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## FINANCIAL STATEMENTS

For the Three Months Ending  
May 31, 2009

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### NOTICE OF AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

*The following interim financial statements for Diversified Industries Ltd. have been prepared by and are the responsibility of the Corporation's management.*

*The independent auditor for the Corporation has not performed a review of these interim financial statements, nor has any independent auditor been requested or engaged to perform a review of these interim financial statements.*



**DIVERSIFIED INDUSTRIES LTD.**  
**CONSOLIDATED BALANCE SHEETS**

	May 31 2009 (unaudited)	August 31 2008 (audited)
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 41,170	\$ 15,099
Accounts receivable	1,938,464	2,127,363
Inventory (note 3)	2,606,856	3,065,354
Investments	-	-
Prepaid expenses	207,632	57,183
	\$ 4,794,122	\$ 5,264,998
GOODWILL	3,208,278	3,208,278
PROPERTY, PLANT AND EQUIPMENT (note 4)	6,403,476	6,090,905
Future income taxes recoverable	-	-
	\$ 14,405,876	\$ 14,564,181
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Bank indebtedness (Note 5)	\$ 1,685,451	\$ 1,716,932
Accounts payable and accrued liabilities	1,433,902	1,512,994
Short term loan	-	-
Interest payable on debenture - current portion(note 5(c))	158,702	114,988
Income Taxes Payable	-	26,177
Current portion of long-term debt (Note 6)	63,233	252,933
	\$ 3,341,288	\$ 3,624,024
<b>LONG TERM LIABILITIES</b>		
Long-term bank debt, non-current portion	8,854,878	7,730,774
Future Income Taxes	109,577	125,000
Due to shareholders	-	-
Interest payable on debenture(note 5(c))	-	23,849
Non-Controlling Interest	(24,974)	295,246
	\$ 8,939,481	\$ 8,174,869
	\$ 12,280,768	\$ 11,798,893
<b>SHAREHOLDERS' EQUITY</b>		
SHARE CAPITAL (Note 7(b))	4,269,177	4,269,177
CONTRIBUTED SURPLUS (Note 8)	740,684	680,612
OTHER PAID IN CAPITAL (Note 7(c))	437,664	437,664
DEFICIT	(3,322,418)	(2,622,165)
	2,125,107	2,765,288
	\$ 14,405,876	\$ 14,564,181

“Darren J. Lamothe”

Director

“Reg M. Allen”

Director

# DIVERSIFIED INDUSTRIES LTD.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT FOR THE THREE MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008

	Three Months Ended		Nine Months Ended	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
REVENUE	\$ 2,973,152	\$ 4,320,087	\$ 13,452,720	\$ 17,849,711
DIRECT COSTS	2,401,043	3,279,314	10,683,481	13,857,262
	572,109	1,040,773	2,769,239	3,992,449
EXPENSES				
Personnel	556,111	456,647	1,591,971	1,558,907
Rent, property and utilities	183,024	155,981	501,449	507,919
Professional fees	54,287	26,774	197,930	303,408
Bank charges and interest	45,139	26,940	163,554	149,679
Long-term debt interest	202,986	198,861	590,822	579,483
General and administrative (Schedule)	63,186	69,339	183,811	217,077
Research and testing	19,532	14,174	77,350	32,947
Investor relations	1,500	5,756	12,480	39,817
Marketing and promotion	15,598	10,785	102,163	111,625
Amortization	117,655	63,826	346,285	184,648
	1,259,017	1,029,083	3,767,816	3,685,509
LOSS BEFORE THE FOLLOWING	(686,908)	11,690	(998,577)	306,940
Sale of Assets - (Gain)/Loss	-	-	-	3,270
Foreign exchange - (Gain)/Loss	(95,437)	(37,244)	21,895	(67,073)
Recovered forgiveness of loan	-	-	-	-
Other	-	-	-	-
Non-Controlling Interest	(243,367)	-	(320,220)	-
Income Tax Expense	-	-	-	-
LOSS FOR THE PERIOD	(348,105)	48,934	(700,253)	370,744
DEFICIT, beginning of period	(2,974,313)	(1,808,308)	(2,622,165)	(2,130,117)
DEFICIT, end of period	\$ (3,322,418)	\$ (1,759,373)	\$ (3,322,418)	\$ (1,759,373)
LOSS PER SHARE:				
Basic and fully diluted	(0.0118)	0.0017	(0.0237)	0.0126
NUMBER OF SHARES OUTSTANDING:				
Basic and fully diluted	29,587,743	29,519,816	29,587,743	29,519,816

# DIVERSIFIED INDUSTRIES LTD.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS AND NINE MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008

CASH PROVIDED BY (USED IN)	Three Months Ended		Nine Months Ended	
	2009	2008	2009	2008
<b>OPERATING ACTIVITIES:</b>				
Income (Loss) for the period	\$ (348,105)	\$ 48,934	\$ (700,253)	\$ 370,744
Items not involving Cash:				
Stock-based compensation	18,340	25,123	60,072	53,352
Accreted interest	(37,020)	5,513	(23,849)	17,276
Minority Interest	(243,367)	-	(320,220)	-
Amortization	117,655	63,826	346,285	184,648
Changes in non-cash operating working capital:				
Accounts receivable	2,134,740	3,788,336	188,898	(1,212,260)
Prepaid expenses	(5,755)	8,112	(150,449)	72,634
Inventory	(127,977)	4,711	458,498	(805,820)
Accounts payable and accrued liabilities	84,774	(1,253,603)	(77,096)	(623,304)
	1,593,287	2,690,953	(218,113)	(1,942,732)
<b>INVESTING ACTIVITIES:</b>				
Additions to equip. and leaseholds	(207,011)	(191,241)	(658,738)	(816,700)
Recapture of Accum. Dep from sale of assets	-	-	-	-
Investments	-	-	-	(2,818,210)
	(207,011)	(191,241)	(658,738)	(3,634,909)
<b>FINANCING ACTIVITIES</b>				
Issue of share capital	-	-	-	2,564,471
Issuance of convertible debenture	-	-	-	(150,000)
Issue costs	-	-	-	-
Short term debt	(1,454,189)	(2,495,659)	(31,482)	2,143,515
Long term debt	60,870	(63,233)	934,404	2,400,301
Shareholders loan	-	-	-	(2,590,000)
	(1,393,319)	(2,558,892)	902,922	4,368,287
Increase (Decrease) in cash and cash equivalents	(7,043)	(59,181)	26,071	(1,209,354)
Cash and cash equivalents, beginning of period	48,213	73,059	15,099	1,223,232
Cash and cash equivalents, end of period	\$ 41,170	\$ 13,878	\$ 41,170	\$ 13,878
Increase (Decrease) in cash and cash equivalents	(7,043)	(59,181)	26,071	(1,209,354)

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE NINE MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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Diversified Industries Ltd. (the "Company") is incorporated under the laws of British Columbia and its principal business activity is the development and marketing of unique products and technologies for industrial and commercial markets.

On March 8, 2007, the Company acquired a 40% ownership in CFR Chemicals Inc., and subsequently purchased an additional 10% on November 30, 2007 (see Note 9). These consolidated financial statements include the accounts of the Company and CFR Chemicals Inc. after eliminating material intercompany transactions and balances.

**1. SIGNIFICANT ACCOUNTING POLICIES**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The following is a summary of the significant accounting policies used in the preparation of the financial statements.

(a) Cash and cash equivalents

Cash and cash equivalents are defined as cash and highly liquid investments consisting of short-term instruments with remaining maturities at the date of purchase of three months or less.

(b) Inventory

Inventories are recorded at the lower of cost, on a FIFO basis, and net realizable value.

(c) Property, plant and equipment

Amortization is determined at rates which will reduce original cost to estimated residual value over the useful life of each asset. The annual rates used to compute amortization are as follows:

Buildings	25 year straight line
Leasehold improvements	5 year straight line
Computer equipment	3 year straight line
Tanks and equipment	10 year straight line
Furniture and fixtures	10 year straight line
Other machinery and equipment	10 year straight line
Vehicles	7 year straight line

One-half of the normal rates are applied in the year of acquisition

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE NINE MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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**2. SIGNIFICANT ACCOUNTING POLICIES (continued)**

(d) Revenue recognition

Revenue is recognized at the time the product is shipped, title passes and collection is reasonably assured. Revenue from services is recognized at the time the services are provided to and accepted by the customer.

(e) Earnings (loss) per share

The Company calculates earnings (loss) per share using the weighted average number of common shares outstanding during the period excluding escrowed shares, the release of which are subject to the satisfaction of performance criteria. Diluted net earnings (loss) per share are calculated by the treasury stock method. Under the treasury stock method, the weighted average number of common shares outstanding for the calculation of diluted net income (loss) per share assumes that the proceeds to be received on the exercise of dilutive stock options and warrants are applied to repurchase common shares at the average market price for the period. Stock options and warrants are dilutive when the Company has income from continuing operations and the average market price of the common shares during the period exceeds the exercise price of the options and warrants.

(f) Future income taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts for existing assets and liabilities and their respective tax bases and loss carryforwards. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable earnings in the year in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the date of substantive enactment. A valuation allowance is established and deducted from future tax assets if realization of the tax assets is not considered more likely than not.

(g) 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 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 period. The more subjective of such estimates include stock-based compensation expense and accounting for the convertible debenture. Actual results could differ from these estimates.

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE NINE MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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**2. SIGNIFICANT ACCOUNTING POLICIES (continued)**

(h) Stock-based compensation

The Company has a stock-based compensation plan. The Company accounts for all stock-based payments and awards under the fair value based method. Under the fair value based method, stock-based payments to non-employees are measured at the fair value of the consideration received, or the fair value of the equity instruments issued, or liabilities incurred, whichever is more reliably measurable. The fair value of stock-based payments to non-employees is periodically re-measured until counterparty performance is complete, and any change therein is recognized over the period and in the same manner as if the Company had paid cash instead of paying with or using equity instruments. The cost of stock-based payments to non-employees that are fully vested and non-forfeitable at the grant date is measured and recognized at that date. Under the fair value based method, compensation cost attributable to awards to employees is measured at fair value at the grant date and recognized over the vesting period. Compensation cost attributable to awards to employees that call for settlement in cash or other assets is measured at intrinsic value and recognized over the vesting period. Changes in intrinsic value between the grant date and the measurement date result in a change in the measure of compensation cost. Compensation costs are generally recognized on modification of awards if such modification results in a more valuable award. Compensation cost is generally recognized on a straight-line basis over the vesting period. The Company accounts for the fair value of the granted options in the statements of operations and deficit and it is included in the determination of income.

(i) Goodwill

In accordance with recommendations of The Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 3062, goodwill is not amortized and is subject to an annual impairment test. Goodwill impairment is evaluated between annual tests upon the occurrence of certain events or circumstances. Goodwill impairment is assessed based on a comparison to the fair value of a reporting unit's net assets including goodwill. When the carrying amount of the reporting unit exceeds its fair value, the fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of impairment, if any.

**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

**3. INVENTORY**

	May 31, 2009	February 28 2009	November 30, 2008	August 31, 2008	May 31, 2008
Finished goods	\$ 811,168	\$ 611,191	\$ 765,910	\$ 528,636	\$ 83,709
Raw materials	1,795,688	1,867,688	2,448,598	2,536,717	2,282,706
	<b>\$ 2,606,856</b>	<b>\$ 2,478,879</b>	<b>\$ 3,214,508</b>	<b>\$ 3,065,354</b>	<b>\$ 2,366,415</b>

**4. PROPERTY, PLANT AND EQUIPMENT**

May 31, 2009	Cost	Accumulated amortization	Netbook Value
Land	1,200,000	-	1,200,000
Buildings	1,400,000	108,092	1,291,908
Computer equipment	170,985	85,275	85,710
Tanks and tank farm	3,829,643	663,294	3,166,350
Furniture and fixtures	59,575	24,981	34,594
Machinery & equipment	632,551	219,739	412,812
Vehicles	207,046	49,308	157,738
Leasehold improvements	\$ 15,280	\$ 1,549	\$ 13,731
Construction in Progress	40,632	-	40,632
	<b>\$ 7,555,713</b>	<b>\$ 1,152,237</b>	<b>\$ 6,403,476</b>

November 30, 2008	Cost	Accumulated amortization	Netbook Value
Land	1,200,000	-	1,200,000
Buildings	1,400,000	84,292	1,315,708
Computer equipment	156,908	62,063	94,846
Tanks and tank farm	3,607,491	446,040	3,161,451
Furniture and fixtures	56,784	21,273	35,511
Machinery & equipment	625,350	259,138	366,212
Vehicles	54,702	46,507	8,194
Leasehold improvements	\$ 7,868	\$ 971	\$ 6,897
Construction in Progress	40,632	-	40,632
	<b>\$ 7,149,735</b>	<b>\$ 920,284</b>	<b>\$ 6,229,450</b>

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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**5. BANK INDEBTEDNESS**

The Company has established a credit facility with the Bank of Montreal which provides for bank financing to a maximum of \$10,600,000 with interest at the bank rate of prime plus 1%. The facility agreement provides for a revolving loan of up to \$8,000,000 and two non-revolving loans (see Note 6).

The credit facility is secured by a General Security Agreement and a mortgage on the Company's Alberta property and is guaranteed by Diversified and Cathedral.

**6. LONG-TERM DEBT**

a) Term bank loan, repayable in monthly instalments of \$11,044 together with interest at prime plus 1%, due September 10, 2011	\$ 1,745,024
b) Term bank loan, repayable in monthly instalments of \$10,033 together with interest at prime plus 1%, due September 10, 2011	381,267
c) Loans and advances from No. 321 Cathedral Ventures Ltd., interest at 10%, no fixed repayment conditions	6,728,587
	\$ 8,854,878
Current portion of long-term debt	63,233
	\$ 8,918,111

The term bank loans are secured under the Credit Facility referred to in Note 5. Loans and advances from No. 321 Cathedral Ventures Ltd. are secured by a general security agreement and a \$6,000,000 mortgage over the Company's land and buildings.

Term loan principal repayments to be made in the next five years are as follows:

2009	\$ 63,233
2010	252,933
2011	1,810,125
2012	-
2013	-
	\$ 2,126,291

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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**7. SHARE CAPITAL**

The share capital of the Company is as follows:

(a) Authorized:

Unlimited common shares, without par value

(b) Issued:

	<u>Number of shares</u>	<u>Amount</u>
Balance, August 31, 2006	14,015,066	\$ 862,000
Issued for cash	3,009,834	902,950
Issued for corporate finance fee	25,000	7,500
	<u>17,049,900</u>	<u>\$ 1,772,450</u>
Less issue costs	-	(88,122)
Balance, August 31, 2007	17,049,900	\$ 1,684,328
Issued on conversion of debenture and accrued interest	469,916	164,471
Issued on purchase of subsidiary	12,000,000	2,400,000
Issued on exercise of warrants	67,927	20,378
	<u>29,587,743</u>	<u>\$ 4,269,177</u>
Balance, August 31, 2008	29,587,743	\$ 4,269,177
Balance, May 31, 2009	<u>29,587,743</u>	<u>\$ 4,269,177</u>

On February 8, 2006, the Company's shareholders approved that the stated capital of the Company be reduced by \$18,919,449, being an elimination of the accumulated deficit of the Company as at August 31, 2005.

On June 26, 2008, 67,927 warrants were exercised at a rate of \$0.30 per share for a total of \$20,378.

(c) Convertible debenture

On June 9, 2006, the Company issued a \$700,000 convertible debenture. The debenture is convertible into 2,000,000 common shares at the option of the holder or the Company at a fixed conversion price of \$0.35 per common share. The debenture matures on June 9, 2009, and bears interest at 7% per annum payable annually. The purchaser of the debenture also received 490,000 warrants for no additional consideration. The warrants entitled the holder to purchase 490,000 common shares at a price of \$0.40 per share and they expired on June 9, 2008.

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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**7. SHARE CAPITAL (continued)**

As the Company is able to settle the principal portion of the debenture by issuing a fixed number of common shares, the debenture is accounted for as a compound financial instrument with both a liability and an equity component. On issuance of the debenture, the liability component was calculated as the present value of the future interest payments discounted at the rate of 20% per annum, the Company's cost of capital. The remainder of the proceeds reflects the equity component (the conversion feature and the warrants) and was accounted for as other paid in capital, a component of shareholders' equity.

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.

The Company has accounted for the liability and equity components as follows:

	<u>Liability Component</u>	<u>Equity Component</u>
Issuance of convertible debentures	\$ 103,189	\$ 596,811
Less issue costs	-	(9,147)
	<hr/>	<hr/>
	\$ 103,189	\$ 587,664
Accretion of liability	4,693	-
	<hr/>	<hr/>
Balance as at August 31, 2006	\$ 107,882	\$ 587,664
Accretion of liability	21,577	-
	<hr/>	<hr/>
Balance as at August 31, 2007	\$ 129,459	\$ 587,664
Less conversion to common shares	14,471	150,000
Accretion of liability	23,849	-
	<hr/>	<hr/>
Balance as at August 31, 2008	\$ 138,837	\$ 437,664
Accretion of liability	19,866	-
	<hr/>	<hr/>
Balance as at May 31, 2009	\$ 158,702	\$ 437,664
Less current portion	158,702	-
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Long-term portion as at May 31, 2009	\$ 0	\$ 437,664
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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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**7. SHARE CAPITAL (continued)**

(d) Warrants

The Company issued no warrants during the nine months ended May 31, 2009.

On April 14, 2008, the Company received regulatory approval to extend the expiry date of warrants that were issued on July 19, 2007, with an original expiry date of July 19, 2008 to a new expiry date of July 19, 2009. There were 1,504,917 warrants extended.

Warrants that total 165,302 that were part of the issuance fee and commission for the July 19, 2007, placement were not part of the warrant extension and expired on July 19, 2008.

On June 28, 2008, there were 67,927 warrants exercised at \$0.30.

Warrants outstanding:

	Number of shares	Weighted average exercise price	Weighted average remaining life (months)
Balance, August 31, 2006	5,530,078	\$ 0.52	9
Granted	1,738,146	0.43	10
Expired	(3,040,078)	0.52	
Balance, August 31, 2007	4,228,146	\$ 0.45	10
Granted	-		
Expired	(2,655,302)		
Exercised	(67,927)		
Balance, August 31, 2008	1,504,917	\$ 0.45	10
Balance, May 31, 2009	1,504,917	\$ 0.45	1.6

During the year ended August 31, 2008, a total of 2,655,302 warrants expired as follows:

- 490,000 warrants priced at \$0.40 expired on June 9, 2008
- 2,000,000 warrants priced at \$0.35 expired on June 9, 2008
- 12,500 warrants priced at \$0.45 expired on July 19, 2008
- 152,802 warrants priced at \$0.30 expired on July 19, 2008

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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**7. SHARE CAPITAL (continued)**

(e) Stock options

Options to purchase common shares of the Company may be granted by the Board of Directors to employees, directors and consultants. Generally, options expire five years from the date granted. A summary of the status of the options outstanding as of May 31, 2009, is as follows:

<u>price</u>	<u>Number of shares</u>	<u>Weighted average exercise</u>
Balance, August 31, 2006	1,740,000	\$ 0.39
Granted	250,000	0.40
Expired	(170,000)	0.40
Cancelled	(170,000)	0.40
Balance, August 31, 2007	1,650,000	\$ 0.38
Granted	1,400,000	0.40
Expired	(365,000)	0.40
Cancelled	(280,000)	0.40
Balance, August 31, 2008	2,405,000	\$ 0.39
Cancelled	375,000	0.40
Balance, February 28, 2009	2,030,000	\$ 0.40
Price change April 28, 2009		
Balance, May 31, 2009	2,030,000	\$ 0.10

During the quarter ended May 31, 2009, the Company applied for and received approval from the exchange to re-price all current options to \$0.10 .

During the quarter ended November 30, 2008, the Company cancelled 375,000 options with a weighted average fair value of \$0.398 due to employee and director turnover.

During the year ended August 31, 2008, the Company granted 1,400,000 options with a weighted average fair value of \$0.40 per option, while 280,000 options were cancelled due to employee turnover and another 365,000 expired.

During the year ended August 31, 2007, the Company granted 250,000 options with a

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED FEBRUARY 28, 2009 AND FEBRUARY 29, 2008**

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**7. SHARE CAPITAL (continued)**

(e) Stock options (continued)

weighted average fair value of approximately \$0.40 per option, while 170,000 options were cancelled due to employee and contractor turnover and another 170,000 expired

The following table summarizes information about the total number of stock options outstanding at August 31, 2008:

Exercise price	Options exercisable	
	Total number outstanding	Weighted average remaining contractual life (years)
\$ 0.10	2,030,000	3.0

The fair value of the compensation costs of stock options issued to both employees and non-employees was calculated using the Black-Scholes option pricing model resulting in an additional charge to personnel and investor relations expense with a corresponding increase in contributed surplus.

During the quarter ended May 31, 2009, \$18,340 in stock-based compensation expense was recorded related to stock option granted or amended and outstanding.

During the year ended August 31, 2008, \$76,150 (2007- \$52,133) in stock-based compensation expense was recorded.

(f) Special options

On March 8, 2007, the Company issued one million share options to No. 321 Cathedral Ventures Ltd. exercisable at \$0.30 per common share, expiring February 28, 2010, as partial consideration for the entering into an option agreement (see Note 9).

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED FEBRUARY 28, 2009 AND FEBRUARY 29, 2008**

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**8. CONTRIBUTED SURPLUS**

Balance, August 31, 2007	\$	604,462
Stock-based compensation expense		76,150
		680,612
Balance, August 31, 2008	\$	680,612
Stock-based compensation expense		22,798
		703,410
Balance, November 30, 2008	\$	703,410
Stock-based compensation expense		18,933
		722,344
Balance, February 28, 2009	\$	722,344
Stock-based compensation expense		18,340
		740,684
Balance, May 31, 2009	\$	740,684

**9. PURCHASE OF CFR CHEMICALS INC.**

On March 8, 2007, the Company acquired 40% ownership of CFR Chemicals Inc. ("CFR") by way of the issuance of 12,000,000 common shares valued at \$2,400,000 (see Note 7). Effective November 30, 2007, a further 10% of CFR was purchased for cash consideration of \$418,210.

The Company has an additional option for the purchase of 50% of CFR, exercisable on February 28, 2010, for: i) \$1,875,000; ii) accrued interest on \$1,875,000 from March 8, 2007 to February 28, 2010; iii) an amount equal to 50% of the EBITDA of CFR for the three year period commencing March 1, 2007 and ending February 28, 2010; and iv) a one million share option exercisable at \$0.30 per common share of the Company, expiring February 28, 2010.

**10. FINANCIAL INSTRUMENTS**

At May 31, 2009, the fair value of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities and bank debt approximates carrying values because of the short-term nature of these instruments. The carrying value of the interest payable on debenture approximates the fair value as the future cash flow stream has been discounted at an interest rate that reflects market conditions. CFR Chemicals has both a credit line and long-term debt financing with the Bank of Montreal. The credit line is based on an 'Asset Based Lending' model and has increased from \$5 million to an \$8 million limit that uses factored accounts receivable and inventory as the security for the funds available to be advanced. The availability of the line of credit is recalculated on a weekly basis. The long-term debt financing is for the land and buildings located at Kuusamo, Alberta.

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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In addition, CFR makes significant purchases of inventories in U.S. dollars and is exposed to foreign exchange fluctuations on net current liabilities of U.S. \$658,700 as of May 31, 2009.

**11. FUTURE INCOME TAXES**

Income tax recovery differs from the amounts computed by applying the combined federal and provincial tax rate of 32.2% (2007 – 34.1%) to pretax income from continuing operations as a result of the following:

	<u>2008</u>	<u>2007</u>
Loss for the year	\$ (315,048)	\$ (928,051)
Computed expected tax recovery	\$ (101,000)	\$ (316,000)
Tax losses not recognized	258,000	293,000
Non-deductible expenses	24,000	23,000
Application of loss carryforwards	(105,000)	-
Recognition of temporary differences	125,000	-
Other reconciling items	(24,000)	-
	<u>\$ 177,000</u>	<u>\$ -</u>

The Company has non-capital losses of approximately \$5,801,000 available to reduce future taxable income, expiring between 2009 and 2020.

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities at August 31, 2008 and 2007 are presented below:

	<u>2008</u>	<u>2007</u>
Future tax assets (liabilities):		
Non-capital loss carryforwards	\$ 1,867,922	\$ 1,814,162
Equipment and leasehold improvements	(125,000)	6,214
Valuation allowance	(1,867,922)	(1,820,376)
	<u>\$ (125,000)</u>	<u>\$ -</u>

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**12. COMMITMENTS**

The Company has entered into operating leases for certain equipment and properties for various periods to 2013. Minimum annual rentals under leases in force at August 31, 2008 are:

2009	\$ 205,404
2010	198,428
2011	120,501
2012	78,970
2013	30,429
	<hr/>
	\$ 633,732
	<hr/> <hr/>

The company has entered into vehicle purchase financing arrangements in the last quarter.

2009	\$ 9,516
2010	38,065
2011	38,065
2012	38,065
2013	38,065
2014	3,959
	<hr/>
	\$ 165,735
	<hr/> <hr/>

**13. ECONOMIC DEPENDENCE AND CREDIT RISK EXPOSURE**

During the three months ended May 31, 2009, 47% of the Company's sales were to five companies out of the over 146 customers for the quarter. The percentage of revenue for each of the five ranged from 6% to 12%.

During the nine months ended May 31, 2009, 34% of the Company's sales were to five companies out of the over 254 customers for the three quarters. The percentage of revenue for each of the five ranged from 6% to 11%.

During the year ended August 31, 2008, 47% of the Company's sales were to five companies out of the over 225 customers for the year. The percentage of revenue for each of the five ranged from 7% to 16%.

During the twelve months ended August 31, 2007, 94% of the Company's sales were to five parties. The percentage of revenue for each of the five ranged from 14% to 33%.

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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**14. CONTINGENCIES**

The Company has committed U.S. \$250,000 by way of a Standby Letter of Credit to a supplier and a further U.S. \$500,000 has been committed on behalf of the Company by an affiliate of No. 321 Cathedral Ventures Ltd.

**15. COMPARATIVE FIGURES**

Certain of the prior years figures provided for the purpose of comparison have been reclassified to conform with the classifications used in the current year.

**16 RECENT CANADIAN ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED**

a) Capital Disclosures

In December, 2006, the CICA issued Handbook Section 1535, "Capital Disclosures". This standard requires that an entity disclose information that enables users of its financial statements to evaluate an entity's objectives, policies and processes for managing capital, including disclosures of any externally imposed capital requirements and the consequences of non-compliance. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. This new standard is not expected to have a material impact to the Company's financial statements as it addresses disclosure requirements only.

b) Financial Instruments – Presentation and Disclosure

In October, 2006, the CICA issued Handbook Sections 3862 and 3863 to replace Section 3861, "Financial Instruments – Disclosure and Presentation". This standard requires an increased emphasis on disclosures about the nature and extent of risk arising from financial instruments and how an entity manages those risks. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. As this standard only addresses presentation and disclosure requirements, it is not expected to have a material impact on the Company's financial statements.

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**DIVERSIFIED INDUSTRIES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED MAY 31, 2009 AND MAY 31, 2008**

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**16 RECENT CANADIAN ACCOUNTING PRONOUNCEMENTS NOT YET ADOPTED**  
**(continued)**

c) Inventories

In June, 2007, the CICA issued Handbook Section 3031, "Inventories" to harmonize accounting for inventories under Canadian GAAP with International Financial Reporting Standards. This standard requires the measurement of inventories at the lower of cost and net realizable value and includes guidance on the determination of cost, including the allocation of overheads and other costs to inventory. This standard requires the allocation of fixed production overheads to the costs of conversion to be based on the normal capacity of the production facilities. The standard also requires the consistent use of either first-in, first-out (FIFO) or weighted average cost formula to measure the cost of other inventories and requires the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008.

The Company is evaluating the impact of this standard, which will be addressed in the August 31, 2009, financial statements.

d) International Financial Reporting Standards "IFRS"

In January, 2006, the CICA's Accounting Standards Board ("AcSB") formally adopted the strategy of replacing Canadian GAAP with IFRS for Canadian enterprises with public accountability ("PAE's"). The current conversion timetable calls for financial reporting under IFRS for accounting periods commencing on or after January 1, 2011. On February 13, 2008, the AcSB confirmed that the use of IFRS will be required in 2011 for publicly accountable profit-oriented enterprises. For these entities, IFRS will be required for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011, i.e. the August 31, 2012, year end of the Company.

**SCHEDULE**

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**DIVERSIFIED INDUSTRIES LTD.**  
**SCHEDULE OF GENERAL AND ADMINISTRATIVE COSTS**  
**FOR THE PAST FIVE QUARTERS**

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	3 <sup>rd</sup> Quarter May 31, 2009	2 <sup>nd</sup> Quarter Feb. 28, 2009	1 <sup>st</sup> Quarter Nov. 30 2008	4th Quarter Aug. 31, 2008	3 <sup>rd</sup> Quarter May 31, 2008
Office and miscellaneous	16,711	13,477	33,978	71,141	34,616
Telephone and internet	16,858	11,858	13,570	14,043	13,960
Insurance	25,918	26,364	20,956	21,194	21,024
Accreted Interest	6,695	6,549	6,622	6,573	5,513
Regulatory	1,083	13,068	684	800	750
Other Income	(4,078)	(11,897)	(24,658)	(2,200)	(6,523)
	63,186	59,419	51,152	111,551	69,339