

Grizzly Diamonds Ltd.

Financial Statements

For the years ended July 31, 2008 and 2007



STOUT & COMPANY LLP

CHARTERED ACCOUNTANTS EDMONTON, CANADA

AUDITORS' REPORT

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

We have audited the balance sheets of **Grizzly Diamonds Ltd.** as at July 31, 2008 and 2007 and the statements of net loss and deficit, comprehensive loss 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, 2008 and 2007, 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 6, 2008

Chartered Accountants

Grizzly Diamonds Ltd.

Balance Sheets

As at July 31, 2008 and 2007

	2008	2007
	\$	\$
Assets		
Current assets		
Cash and cash equivalents (note 3)	1,227,150	1,451,409
Restricted cash (note 4)	25,000	25,000
Accounts receivable	163,802	44,556
Marketable securities (note 5)	79,000	-
Prepaid expenses	30,650	20,843
	<u>1,525,602</u>	1,541,808
Restricted cash (note 4)	28,200	28,200
Mineral properties (note 6)	7,263,369	3,800,668
	<u>8,817,171</u>	5,370,676
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	396,440	152,198
Future income taxes (note 7)	916,010	437,166
	<u>1,312,450</u>	589,364
Shareholders' equity		
Share capital (note 8)	7,987,153	5,096,356
Contributed surplus (note 9)	1,318,397	536,353
Accumulated other comprehensive loss	(16,055)	-
Deficit	(1,784,774)	(851,397)
	<u>7,504,721</u>	4,781,312
	<u>8,817,171</u>	5,370,676

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, 2008 and 2007

	2008	2007
	\$	\$
Revenue		
Interest	76,698	68,538
	<hr/>	<hr/>
Expenses		
Advertising and promotion	38,137	40,580
Office	71,054	25,302
Conferences and corporate travel	44,744	38,480
Corporate filing and transfer fees	21,443	16,533
Professional fees	60,078	60,944
Consulting fees	258,696	47,199
	<hr/>	<hr/>
	494,152	229,038
	<hr/>	<hr/>
	(417,454)	(160,500)
Other expenses		
Stock-based compensation (note 8)	(683,000)	(131,250)
Write down of mineral properties (note 6)	-	(122,122)
	<hr/>	<hr/>
Loss before income taxes	(1,100,454)	(413,872)
Future income tax benefit (note 7)	167,077	93,838
	<hr/>	<hr/>
Net loss for the year	(933,377)	(320,034)
Deficit - beginning of year	(851,397)	(531,363)
	<hr/>	<hr/>
Deficit - end of year	(1,784,774)	(851,397)
	<hr/>	<hr/>
Basic and diluted net loss per common share	(0.05)	(0.02)
	<hr/>	<hr/>
Weighted average number of common shares outstanding	17,687,083	15,051,255
	<hr/>	<hr/>

See accompanying notes to financial statements

Grizzly Diamonds Ltd.
Statements of Comprehensive Loss
For the years ended July 31, 2008 and 2007

	2008	2007
	\$	\$
Net loss for the year	(933,377)	(320,034)
Other comprehensive loss:		
Unrealized loss on available for sale investments, net of future income taxes of \$2,945	<u>(16,055)</u>	<u>-</u>
Comprehensive loss for the year	<u>(949,432)</u>	<u>(320,034)</u>

See accompanying notes to financial statements

Grizzly Diamonds Ltd.
Statements of Cash Flows
For the years ended July 31, 2008 and 2007

	2008	2007
	\$	\$
Cash provided by (used in)		
Operating activities		
Net loss for the year	(933,377)	(320,034)
Items not affecting cash and cash equivalents		
Stock-based compensation	683,000	131,250
Write down of mineral properties	-	122,122
Future income tax benefit	(167,077)	(93,838)
	<u>(417,454)</u>	<u>(160,500)</u>
Net change in non-cash working capital items	<u>115,189</u>	112,455
	<u>(302,265)</u>	<u>(48,045)</u>
Investing activities		
Mineral properties	<u>(3,456,201)</u>	<u>(1,626,378)</u>
Financing activities		
Issuance of shares	3,890,200	1,605,619
Share issuance costs	<u>(355,993)</u>	<u>(111,968)</u>
	<u>3,534,207</u>	<u>1,493,651</u>
Increase (decrease) in cash and cash equivalents	(224,259)	(180,772)
Cash and cash equivalents - beginning of year	<u>1,451,409</u>	<u>1,632,181</u>
Cash and cash equivalents - end of year	<u>1,227,150</u>	<u>1,451,409</u>
Cash and cash equivalents consist of:		
Cash on deposit with financial institutions	<u>1,227,150</u>	<u>1,451,409</u>

The non-cash transactions described in note 6 and note 8 have been excluded from the statement of cash flows.

See accompanying notes to financial statements

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the years ended July 31, 2008 and 2007

1. Nature of operations

Grizzly Diamonds Ltd. (“Grizzly” or “the Company”) 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

New accounting standards and policies

Effective August 1, 2007, the Company adopted the revised Canadian Institute of Chartered Accountants’ (CICA) Handbook Section 1506 – Accounting Changes, which requires that: (a) a voluntary change in accounting policies can be made if, and only if, the changes result in more reliable and relevant information, (b) changes in accounting policies are accompanied with disclosures of prior period amounts and justification for the change, and (c) for changes in estimates, the nature and amount of the change should be disclosed. The Company has not made any voluntary changes in accounting policies since the adoption of the revised standard.

Effective August 1, 2007, the Company adopted the following new or revised CICA Handbook Sections:

- Section 1530 – Comprehensive Income;
- Section 3251 – Equity;
- Section 3855 – Financial Instruments – Recognition and Measurement;
- Section 3861 – Financial Instruments – Disclosure and Presentation; and
- Section 3865 – Hedges.

These standards require that the Company initially recognize all arms length financial assets and financial liabilities on the balance sheet at their fair values. Subsequent to initial recognition, financial instruments are measured at fair value, amortized cost or cost depending on the financial instrument classification. The Company’s financial instruments recognized on the balance sheet consist of cash and cash equivalents, restricted cash, marketable securities, accounts payable and accrued liabilities, and accounts receivable. The Company has no unrecognized financial instruments or derivative financial instruments.

Upon initial recognition, the Company has designated its cash and cash equivalents and restricted cash as held for trading, and accordingly they are recognized on the balance sheet at their fair values, and changes in fair value are recognized in net income in the period in which the change arises. Accounts receivable has been classified as loans and receivables, and is measured at amortized cost. Marketable securities have been classified as available for sale financial assets, and accordingly they are recognized on the balance sheet at their fair values, and changes in fair values are recognized as a component of comprehensive income in the period in which the change arises, net of future income taxes. Accounts payable and accrued liabilities have been classified as other liabilities, and are measured at amortized cost.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the years ended July 31, 2008 and 2007

The estimated fair market values of the Company's financial instruments approximate their carrying values due to their short-term nature.

Purchases and sales of financial assets will be accounted for using trade-date accounting, and transaction costs on financial instruments other than those classified as held for trading will be recognized in net income in the period in which they occur. It is management's opinion that they are not subject to significant interest, currency or credit risks arising from their financial instruments.

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 assets and 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 financial institutions 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.

Where the Company receives payments under option agreements with a third party, the proceeds of any option payments under such agreements are applied to the property to the extent of costs incurred, with any excess included in net income.

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.

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.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the years ended July 31, 2008 and 2007

Income taxes

The liability method is used for determining income taxes. Under this method, future income tax assets and liabilities are recognized for the estimated tax recoverable or payable that would arise if assets and liabilities were recovered or settled at the financial statement carrying amounts. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the year in which temporary differences are expected to be recovered or settled. Changes to these balances, including changes due to changes in income tax rates, are recognized in income in the period in which they occur. The amount of future tax assets recognized is limited to the amount that is more likely than not to be realized.

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.

Net loss per share

Basic 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. Diluted loss per share figures is equal to those of basic loss per share if the effects of stock options and warrants have been excluded since they are anti-dilutive.

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.

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.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the years ended July 31, 2008 and 2007

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.

Future accounting changes

The CICA has issued Section 1535 – Capital Disclosures, which established standards for disclosing information about an entity's capital and how it is managed. The new accounting standard is effective on the Company's interim and annual financial statements beginning August 1, 2008. The effect on the Company will be increased disclosure surrounding its objectives, policies and processes for managing capital.

The CICA has issued Section 3862 – Financial Instruments – Disclosures and Section 3863 – Financial Instruments – Presentation which replace Section 3861 – Financial Instruments – Recognition and Measurement. These accounting standards are effective on the Company's interim and annual financial statements beginning August 1, 2008. The effect on the Company will be enhanced disclosure required on the nature and extent of risks arising from financial instruments and how the Company manages those risks.

The CICA has amended Section 1400 - General Standards of Financial Statement Presentation, to include requirements to assess and disclose the Company's ability to continue as a going concern. The new accounting standard is effective on the Company's interim and annual financial statements beginning August 1, 2008. The adoption of this new section is not expected to have an impact on the Company's financial statements.

The CICA has issued Section 3064 – Goodwill and Intangible Assets, which replaces Section 3062 – Goodwill and Other Intangible Assets and Section 3450 – Research and Development Costs. The new accounting standard is effective on the Company's interim and annual financial statements beginning August 1, 2009. This Section establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The Company is currently evaluating the impact of this standard on its financial statements.

In February 2008, the Accounting Standards Board confirmed that Canadian Generally Accepted Accounting Principles for publicly accountable enterprises will be converged with International Financial Reporting Standards ("IFRS") effective for the Company's interim and annual financial statements beginning on August 1, 2011. The Company is currently evaluating the impact of the adoption of IFRS.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the years ended July 31, 2008 and 2007

3. Cash and cash equivalents

Cash and cash equivalents consists of cash on deposit with financial institutions. The repayment of monies on deposit and interest payable on those monies is guaranteed by the Crown in right of Alberta.

4. Commitments

The Company has restricted cash in the amount of \$25,000 (2007 – \$25,000) as security for corporate credit card liabilities. The Company also has restricted cash in the amount of \$28,200 (2007 – \$28,200) relating to two letters of guarantee for reclamation work in order to facilitate exploration in certain mineral property areas.

5. Marketable securities

The following table summarizes information about the Company's marketable securities as at July 31, 2008:

	Cost	Fair value	Carrying value
	\$	\$	\$
Shear Minerals Ltd.			
200,000 common shares	56,000	49,000	49,000
Takara Resources Inc.			
200,000 common shares	27,000	20,000	20,000
Nordic Diamonds Ltd.			
200,000 common shares	15,000	10,000	10,000
	98,000	79,000	79,000

The Company did not have marketable securities as at July 31, 2007. Subsequent to July 31, 2008, the carrying value of the Company's marketable securities has significantly decreased.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the years ended July 31, 2008 and 2007

6. Mineral properties

	Alberta Diamond Properties	BC Precious Mineral Properties	Alberta Industrial Mineral Properties	Total
Ownership interest (%)	49-100	51-100	100	49-100
	\$	\$	\$	\$
Balance, July 31, 2006	1,717,184	526,728	-	2,243,912
Acquisition costs	36,063	67,425	-	103,488
Fieldwork	268,629	218,517	-	487,146
Geophysics	366,137	40,000	-	406,137
Drilling	383,899	235,340	-	619,239
Analysis	18,661	44,207	-	62,868
Write downs	-	(122,122)	-	(122,122)
Balance, July 31, 2007	2,790,573	1,010,095	-	3,800,668
Acquisition costs	1,250	135,924	109,378	246,552
Fieldwork	357,996	269,848	11,832	639,676
Geophysics	626,818	361,131	-	987,949
Drilling	1,035,307	377,789	-	1,413,096
Analysis	51,831	123,597	-	175,428
Balance, July 31, 2008	4,863,775	2,278,384	121,210	7,263,369
Balances				
Acquisition	286,826	387,010	109,378	783,214
Exploration	4,576,949	1,891,374	11,832	6,480,155
Balance, July 31, 2008	4,863,775	2,278,384	121,210	7,263,369

a) Alberta Diamond Properties

During the year ended July 31, 2008, the following properties were re-allocated for presentation purposes into one large area of interest renamed Alberta Diamond Properties: Bear Paw, Call of the Wild, Grand Cub Aidan, Grand Cub Parker, Kodiak, Legend, Smoky the Bear, White Bear, and Preston Upon the Wolverine.

Legend

During the year ended July 31, 2006, the Company acquired a 100% interest in the Legend property and an 85% interest in the Little Legend property (collectively "Legend Property") from Blue Diamond Mining Corporation ("Blue") by paying \$12,500 and issuing 85,000 common shares recorded at a value of \$1.01 per share. The Company will issue an additional 15,000 common shares if kimberlite or related rock is discovered on the Legend Property. The Company agreed to carry the remaining 15% interest in the Little Legend property held by Grizzly Gold Inc. (a company controlled by a director and shareholder) to commercial production. Blue will retain a 2% Gross Overriding Royalty on all diamonds produced on the properties.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the years ended July 31, 2008 and 2007

Call of the Wild

During the year ended July 31, 2006, the Company 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 Call of the Wild property.

During the year ended July 31, 2007, Stornoway completed its initial earn-in to a 51% interest in the property by flying the entire property with an airborne fixed wing magnetic survey and collecting twenty five diamond indicator samples. Stornoway may earn an additional 9% interest by incurring \$5,000,000 in exploration expenditures within five years and a further 10% interest (totaling 70%) by providing the Company with a bankable feasibility study.

Other

During the years ended July 31, 2004 and 2005, the Company acquired a 90% interest in a number of mineral claims situated in northern Alberta from Grizzly Gold Inc. by reimbursing Grizzly Gold Inc.’s aggregate staking costs of \$71,833 and issuing 2,710,000 common shares. The Company agreed to carry Grizzly Gold Inc.’s remaining 10% interest to commercial production and has the option to acquire up to an additional 5% interest in the properties upon payment of \$1,000,000 for each additional 1% interest.

During the years ended July 31, 2006 and 2007, the Company successfully acquired, by bid process, additional townships (100% interest) adjacent to its existing properties.

b) BC Precious Mineral Properties

During the year ended July 31, 2008, the following properties were re-allocated for presentation purposes into one large area of interest renamed BC Precious Mineral Properties: Greenwood, Peak, French, Silver Bear, and Ant.

Greenwood

During the year ended July 31, 2008, the Company signed an option agreement to acquire a 100% interest in the Greenwood property from a private arms length company (the “Vendor”) by paying \$12,500 and issuing 25,000 common shares recorded at \$1.16 per share. In addition, the Company must pay a further \$212,500, issue an additional 175,000 common shares on or before March 1, 2012, and incur minimum exploration expenditures on the property totaling \$2,000,000 on or before March 1, 2013. The Vendor will retain a combined 2.5% net smelter royalty (“NSR”) on the property which Grizzly can reduce by up to 1.5% for a price of \$1,500,000.

Subsequent to the original agreement and during the year ended July 31, 2008, the Company signed an amendment to acquire additional claim groups in the area, increasing the total size of the Greenwood property. These claim groups have been added to the property for an additional cost of \$10,000 cash, the issuance of an additional 125,000 common shares over four years, and an increased expenditure commitment of \$50,000 during each of the first two years of the original agreement. During the year ended July 31, 2008, the Company paid an additional \$10,000 and issued 25,000 additional common shares at a fair value of \$1.08 per share, leaving a total of 275,000 common shares left to be issued.

Peak and French

During the year ended July 31, 2008, the Company completed its exploration expenditure commitments on the Peak and French properties from the original option agreements with Valley Gold Inc. (“Valley”) and an individual. Valley and an individual will retain a 3% NSR on the Peak property and a 2% NSR on the French property. The Company has a first right of refusal to purchase either NSR.

Grizzly Diamonds Ltd.

Notes to Financial Statements

For the years ended July 31, 2008 and 2007

Silver Bear

During the year ended July 31, 2008, the Company issued its final share payment of 50,000 common shares pursuant to an option agreement with two individuals for the Silver Bear property. The common shares were issued at \$0.97 per share. The two individuals will retain a 3% NSR on the property which Grizzly can reduce by up to 2% for a price of \$1,000,000.

During the year ended July 31, 2007, the Company issued 50,000 common shares pursuant to an option agreement with two individuals for the Silver Bear property. The common shares were issued with a fair value of \$1.05 per share.

Ant

During the year ended July 31, 2007, the Company signed an option agreement to acquire an undivided 51% interest in the Ant property by paying \$10,000 to the optionor. In addition, the Company must pay a further \$10,000 and incur minimum exploration expenditures on the property totaling \$100,000 by March 1, 2009.

During the year ended July 31, 2008, as a condition of the option agreement, the optionor was required to have registered the mineral claims in the name of Grizzly and/or the optionor. As at July 31, 2008, this condition has not been fulfilled by the optionor, and Grizzly has withheld its second payment of \$10,000 until the condition is met.

Goat Mine

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

c) Alberta Industrial Mineral Properties

During the year ended July 31, 2008, the Company was awarded a number of metallic mineral permits, which include the rights to subsurface potash, by application and bid process in east-central Alberta along the Saskatchewan-Alberta border. The lands acquired for potash exploration total more than 850,000 acres. Subsequent to July 31, 2008, Grizzly received the formal metallic mineral permits previously awarded.

Rattlesnake North

During the year ended July 31, 2008, the Company entered into an option agreement with Shear Minerals Ltd. ("Shear"), a company with a common director, whereby Shear has the right to earn up to a 70% interest in the Company's 50,000 acre Rattlesnake North property.

To earn an initial 51% interest, Shear must pay Grizzly \$25,000, issue 200,000 common shares of Shear, and must incur a minimum \$2,000,000 in exploration expenditures on or before September 1, 2009. Shear can earn an additional 19% by carrying Grizzly to a pre-feasibility study on or before September 1, 2011. Grizzly received the shares on August 7, 2008.

Teddybear-2

During the year ended July 31, 2008, the Company entered into an option agreement with Nordic Diamonds Ltd. ("Nordic") whereby Nordic has the right to earn up to a 70% interest in the Company's 50,000 acre Teddybear-2 property.

To earn an initial 51% interest, Nordic paid Grizzly \$25,000, issued 200,000 common shares of Nordic, and must incur a minimum \$2,000,000 in exploration expenditures on or before September 1, 2009. Nordic can earn an additional 19% by carrying Grizzly to a pre-feasibility study on or before September 1, 2011. Grizzly received the shares on September 3, 2008.

Grizzly Diamonds Ltd.

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Teddybear-3

During the year ended July 31, 2008, the Company entered into an option agreement with Takara Resources Ltd. ("Takara"), a company with a common director, whereby Takara has the right to earn up to a 70% interest in the Company's 50,000 acre Teddybear-3 property.

To earn an initial 51% interest, Takara must pay Grizzly \$25,000, issue 200,000 common shares of Takara, and must incur a minimum \$2,000,000 in exploration expenditures on or before September 1, 2009. Takara can earn an additional 19% by carrying Grizzly to a pre-feasibility study on or before September 1, 2011.

Grizzly Diamonds Ltd.
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7. 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>2008</u>	<u>2007</u>
	\$	\$
Expected tax recovery at a rate of 31.54% (2007 – 33.10%)	347,083	136,992
Increase (decrease) resulting from:		
Stock based compensation	(215,418)	(43,444)
Share issuance costs	52,692	-
Changes in income tax rates	37,258	(3,486)
Change in temporary differences	(54,538)	3,776
	<u>167,077</u>	<u>93,838</u>
Income tax benefit	<u>167,077</u>	<u>93,838</u>

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

	<u>2008</u>	<u>2007</u>
	\$	\$
Mineral properties	1,397,467	749,148
Non-capital losses carried forward	(360,487)	(234,604)
Share issuance costs	(118,405)	(77,378)
Marketable securities	(2,565)	-
	<u>916,010</u>	<u>437,166</u>
Net recognized future income tax liability	<u>916,010</u>	<u>437,166</u>

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
2008	578,000	2028
	<u>1,334,000</u>	

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8. Share capital

Shares

Authorized:

Unlimited number of common shares
 Unlimited number of preferred shares

Issued:

	Year ended July 31, 2008		Year ended July 31, 2007	
	Common Shares #	Amount \$	Common Shares #	Amount \$
Balance – beginning of year	15,761,706	5,096,356	13,756,876	4,081,362
Shares issued for cash	3,639,363	3,890,200	1,954,830	1,605,619
Shares issued for mineral properties	100,000	104,500	50,000	52,500
Reclassified from contributed surplus	-	78,000	-	5,733
Share issuance costs	-	(533,037)	-	(159,668)
Future income taxes	-	(648,866)	-	(489,190)
Balance – end of year	19,501,069	7,987,153	15,761,706	5,096,356

During the year ended July 31, 2008, the Company issued 150,000 (2007 – 58,980) common shares from the exercise of options for gross proceeds of \$150,000 (2006 - \$17,694), and, during the year ended July 31, 2007, issued 795,850 common shares from the exercise of warrants for gross proceeds of \$397,925. No warrants were exercised in the year ended July 31, 2008.

On April 11, 2008, Grizzly closed a non-brokered private placement (“Offering”) of an aggregate of 971,000 units (“Units”) at a price of \$1.00 per Unit, for gross proceeds of \$971,000. Each Unit consisted of one common share of the Company and one-half of a non-transferable share purchase warrant (“Warrant”) and each whole Warrant entitles the holder to acquire one additional common share at a price of \$1.25 until April 11, 2010. Grizzly also issued to the agents warrants (“Agent warrants”) to acquire up to 66,220 common shares of the Company at a price of \$1.00 per Agent warrant until April 11, 2010.

On December 21, 2007, Grizzly closed a non-brokered private placement (“Offering”) of an aggregate of 2,508,363 flow through units (“FT units”) at a price of \$1.10 per FT unit and 10,000 non-flow through units (“Non-FT units”) at a price of \$1.00 per Non-FT unit, for gross proceeds of \$2,769,200. Each FT unit consisted of one flow through common share of the Company and one-half of a share purchase warrant (“warrant”). Each Non-FT unit consisted of one common share of the Company and one-half of a warrant. Each whole warrant entitles the holder to acquire one additional common share at a price of \$1.50 until December 21, 2009.

In connection with the offering, Grizzly also issued agent's warrants to acquire up to 237,927 units of the Company (“Agent's Units”) at a price of \$1.10 per Agent's Unit until December 21, 2009. The Agent's Units are on the same terms as the Non-FT units in that they consist of one non-flow-through common share and one-half of a warrant.

As at July 31, 2008, Grizzly has incurred approximately \$2,704,000 of eligible flow-through expenditures, and is committed to incur another \$55,200 by December 31, 2008.

Grizzly Diamonds Ltd.

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For the years ended July 31, 2008 and 2007

On August 15, 2007, Grizzly entered into a one year agreement with Com-advice AG of Baar, Switzerland for the provision of advertising and promotional services in Europe, the Middle East and Africa. Pursuant to the agreement, Grizzly has paid Com-advice AG a fee of \$100,000 and has granted 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 agreement terminated on August 14, 2008.

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. The flow-through expenditure commitment has since been met.

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. On December 22, 2007, all of the 450,000 warrants and 90,000 Agent's Units had not been exercised and expired.

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.

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, 2008		Year ended July 31, 2007	
	Number of options #	Weighted average exercise price \$	Number of options #	Weighted average exercise price \$
Balance – beginning of year	1,265,000	0.78	1,108,980	0.65
Granted	950,000	1.18	365,000	1.06
Expired	(90,000)	1.10	(150,000)	0.70
Exercised	(150,000)	1.00	(58,980)	0.30
Balance – end of year	1,975,000	0.94	1,265,000	0.78

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

Year ended July 31, 2008			Year ended July 31, 2007		
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	1.4	575,000	0.35	2.4
325,000	1.22	2.5	325,000	1.22	3.5
25,000	0.89	3.2	25,000	0.89	4.2
100,000	1.15	3.8	150,000	1.00	2.3
100,000	1.20	4.1	90,000	1.10	0.4
50,000	1.50	4.1	100,000	1.15	4.8
100,000	1.05	4.4	-	-	-
600,000	1.20	4.6	-	-	-
100,000	1.00	4.9	-	-	-
1,975,000	0.94	3.2	1,265,000	0.78	2.8

All of the Company's outstanding options were exercisable as at July 31, 2008 (2007 – 1,190,000 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 \$683,000 (2007 – \$131,250) 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 1,025,000 (2007 – 200,000) options at the grant date, with a weighted average fair value of \$0.67 per option (2007 – \$0.66 per option).

The Company has recorded share issuance costs in the amount of \$177,044 (2007 – \$47,700) relating to the Agent's Units and Agent's warrants issued to the agents during the year. The fair value of each Agent's Unit and Agent's warrant granted has been determined based on the fair value of 304,147 (2007 – 90,000) Agent's Units and Agent's warrants at the grant date, with a fair value of \$0.58 per Agent's Unit and Agent's warrant (2007 – \$0.53).

All of the Company's options were issued with an exercise price greater than 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, 2008	Year ended July 31, 2007
Risk-free interest rate	3.35%	4.08%
Expected volatility	80.0%	80.0%
Annual dividend yield	0.0%	0.0%
Expected life of options	4 years	3 years

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Warrants

The following table summarizes activity related to warrants:

	Year ended July 31, 2008		Year ended July 31, 2007	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
	#	\$	#	\$
Balance – beginning of year	1,244,077	1.50	1,596,427	1.00
Issued	2,048,827	1.38	450,000	1.50
Exercised	-	-	(795,850)	0.50
Expired	(1,244,077)	1.50	(6,500)	0.50
Balance – end of year	2,048,827	1.38	1,244,077	1.50

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

	Year ended July 31, 2008			Year ended July 31, 2007		
	Number of warrants outstanding	Weighted average exercise price	Weighted average remaining contractual life	Number of warrants outstanding	Weighted average exercise price	Weighted average remaining contractual life
	#	\$	Years	#	\$	Years
	1,259,180	1.50	1.4	794,077	1.50	0.2
	237,927	1.10	1.4	450,000	1.50	0.4
	485,500	1.25	1.7	-	-	-
	66,220	1.00	1.7	-	-	-
	2,048,827	1.38	1.5	1,244,077	1.50	0.3

9. Contributed surplus

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

	Year ended July 31, 2008	Year ended July 31, 2007
	\$	\$
Balance – beginning of year	536,353	363,136
Options granted	860,044	178,950
Exercise of options	(78,000)	(5,733)
Balance – end of year	1,318,397	536,353

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10. Related party transactions

During the year ended July 31, 2008, consulting fees of \$84,000 (2007 – \$57,000) were paid to companies controlled by current officers of the Company; consulting fees of \$2,256 (2007 – \$3,750) were paid to a company controlled by a director. All amounts were fully paid as at July 31, 2008 and 2007.

Included in accounts receivable is \$25,000 from Shear and \$25,000 from Takara both relating to option agreements signed during the year (note 6).

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.

11. Comparative amounts

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

12. Subsequent events

Subsequent to July 31, 2008, the Company signed a letter of intent ("LOI") with Fractal Mining Corporation ("Fractal") whereby Fractal has the option to earn a 70% interest in Grizzly's French Property. Under the terms of the LOI, upon signing a formal agreement, Fractal will pay the Company \$5,000 and issue 50,000 common shares of Fractal. To earn a 70% interest in the property, Fractal must issue an additional 150,000 common shares of Fractal and incur a minimum of \$500,000 in exploration expenditures on the property prior to the third anniversary of a formal agreement. The option is subject to finalization of a formal agreement, due diligence, and regulatory approval.

Subsequent to July 31, 2008, the Company closed a non-brokered private placement offering ("Offering") of an aggregate of 271,000 flow-through units ("FT Units") at a price of \$1.00 per FT Unit, and 599,556 non-flow-through units ("Units") at a price of \$0.90 per Unit, for gross proceeds of \$810,600. Each FT Unit consisted of one flow-through common share ("FT Share") and one-half of a non-transferable share purchase warrant ("FT Unit Warrant") where each whole FT Unit Warrant entitles the holder to acquire one additional common share at a price of \$1.35 until August 27, 2010. Each Unit consisted of one common share and one-half of a non-transferable share purchase warrant ("Warrant") where each whole Warrant entitles the holder to acquire one additional common share at a price of \$1.25 until August 27, 2010.