunities. The Company has forfeited its option to acquire a 100% interest in the property, and consequently, ownership of the related mineral claims has reverted to the vendor of the property. As a result, the Company has recorded a write-off in the statement of loss and deficit representing the carrying value of the property.

#### h) Ant

During the year ended July 31, 2007, Grizzly entered into an option agreement to acquire an undivided 51% interest in a number of mineral claims situated in the Similkameen Mining District of British Columbia. To earn this interest, Grizzly has made a cash payment of \$10,000 to the optionor, and, in addition, must meet the following commitments:

- Incur a minimum of \$50,000 in exploration expenditures on the property by March 1, 2008.
- A cash payment of \$10,000 to the optionor by March 1, 2008.
- Incur a cumulative minimum of \$100,000 in exploration expenditures on the property by March 1, 2009.

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

### **For the years ended July 31, 2007 and 2006**

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

##### **i) 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.

##### **j) 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.

##### **k) Silver Bear**

During the year ended July 31, 2006, pursuant to an option agreement signed February 3, 2005, the Company had issued 50,000 common shares for a deemed value of \$64,500.

On February 3, 2007, as part of an option agreement signed February 3, 2005 to acquire a 100% interest in the property, the Company has issued 50,000 common shares to two individuals at a deemed value of \$52,500. To satisfy the terms of the agreement, Grizzly must issue a final payment of 50,000 common shares by February 3, 2008 and incur sufficient exploration expenditures on the property to satisfy assessment requirements until February 3, 2008. 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%).

#### **5. Commitments**

The Company has restricted cash in the amount of \$25,000 (2006 – \$25,000) as security for corporate credit card liabilities. The Company also has restricted cash in the amount of \$28,200 (2006 - \$28,200) relating to two letters of guarantee for 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, 2007 and 2006**

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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>2007</u>	<u>2006</u>
	\$	\$
Expected tax recovery at a rate of 33.10% (2006 – 33.13%)	136,992	181,295
Increase (decrease) resulting from:		
Stock based compensation	(43,444)	(102,874)
Changes in income tax rates	(3,486)	(3,045)
Share issuance costs deducted	-	24,339
Change in valuation allowance	-	21,851
Other differences	3,776	2,254
	<hr/>	<hr/>
Income tax benefit	93,838	123,820
	<hr/>	<hr/>

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

	<u>2007</u>	<u>2006</u>
	\$	\$
Mineral properties	749,148	281,157
Non-capital losses carried forward	(234,487)	(161,990)
Share issuance costs	(77,378)	(77,353)
Incorporation costs	(117)	-
	<hr/>	<hr/>
Net recognized future income tax liability	437,166	41,814
	<hr/>	<hr/>

The Company has incurred the following approximate 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
2007	254,000	2027
	<hr/>	
	756,000	
	<hr/>	

**Grizzly Diamonds Ltd.**  
**Notes to Financial Statements**  
**For the years ended July 31, 2007 and 2006**

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**7. Share capital**

**Shares**

Authorized:

- Unlimited number of common shares
- Unlimited number of preferred shares

Issued:

	Year ended July 31, 2007		Year ended July 31, 2006	
	Common Shares #	Amount \$	Common Shares #	Amount \$
Balance – beginning of year	13,756,876	4,081,362	10,010,001	1,104,440
Shares issued for cash	1,954,830	1,605,619	3,561,875	2,992,311
Shares issued for mineral properties	50,000	52,500	185,000	197,850
Reclassified from contributed surplus	-	5,733	-	41,409
Share issuance costs	-	(159,668)	-	(89,014)
Future income taxes	-	(489,190)	-	(165,634)
Balance – end of year	15,761,706	5,096,356	13,756,876	4,081,362

On December 22, 2006, Grizzly closed a non-brokered private placement of 900,000 units (“Units”) at a price of \$1.10 per Unit for gross proceeds of \$990,000. Each Unit consisted of one flow-through common share of the Company and one-half of a common share purchase warrant. Each whole warrant may be exercised for one additional non-flow through common share of the Company at a price of \$1.50 per common share until December 22, 2007. As at July 31, 2007, Grizzly has incurred \$340,000 of eligible flow-through expenditures, and is committed to incur another \$650,000.

In connection with the offering, Grizzly also issued agent's options to acquire up to 90,000 units of the Company ("Agent's Units") at a price of \$1.10 per Agent's Unit until December 22, 2007. The Agent's Units are on the same terms as the Units except that they consist of one non-flow-through common share and one-half of a warrant.

On October 12, 2006, Grizzly closed a non-brokered private placement to one purchaser of 200,000 flow-through common shares of Grizzly at a price of \$1.00 per share for aggregate proceeds of \$200,000. The flow-through expenditure commitment has since been met.

During the year ended July 31, 2007, the Company issued 50,000 (2006 - 185,000) common shares at a deemed value of \$52,500 (2006 - \$197,850) as consideration for mineral property acquisitions (note 4).

During the year ended July 31, 2007, the Company issued 795,850 (2006 - 522,700) common shares from the exercise of warrants for gross proceeds of \$397,925 (2006 - \$261,350) and 58,980 (2006 - 451,020) common shares from the exercise of options for gross proceeds of \$17,694 (2006 - \$142,806).

# Grizzly Diamonds Ltd.

## Notes to Financial Statements

For the years ended July 31, 2007 and 2006

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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. Insiders of the corporation purchased an aggregate of 430,000 flow-through shares. The flow-through expenditure commitment has since been met.

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 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. During the year ended July 31, 2007, the expiry date of the 794,077 warrants outstanding was extended by an additional year to October 24, 2007. Related to this private placement, the Company paid an aggregate of \$47,415 in finder's fees included in share issuance costs. The flow-through expenditure commitment has since been met.

#### 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 agents which do not fall under the plan.

The following table summarizes activity related to stock options:

	Year ended July 31, 2007		Year ended July 31, 2006	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	#	\$	#	\$
Balance – beginning of year	1,108,980	0.65	1,085,000	0.33
Granted	365,000	1.06	475,000	1.06
Cancelled	(150,000)	0.70	-	-
Exercised	(58,980)	0.30	(451,020)	0.32
Balance – end of year	1,265,000	0.78	1,108,980	0.65

**Grizzly Diamonds Ltd.**  
**Notes to Financial Statements**  
**For the years ended July 31, 2007 and 2006**

**7. Share capital, cont.**

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

Year ended July 31, 2007			Year ended July 31, 2006		
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
575,000	0.35	2.4	58,980	0.30	0.4
325,000	1.22	3.5	575,000	0.35	3.4
25,000	0.89	4.2	150,000	0.70	4.1
150,000	1.00	2.3	325,000	1.22	4.5
90,000	1.10	0.4	-	-	-
100,000	1.15	4.8	-	-	-
1,265,000	0.78	2.8	1,108,980	0.65	3.7

Of the Company's outstanding options as at July 31, 2007, 1,190,000 were exercisable (2006 – 1,108,980).

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 \$131,250 (2006 – \$310,545) in the statement of loss and deficit for options vesting in the year. The stock-based compensation expense has been determined based on the fair value of an aggregate 200,000 (2006 – 475,000) options at the grant date, with a weighted average fair value of \$0.66 per option (2006 – \$0.65 per option).

The Company has recorded share issuance costs in the amount of \$47,700 (2006 – nil) relating to the Agent's Units issued to the agents on the Company's private placement on December 22, 2006. The fair value of each Agent's Unit granted has been determined based on the fair value of 90,000 (2006 – nil) Agent's Units at the grant date, with a fair value of \$0.53 per Agent's Unit (2006 – nil).

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:

	Year ended July 31, 2007	Year ended July 31, 2006
Risk-free interest rate	4.08%	3.67%
Expected volatility	80.0%	91.3%
Annual dividend yield	0.0%	0.0%
Expected life of options	3 years	4 years

**Grizzly Diamonds Ltd.**  
**Notes to Financial Statements**  
**For the years ended July 31, 2007 and 2006**

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**7. Share capital, cont.**

**Warrants**

The following table summarizes activity related to warrants:

	<b>Year ended July 31, 2007</b>		<b>Year ended July 31, 2006</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	1,596,427	1.00	1,325,050	0.50
Issued	450,000	1.50	794,077	1.50
Exercised	(795,850)	0.50	(522,700)	0.50
Expired	(6,500)	0.50	-	-
Balance – end of year	<b>1,244,077</b>	<b>1.50</b>	<b>1,596,427</b>	<b>1.00</b>

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

	<b>Year ended July 31, 2007</b>			<b>Year ended July 31, 2006</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>
	794,077	1.50	0.2	802,350	0.50	0.4
	450,000	1.50	0.4	794,077	1.50	0.2
	<b>1,244,077</b>	<b>1.50</b>	<b>0.3</b>	<b>1,596,427</b>	<b>1.00</b>	<b>0.3</b>

During the year ended July 31, 2007, 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, 2007 and 2006

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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:

	<b>Year ended July 31, 2007</b>	<b>Year ended July 31, 2006</b>
	\$	\$
Balance – beginning of year	363,136	94,000
Stock options granted	178,950	310,545
Exercise of options	(5,733)	(41,409)
Balance – end of year	<u>536,353</u>	<u>363,136</u>

#### 9. Related party transactions

During the year ended July 31, 2007, consulting fees of \$57,000 (2006 – \$30,250) were paid to companies controlled by current officers of the Company (2006 – former officer of the Company); consulting fees of \$3,750 (2006 – \$4,750) were paid to a company controlled by a director. All amounts were fully paid as at July 31, 2007 (2006 – \$750 included in accounts payable).

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.

#### 12. Subsequent events

Effective August 15, 2007, Grizzly entered into an agreement with Com-advice AG of Baar, Switzerland for the provision of advertising and promotional services in Europe, the Middle East and Africa. Com-advice AG specializes in research and analysis of mineral companies.

# **Grizzly Diamonds Ltd.**

## **Notes to Financial Statements**

**For the years ended July 31, 2007 and 2006**

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### **12. Subsequent events, cont.**

Pursuant to the agreement, Grizzly has paid Com-advice AG a fee of \$100,000 on execution of the agreement and will grant stock options to Com-advice AG pursuant to the Company's stock option plan to acquire 100,000 common shares of Grizzly at an exercise price of \$1.20 and 50,000 common shares at an exercise price of \$1.50.

The term of the agreement will be until August 14, 2008 and will be automatically renewed for an additional one year term at a cash compensation of \$100,000 if not cancelled three months prior to expiration of the first term.