



**51-102F1 – ANNUAL MD&A**

For the year ended  
August 31, 2008





## Annual Management Discussion and Analysis For the year ended August 31, 2008

*The following discussion and analysis of financial results of Diversified Industries Ltd. (the "Corporation" or "Diversified") on a consolidated basis, using the Purchase Method, with CFR Chemicals Inc. should be read in conjunction with the Corporation's audited annual financial statements and the accompanying notes for the periods ended August 31, 2008 and August 31, 2007 and is based on information available to **December 19, 2008**. Diversified purchased 40% of the common shares of CFR on October 26, 2007 and then purchased additional 10% on Nov 30, 2007. As of November 30, 2007, the 1<sup>st</sup> quarter, Diversified owned 50% of the outstanding common shares and has effective control of the operational assets and liabilities of CFR. The financial statements have been prepared in accordance with Generally Accepted Accounting Practices for a business combination using the Purchase Method for the presentation of the Balance Sheet, Statement of Operations and Statement of Cash flows. Additional information on the Corporation is available on SEDAR at [www.Sedar.com](http://www.Sedar.com).*

### Forward Looking Information

*Statements in this Management's Discussion and Analysis relating to matters that are not historical facts are forward-looking statements. Such forward-looking statements involve known and unknown risks and uncertainties which may cause the actual results, performance or achievements of the Corporation to be materially different from any future results implied by such forward-looking statements. Such factors include fluctuations in the oil and gas industries, both production rates and price and the ability of the Corporation to continue to grow sales of speciality blended chemicals and bulk commodity chemicals to the industrial and oil and gas industries. The on going ability of the Corporation to acquire and successfully commercialize other technologies, political and economic conditions in North America and other factors that are described in further detail in Diversified's continuous disclosure filings..*

### 1. DESCRIPTION OF BUSINESS

Diversified Industries Ltd. comprises of two business segments, the significant segment currently is the development, marketing and sale of blended specialty chemicals and bulk commodity chemicals through CFR Chemicals Inc. from its Alberta and British Columbia locations. The remaining business segment is the product commercialization and development of emerging or unique products and solutions in industries including, but not limited to the oil and gas sector. Through this initiative the Corporation continues to pursue technologies for acquisition and commercialization in addition to the development of its own intellectual property. The objective is to evaluate other business opportunities and build a family of oilfield chemicals and solutions, through joint venture, merger or acquisition.

**Strategy:** The Corporation's key strategy is to focus on the overall growth and profitability of CFR Chemicals Inc. through expanded market share of both commodity and specialty chemicals to the oil and gas industries and the continued growth of DVS

6000. The Corporation has been investing in expanded infrastructure to support sales to a wider geographic region in western Canada. This has resulted in continued growth in overall sales over the past four quarters. The Corporation has also evaluated other chemicals and based on customer demand has increased its product family accordingly. In addition the Corporation continues to evaluate other unique technologies and products in the early stage of development and assuming appropriate synergy will incorporate them into the Corporation. This will be achieved through acquisition, merger or licensing.

Diversified's scavenger technology, DVS 6000, has been developed for several applications in multiple industries for the removal of H<sub>2</sub>S from gas, oil, air, or water. The Corporation has chosen to focus its efforts on marketing DVS 6000 to the Western Canadian oil and gas industry as a primary market but has also generated ongoing interest from the United States and overseas markets. DVS 6000 is non-corrosive, water-based, non-flammable, has a mild odor, has an extremely low freeze point (below -45° C), and is competitive in price. In addition, the by-product is easy to dispose of due to its small micron size; as well, when compared to caustic soda and ammonia, DVS 6000 has the potential to produce as little as 10 times less by-product. DVS 6000 works longer than caustic soda and ammonia, resulting in less product to inventory, less shipping and handling costs, less by-product, and less disposal costs – all of which save the distributors and end users money and make DVS 6000 a smart product choice. It is a safe and effective alternative to other hazardous scavenger technologies. The product can be used in truck scrubbers, stationary scrubbers, vent gas scrubbers, under-balanced drilling, fuel gas scrubbing, down-hole scrubbing, well bleed downs, tank and vessel decontamination, vacuum truck scrubbing, plant shutdowns, flushing of coil tubing, flushing of pipe and pipelines to neutralize H<sub>2</sub>S, and in the majority H<sub>2</sub>S safety related situations. Ongoing lab testing and field trials are a significant part of day-to-day operations in order to further market penetration. Over the past 12 months, the Company has done extensive work to further develop the technology to give it value in a wider range of applications. There is growing acceptance of the product among service providers, oil and gas producers and regulatory agencies. The Corporation is in the process of evaluating two new versions of this technology and will consider filing for a provisional patent if management feel the benefits are significant and unique enough to warrant protecting the new formulations.

The Corporation will continue to invest in other new product development for unique oil and gas applications with a focus on enhanced oil recovery and well stimulation products.

**Distribution and Sales of blended and bulk commodity:** Diversified has recognised that CFR Chemicals' primary focus is the distribution and manufacturing of production and process chemicals, supplying customer specific blended product, proprietary chemicals and bulk commodity chemicals. At the CFR Kuusamo location there is approximately 7,500,000 litres of storage capacity spread over 50 tanks ranging in size from 20,000 to 320,000 litres.

**Distribution and Sales of Core Technology:** In Canada, Diversified has built strategic relationships with several oil and gas production and service companies who are either marketing the product to their customers or using the product internally. Diversified

continues to work with several other companies both in Canada, the United States and abroad in efforts to expand DVS 6000 sales and distribution.

## **2. OVERALL PERFORMANCE**

Diversified is a venture issuer and in the past has not had significant revenues. In October 2007, the Corporation concluded the acquisition of 40% of CFR Chemicals Inc. for the issuance of 12,000,000 common shares and on November 30, 2007 exercised its option to purchase an additional 10% of CFR Chemicals Inc. for the sum of \$418,210. For the year ended August 31, 2008 operations were supported 94% by gross margin and 6% from financing initiatives. Operations over the 2007 fiscal year were supported 80% through financing initiatives and 20% through margin. CFR Chemicals profit for the year after tax was \$590,000. The Company's consolidated loss for the year was \$492,048 compared to a loss of \$928,051 the same period ending August 31, 2007.

### **a. Revenue:**

Revenue for the corporation increased from \$242,788 to \$20,632,994 for the year ended August 31, 2008, an increase of \$20,390,206. The consolidated activities with CFR Chemicals Inc. have led to this increase. Revenue of DVS 6000 increased from \$349,000 to \$428,600 an increase of 22%, (kg of product sold increased by 40%) for the year ended August 31, 2008. This is in part due to the fact that from May 1, 2007 forward, the pricing for DVS6000 was reduced. As a result of the consolidation of Diversified and CFR financial statements, there is a significant change to overall revenue and profitability, which will continue going forward.

The Corporation will continue to market itself mainly in Alberta with some international marketing efforts in the Middle East, the United States, South America and South East Asia markets. At this point, the majority of all sales and marketing will be carried out through CFR Chemicals Inc. The oil and gas industry exhibits a strong demand for all the family of products, however, there are barriers to entry that Diversified and its distribution partners are working to overcome. Research and testing and successful field trial efforts have shown promise for expanding product applications and are part of an effort to generate more data to assist in building the customer's willingness to implement use of products. Customer trials and testimonials are also helping in this area. The Corporation has and will continue to increase its marketing efforts. For example opportunities in the tens of millions exist for H<sub>2</sub>S mitigation and sulphur removal projects.

During the year consolidated sales were to over 225 companies. The percentage of revenue for the top five was 47% (2007 – 94%). The current period consolidated revenue for Diversified is generated through CFR Chemicals operations, , bulk and blended product, tank and product rental and specialty chemical blends and DVS6000.

### **b. Direct Costs:**

Direct costs increased from \$123,848 to \$15,927,761, an increase of \$15,803,913 for the year. Cost of Goods sold as a percent of revenue in 2008 was, 77.2% (2007 51.0%) or 22.8% Gross Margin (2007 49.0%). The result is a higher level of overall sales with a lower margin for the Corporation. The increase in direct costs as a percentage of revenue in 2008 versus 2007 was due to the new mix of products sold which included distribution of several commodity type chemicals. The corporation is working with key suppliers to ensure stable costing and supply of material. The 2007 direct costs were strictly related to DVS6000, the 2008 direct costs are a result of CFR's products.

**c. Operating Expenses:**

The following table shows the percentage change for each area of operating expense for the years ended August 31, 2008 and August 31, 2007.

<b>Years ended August 31, 2008 and 2007</b>			
<b>Operating Expenses</b>	<b>2008</b>	<b>2007</b>	<b>% Change</b>
Personnel	2,047,135	479,353	327%
Rent, property and utilities	674,310	89,594	653%
Professional fees	408,131	198,118	106%
Bank charges and interest	194,508	-	
Long-term debt interest	756,055	-	
General and administrative (Schedule)	328,627	120,917	172%
Research and testing	90,521	86,573	5%
Investor relations	49,705	55,101	-10%
Marketing and promotion	126,229	53,306	137%
Amortization	318,571	13,041	2343%
	<b>4,993,793</b>	<b>1,096,003</b>	<b>356%</b>

Operating expense in the year has increased significantly over the past year. This is due to control of CFR operations. The following table outlines the expenses for each of the five most recent quarters:

<b>Quarterly Operating Expenses:</b>	<b>4th Quarter - Three Months Ended August 31, 2008</b>	<b>3<sup>rd</sup> Quarter - Three Months Ended May 31, 2008</b>	<b>2<sup>nd</sup> Quarter- Three Months Ended Feb. 28, 2008</b>	<b>1<sup>st</sup> Quarter - Three Months Ended Nov. 30 2007</b>	<b>4<sup>th</sup> Quarter - Three Months Ended Aug. 31, 2007</b>
Personnel	\$ 488,228	\$ 456,647	\$ 541,259	\$ 565,971	\$85,618
Rent, property and utilities	195,727	\$ 155,981	167,086	154,209	9,697
Professional fees	104,723	\$ 26,774	101,657	174,978	62,333
Bank charges and interest	44,829	\$ 26,940	57,145	65,522	-
Long-term debt interest	176,572	\$ 198,861	197,013	183,609	-
Applied overhead	(24,362)	\$ (124,157)	(186,597)	(119,791)	-
General and administrative (Schedule)	111,551	\$ 69,339	89,808	74,730	23,893
Research and testing	28,239	\$ 14,174	6,203	26,413	12,647
Investor relations	9,888	\$ 5,756	22,501	15,179	13,043
Marketing and promotion	14,604	\$ 10,785	69,315	31,525	3,837
Accreted interest	6,573	\$ 5,513	5,453	6,140	6,140
Amortization	133,923	\$ 63,826	60,814	60,008	3,261
	<b>\$ 1,290,494</b>	<b>\$ 910,438</b>	<b>\$ 1,131,655</b>	<b>\$ 1,238,493</b>	<b>\$ 220,469</b>

Personnel expenses for the current year are for approximately 21-25 full-time employees. The fourth quarter of fiscal 2007 was lower than the current year as it occurred prior to the consolidation of CFR and Diversified.

The majority of research and testing expenditures over the past five quarters are associated with lab work and field trials on DVS 6000 and the Corporation's second H<sub>2</sub>S scavenger under development. On an annual basis, research and testing for fiscal 2008 \$90,521 was up slightly from 2007 (\$85,573).

Marketing and promotion expense has fluctuated significantly from quarter to quarter over the past five quarters. The first quarter of fiscal 2008 has seen a sizeable increase due to the significant sales in CFR. Marketing and promotional activities slowed down significantly during the spring. Marketing and promotion expense in the fourth quarter was up slightly from the quarter prior due to preparations for the fall and winter season.

Investor relations expense consists of communications and news dissemination costs, retainer or consulting fees to investor relations firms, and non-cash stock-based compensation expense. The current quarterly expense (\$9,888) is up over the previous quarter but down from the previous 3 quarters.

The above personnel and investor relations costs include amortization of non-cash, stock-based compensation for the past five quarterly periods as follows:

#### Non-Cash, Stock-Based Compensation Expense:

##### Non-Cash, Stock-Based Compensation Expense

Quarter	Quarter End Date	Investor Relations Stock-based Compensation	Personnel Stock-based Compensation	Total Stock-based Compensation Expense
Q4-2008	August 31, 2008	-	22,799	22,799
Q3-2008	May 31, 2008	-	25,123	25,123
Q2-2008	February 29, 2008	1,208	18,655	19,863
Q1-2008	November 30, 2007	1,208	7,158	8,366
Q4-2007	August 31, 2007	3,619	13,337	16,956

A further breakdown of the Corporation's general and administrative expenses for the current and comparative period is found below. During the current period, general and administrative costs have increased relative to the first three months of the prior fiscal year. This increase is attributable to higher professional costs, long-term interest and rent/property costs for the period.

##### Schedule of General and Administrative Costs for the year ended August 31, 2008 and 2007

	2008	2007
Office and miscellaneous	\$ 186,963	\$ 22,105
Telephone and internet	62,751	20,985
Insurance	88,116	21,944
Accreted Interest	23,849	21,576
Regulatory	7,838	34,307
Other Income	(40,890)	-
<b>Total general and administrative expense</b>	<b>\$ 328,627</b>	<b>\$ 120,917</b>

Overall, there was a significant increase in general and administrative costs in the year (\$328,627) versus 2007 (\$120,917). This can be attributed to the considerably larger consolidated operations with CFR.

#### **d. Net Income and Earnings per Share:**

The annual net loss and loss per share have both dropped significantly from the prior year. The current year's net loss of \$492,048 is a 47% decrease from that of the prior year net loss of (\$928,051). This is a result of the CFR acquisition. Loss per share decreased from \$0.0646 in 2007 to \$0.0171 in 2008. There was also an increase in the basic and fully diluted weighted average # of shares outstanding, which aides in the reduction of the net loss per share.

#### **e. Assets:**

At August 31, 2008, total assets have increased to 14,564,181 from \$1,217,650 at August 31, 2007.

- **Cash** decreased to \$13,878 from \$898,240 at year end, a drop of \$884,362 (646%)  
The decrease in cash is the result of several issues; an increase in inventory and fixed assets, the purchase of 10% of CFR from 321 Cathedral Ltd and the intent to keep the revolving loan balance as low as possible.
- **Receivables** have increased from \$110,442 to \$2,127,363 due to increased sales in CFR. Average customer days to pay are approximately 59 to 62.
- **Inventory** has increased from zero at year-end to \$3,065,354 again due to the consolidation with CFR.
- **Pre-paid expenses** increased to \$57,182 from \$11,616 at the prior year end. This increase is due to prepaid property taxes, liability insurance and a deposit on equipment purchased.
- **Capital assets** increased to \$6,090,905 from \$39,852 at year-end. This increase is due to the land, property, plant and equipment owned by CFR at the tank farm locations in Alberta. (see Property, Equipment and leasehold improvements in note 4 of the August 31, 2008 financial statements).

#### **f. Liabilities:**

The bank indebtedness of \$1,716,932 at August 31, 2008 is a credit facility from The Bank of Montreal supported by Accounts Receivable and Inventory through an Assets Based Lending agreement. At August 31, 2008 the accounts payable and accrued liabilities have increased to \$1,512,994 from \$91,854 at the end of fiscal 2007. These accounts payable and accrued liabilities have been incurred during the normal course of operations. The total current liabilities increased to \$3,624,024 from \$449,365 at August 31, 2007. The long term debt of \$7,730,774 is due to the property plant and equipment of CFR. (see Long-term Debt in note 6 of the August 31, 2008 financial statements)

#### **g. Industry and Economic Factors:**

The economic and industry factors have changed since the last annual Management Discussion and Analysis (MD&A) was filed for the 2007 fiscal year end. The oil and gas industry has experienced a slight slowdown in drilling and exploration activity in Alberta. At this point the slowdown in drilling has not resulted in reduced sales for the Corporation. The Canadian currency, which was up for approximately 9-10 months of the year weakened through August 2008 and

ended the year at approximately 1.05 Canadian. The strong dollar through most of the year has resulted in a decrease in costs of raw products purchased from the United States.

### 3. SELECTED ANNUAL INFORMATION

This section is not required for the purposes of the interim management discussion and analysis. Please refer to the annual management discussion and analysis dated August 31, 2007 for the selected annual information.

The following table sets forth certain financial information for the years ended August 31, 2008, 2007, and 2006.

(all figures are in Canadian dollars)	Year Ended August 31 2008 (12 months)	Year Ended August 31 2007 (12 months)	Year Ended August 31 2006 (12 months)
Revenue	\$ 20,632,994	\$ 242,788	\$ 378,210
Loss from operations	\$ 315,048	\$ 977,063	\$ 1,204,555
Net Loss	\$ 492,048	\$ 928,051	\$ 1,202,066
-Per common share-Basis and Diluted	\$ 0.02	\$ 0.06	\$ 0.10
Total Assets	\$ 14,564,181	\$ 1,217,650	\$ 1,074,711
Total Long Term Financial Liabilities	\$ 8,174,869	\$ 21,948	\$ 56,684
Dividends Declared	\$ -	\$ -	\$ -
Weighted Average Shares Outstanding	29,587,743	14,372,594	12,469,861
Shares Outstanding at Year End	33,712,013	17,049,900	14,015,066

This financial data is prepared in accordance with Canadian GAAP

Over the past year the company has moved from being a development stage venture company without significant revenues to be a chemical manufacturer and distributor. The recent acquisition of 50% of CFR Chemicals has significantly changed the financial picture of the Corporation. During the course of the above three year period, there has been a tremendous amount of change and growth within the Corporation, both from a standpoint of staffing and expenditures as well as from the growth in the Corporation's technologies. DVS 6000 has gone from concept to patent pending, early stage sales and now in house large volume production. (Discussion on the changes in revenue, net loss, and assets has been presented previously in this report.)

#### 4. SUMMARY OF QUARTERLY RESULTS

##### SUMMARY OF QUARTERLY RESULTS

	4th 2008 31-Aug-2008	3rd 2008 31-May-2008	2nd 2008 29-Feb-2008	1st 2008 30-Nov-2007
(all figures are in Canadian dollars)				
Revenue	\$ 2,779,434	\$ 4,320,087	\$ 8,607,958	\$ 4,925,515
Profit (Loss) from operations	\$ (615,021)	\$ 11,690	\$ 442,612	\$ (154,329)
Net Income (Loss)	\$ (855,824)	\$ 48,934	\$ 449,999	\$ (135,157)
-Per common share-Basis and Diluted	\$ (0.029)	\$ 0.002	\$ 0.015	\$ 0.005
Weighted Average Shares Outstanding	29,587,743	29,519,816	29,519,816	29,519,816
	4th 2007 31-Aug-2007	3rd 2007 31-May-2007	2nd 2007 28-Feb-2007	1st 2007 30-Nov-2006
Revenue	\$ 25,509	\$ 34,498	\$ 95,761	\$ 87,020
Profit (Loss) from operations	\$ (197,158)	\$ (300,724)	\$ (268,140)	\$ (211,041)
Net Income (Loss)	\$ (147,292)	\$ (310,075)	\$ (264,371)	\$ (206,313)
-Per common share-Basis and Diluted	\$ (0.010)	\$ (0.022)	\$ (0.019)	\$ (0.015)
Weighted Average Shares Outstanding	14,372,594	1,415,066	14,015,066	14,015,066

#### 4<sup>th</sup> Quarter of 2008, ended August 31, 2008

Revenue for the 4<sup>th</sup> quarter of 2008 dropped dramatically, falling 36% from the prior quarter. This decline in revenue is attributable to the cyclical nature of the oil and gas industry. The loss from operations and net loss are due to several reasons: namely lower gross margins, increase in year-end amortization expense for fixed assets, income tax expense and minority interest adjustment.

General and administrative expenses are also higher than in previous quarters, professional fees are up at year end due to audited year-end inventory counts and one time banking credit line changes.

#### 3<sup>rd</sup> Quarter of 2008, ended May 31, 2008

Revenues for the 3<sup>rd</sup> quarter declined from the record high of the second quarter, due to the seasonal trend of the O&G industry going into spring breakup, April and May. The net income for the 3<sup>rd</sup> quarter has added to the year-to-date net income. Gross Margin for the quarter, 21.2%, was higher than the year-to-date, 19.95%, bringing up the overall average. More annual maintenance activities occurred in the quarter with the slow down of the industry. The 4<sup>th</sup> tank farm was commissioned in March and incurred one-time expenses.

#### 2<sup>ND</sup> Quarter of 2008, ended February 29, 2008

Revenues for the 2<sup>nd</sup> quarter rose again over the first quarter to a new record. The net income for the second quarter has produced a year-to-date net income from the year-to-date loss last quarter. The tank farm expansion at Kuusamo added capacity and came into operations in late October 2007. Another tank expansion further increased capacity in January 2008.

#### **1<sup>st</sup> Quarter of 2008, ended November 30, 2007**

Revenues for the 1<sup>st</sup> quarter of 2008 rose considerably versus those of the 4<sup>th</sup> quarter of fiscal 2007 and were above the quarterly average of \$60,697 for the four most recent quarters as at that date. The loss from operations and net loss were the lowest in the prior two years due to higher revenue which contributed more gross margin than previously. The impact of non-cash stock based compensation expense remained constant.

#### **4<sup>th</sup> Quarter of 2007, ended August 31, 2007**

Revenue for the 4<sup>th</sup> quarter of 2007 dropped dramatically, falling 26% from the prior quarter. This decline in revenue is attributable to the acquisition of CFR and the outsourcing of sales, distribution, blending and marketing to CFR effective May 1, 2007. The loss from operations and net loss have both decreased significantly versus prior quarters, mainly due to reductions in personnel expense and marketing and promotional expense. General and administrative expenses were also lower, however, they were still high in comparison to quarterly averages due to the acquisition of CFR and a higher than normal level of professional fee expenses. The net loss for the quarter is the lowest net loss over the past two years. This ranking is somewhat artificial given the recording of a recovery of aged payables totaling \$53,714 which had a significant impact, lowering the loss for the quarter.

#### **3<sup>rd</sup> Quarter of 2007, ended May 31, 2007**

Revenue for the 3<sup>rd</sup> quarter of 2007 dropped dramatically, falling by 64% from the prior quarter - which was the highest quarterly revenue since the 1<sup>st</sup> quarter of fiscal 2006. The loss from operations and the net loss both increased versus the three prior quarters mainly due to larger than normal professional expenses associated with the acquisition of CFR Chemicals Inc. Still, net loss, on average is in line with the average for the eight most recent quarterly periods (\$298,676). It is anticipated that the net loss will improve going forward as the acquisition is closed.

#### **2<sup>nd</sup> Quarter of 2007, ended February 28, 2007**

Revenues for the 2<sup>nd</sup> quarter of 2007 rose 10% over the prior quarter, increasing 14% over the average quarterly revenue for the four most recent quarters (\$84,020), and achieving the highest quarterly revenues since the 1<sup>st</sup> quarter of fiscal 2006. The operating loss and net loss rose over the first quarter of fiscal 2007, but were below the two year average operating and net loss (\$294,968 and \$296,152 respectively). The rise in operating costs for the current quarter is attributable to professional fees for accounting and legal, due to audit and efforts on acquisitions.

#### **1<sup>st</sup> Quarter of 2007, ended November 30, 2006**

Revenues for the 1<sup>st</sup> quarter of 2007 rose versus those of the 4<sup>th</sup> quarter of fiscal 2006 and were above the quarterly average of \$74,187 for the four most recent quarters as at that date. The loss from operations and net loss were the lowest in the prior two years due to lower personnel costs, lower marketing and promotional expenses, and lower investor relations expense. The impact of non-cash stock based compensation expense also decreased significantly.

#### **4<sup>th</sup> Quarter of 2006, ended August 31, 2006**

Revenues for the 4<sup>th</sup> quarter of 2006 declined significantly versus the 3<sup>rd</sup> quarter and were also lower than revenues for the same quarter in the prior fiscal year. Loss from operations and net loss were also down considerably from prior quarters. This is due mainly to the combination of employee turnover, lower professional costs, lower marketing and promotional costs, lower general and administrative expense and lower stock based compensation expense.

## **5. LIQUIDITY & SOLVENCY**

As at August 31, 2008, the Corporation had \$15,099 in cash and cash equivalents (based on the Bank of Canada US\$ noon exchange rate). As little cash as possible is kept in the bank accounts to reduce the amount of the credit line and the resulting amount of interest expense.

The average monthly net loss for the year has been \$41,004 (this figure includes non-cash items such as depreciation of capital assets, and non-cash, stock-based compensation expense of approximately \$32,977 per month; as well, the net loss figures also include any extraordinary items). The average monthly net loss over the past two year period is \$59,171 (however this figure includes non-cash items such as depreciation of capital assets, and non-cash, stock-based compensation expense of approximately \$19,162 per month; as well, net loss figures also include any extraordinary items). While the acquisition of 50% of CFR did reduce the cash in the Corporations reserve, nearly all of the overhead of the Corporation has been transferred to CFR Chemicals Inc. or has been eliminated due to duplication.

The Corporation is able to generate significant revenues from product sales, the solvency of the Corporation is directly related to CFR's credit line with the Bank of Montreal. As of August 31, 2008 the \$8,000,000 credit line had \$1,716,932 funds advanced. Availability to the credit line is created by the factoring of Accounts Receivable and Inventory.

## **6. CAPITAL RESOURCES**

Currently the Corporation has committed for an additional \$125,000 in capital expenditures. The Corporation, closed a convertible debenture financing in 2007, will be responsible for the payment of 7% interest per annum on principal of \$700,000 in the form of cash or through the issuance of common shares. In 2008 one debenture holder has converted their principal and interest into common shares during the year. In the near term the Corporation will finance through sales revenues and short term debt. It is anticipated that the Corporation will finance fixed assets through long-term debt and may consider equity financing for other long term plans, this to be approved by the Board of Directors.

## **7. OFF BALANCE SHEET ARRANGEMENTS**

The Corporation has several off balance sheet arrangements. This includes several vehicle leases for the Sales department and office equipment leases (photocopier, laptop, computers, server). This results in an approximate \$6,800/month off balance sheet lease commitment.

## **8. TRANSACTIONS WITH RELATED PARTIES**

Transactions with related parties for the period ended August 31, 2008 and 2007 are stated below. These amounts include wages for four different officers, one of whom is also a director.

Related party transactions

For the years ended August 31, 2008 and August 31, 2007	<u>2008</u>	<u>2007</u>
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Paid to an officer or director for:

Wages and benefits for one

officer/director and three directors	\$ 384,500	\$ 281,200
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## 9. Internal Control Over Financial Reporting

The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) are responsible for design of internal control over financial reporting or causing it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principals. The consolidation with CFR Chemicals Inc. has allowed the Corporation more depth and experience in the management of all accounting functions. Effective disclosure controls and procedures are achieved, despite the CFR material weakness, because of the CFO's direct involvement in the disclosure controls and procedures process.

## 10. OUTSTANDING SECURITY DATA

### Description of Share Capital

#### Authorized Capital:

- Unlimited common shares, without par value

#### Issued and Outstanding:

	Number	Amount
▪ Common shares	29,587,743	\$4,269,177

For further detail see Note 5(b) of the annual financial statements for years ended August 31, 2008 and 2007.

### Summary of options, warrants, and convertible securities outstanding at the end of the reporting period:

#### Options Outstanding as at August 31, 2008:

Date of Grant	Optionee Office	Expiry Date	Number of Options	Exercise Price/Share
26-Feb-2008	Directors & Officers	26-Feb-2013	100,000	0.40
4-Dec-2007	Consultant	4-Dec-2012	200,000	0.40
10-Oct-2007	Directors & Officers	10-Oct-2012	400,000	0.40
10-Oct-2007	Consultant	10-Oct-2012	700,000	0.40
21-Mar-2007	Directors & Officers	12-Mar-2012	250,000	0.30
21-Apr-2006	Consultant	21-Apr-2011	50,000	0.40
24-Mar-2006	Consultant	14-Mar-2011	25,000	0.40
2-Mar-2006	Directors & Officers	2-Mar-2011	240,000	0.40
17-Feb-2005	Directors & Officers	17-Feb-2010	190,000	0.40
1-Dec-2004	Consultant	1-Dec-2009	100,000	0.40
3-Aug-2004	Directors & Officers	2-Aug-2009	100,000	0.40
22-Mar-2004	Directors & Officers	22-Mar-2009	50,000	0.40
Total options outstanding & weighted average exercise price			2,405,000	0.39

No options have been amended during the year ended August 31, 2008. There were 1,400,000 options granted at \$0.40, 365,000 options expired at \$0.40 and 280,000 options at \$0.40 were cancelled.

#### Share Purchase Warrants Outstanding as at August 31, 2008:

Date of Grant	Expiry Date	Number of Warrants	Exercise Price/Share
19-Jul-07	19-Jul-09	1,504,917	0.45
Total share purchase warrants outstanding & weighted average price:		1,504,917	\$ 0.45

No warrants have been issued or expired during the year ended August 31, 2008. Warrants that were set to expire on July 19, 2008 were extended to July 19, 2009 with approval by the exchange.

#### Convertible Debentures Outstanding as at May 31, 2008:

Date of Grant	Due Date	Value of Debentures	Number of Common Shares on Conversion	Exercise Price/Share
9-Jun-06	9-Jun -09	\$ 700,000	2,000,000	\$ 0.35
19-Oct-07	Debenture converted	150,000	428,571	0.35
30-Nov-07	Debenture outstanding	550,000	1,571,429	0.35

## 11. FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The financial instruments of the Corporation consist of Canadian and United States dollars, a convertible debenture, accounts receivable, accounts payable and accrued liabilities, a corporate credit card, a credit line consisting of a Canadian and American dollar short-term loans and long-term debt financing. The Corporation does not currently make use of any other financial instruments.

### **Convertible Debenture**

In the fourth quarter of fiscal 2006, the Corporation issued \$700,000 in convertible debentures to a small group of four placees, one of which is a company controlled by an insider and director of the Corporation. The debentures are convertible into common shares at \$0.35 of principal outstanding. In addition, the Corporation has issued 490,000 share purchase warrants to purchase 490,000 common shares at an exercise price of \$0.40 per common share for up to two years from the date of closing. The debenture will yield 7% interest payable annually, but which is also deferrable until the end of the full three year term of the debenture, at which time all principal and interest will become payable either in cash or in common shares of the Corporation.

On October 19, 2007 one debenture holder exercised their conversion privilege, converting their principal of \$150,000 and accumulated interest of \$14,471 into common shares at a conversion price of \$0.35 per common share, resulting in the issuance of 469,916 common shares from treasury. In addition, the conversion reduced the debenture liability by the accumulated interest, and resulted in changes to share capital and other paid in capital.

### **Accounts Receivable**

To date the Corporation has dealt only with North American corporations in terms of sales and thus has not been exposed to the risk of dealing with overseas entities. In addition, the Corporation deals with a small number of clients and receivables are relatively small at this point – thus credit risk from accounts receivable is quite limited. The Corporation is in very regular contact with clients regarding any outstanding receivables that go beyond both 30 and 60 days past due. This has proven to be very effective in ensuring that all accounts receivable are collected on time. Management will look at putting further internal control measures in place to mitigate this risk as sales revenue increases if necessary. As the Corporation or its affiliate, CFR Chemicals Inc. begin to generate sales internationally, it is anticipated that either an irrevocable letter of credit or export accounts receivable insurance will be secured prior to a sale being concluded.

### **Foreign Currency Risk**

The Corporation is exposed to currency risks as a result of sales and purchases in U.S. currency. Sales to the United States are less than US\$20,000 for the period. Purchases of inventory in U.S. currency have been approximately \$2,870,000 for the period. Payments in U.S. currency during the period were \$3,660,000. Due to the large value of transactions to date, the Corporation is exposed to significant foreign currency risk. Management for the Corporation has closely followed \$US/\$CDN exchange rates on a daily basis. This has allowed the purchase of U.S. currency at optimum rates to mitigate currency exchange loss due to the conversion when purchasing inventory and valuing it. For the quarter the Corporation recognized a currency gain of \$37,244. For the three quarters the Corporation recognized a currency gain of \$67,073 on U.S. dollar purchases of \$11,724,000 and U.S. dollar payments of \$11,775,000.

### **Risk Factors**

**Need For Additional Financing** – Diversified may require additional financing in order to support operations or make further investments in its various technologies. There can be no assurance that additional financing will be available to the Corporation on acceptable terms, or at all. Such financing, if available, might have the effect of diluting the holdings of existing shareholders.

**Volatile Commodity Markets** – As the majority of Diversified’s revenues are generated through the chemical sales of CFR Chemicals Inc. there are certain risks due to volatile commodity prices. The corporation has been building stronger relationships with key suppliers and has developed a strategy to minimize risks associated with price fluctuations. The manufacturing costs and thus the marketability of Diversified’s DVS 6000 could be affected directly or indirectly by significant changes in raw chemical prices. If energy prices as a whole were to decrease, there is risk that the overall business would suffer due to decreased activity in E&P markets.

**Government Regulations / Policy** – The Corporation may be subject to and adversely affected from time to time by changes in regulation and policy in the countries it is or plans to be operating in and such factors may create delays in project procurement and implementation that may result in the need for additional funding.

**International Business** – The Corporation undertakes business internationally. Securing of such business introduces currency risks, credit risks, political risks and other risks inherent to conducting business internationally. There can be no assurance that steps taken by management to address these risks will eliminate all adverse affects and, accordingly the Corporation may suffer losses.

**Management of Growth and Key Personnel** – Diversified’s anticipated growth and expansion into new applications for DVS 6000 (as well as other technologies) will require additional management expertise and will place increased demands on Diversified’s resources and management with respect to recruiting, training, budgeting, scheduling and technical skills. These demands will require the addition of new management and technical personnel and the development of additional expertise by existing personnel. A shortage of, or failure to retain, such personnel or develop or acquire the expertise could adversely affect prospects for Diversified’s success.

**Patents** – Diversified’s success with its scavenger business will depend, in part, on its ability to obtain patents, maintain trade secret protection and operate without infringing on the proprietary rights of third parties or having third parties circumvent the Corporation’s rights. Diversified has filed, and is actively pursuing, applications for patents in Canada, the United States and other countries. Furthermore, there can be no assurance that others will not independently develop similar products, which duplicate any of Diversified’s technology or products or, if patents are issued to Diversified, design around those patented products developed by Diversified.

**Conflicts of Interest** - Directors and officers of the Issuer may serve as directors of, or have shareholdings in, other reporting companies. To the extent that such other companies may participate in ventures in which the Issuer may participate, the directors or officers of the Issuer may have a conflict of interest in negotiating and concluding terms respecting the extent of such participation. The laws of Canada, applicable to the Issuer, provide that the directors of the Issuer must act honestly, in good faith and in the best interests of the Issuer in resolving any conflicts that may arise, and all directors of the Issuer are aware of these fiduciary responsibilities. In determining whether or not the Issuer will participate in a particular venture, the directors will primarily consider the degree of risk to which the Issuer may be exposed, its financial position at that time and, depending on the magnitude of the venture and the absence of any disinterested directors, whether or not to subject any

ventures in question to the shareholders of the Issuer for their approval. There are currently no such conflicts of interest as described above.

**Reliance on Third Parties and Future Collaboration** - Diversified has, and will continue, as it moves forward, to enter into, various arrangements with collaborators, licensors, licensees and others for the research, development, testing, manufacturing and marketing of its products and services. There can be no assurance that Diversified will be able to establish such collaborations on favorable terms, if at all, or that its current or future collaborative arrangements will be successful.

**Product Liability and Uninsured Risks** – The sale of products and services may expose Diversified to potential liability resulting from such use. Although liability insurance is currently maintained, the obligation to pay a claim in excess of insurance could have a material adverse effect on the business, financial condition and future prospects of Diversified.

**Environmental Matters** – As the Corporation supplies oilfield products and services there is the certainty that it will be subject to federal, provincial and local laws and regulations regarding the environment. Although management believes its safety procedures are appropriate, the risk of offence or liability cannot be completely eliminated. Moreover, there can be no assurance that Diversified will not be required to incur significant costs to comply with laws and regulations in the future.

## 12. SUBSEQUENT EVENTS

There were no subsequent events.