

## BC FORM 51-901F

<b>ISSUER DETAILS</b>			DATE OF REPORT YY/MM/DD
NAME OF ISSUER		FOR QUARTER ENDED	
DIADEM RESOURCES LTD.		February 29, 2004	2004/04/23
ISSUER ADDRESS			
110 MEADOWVALE ROAD			
CITY/PROVINCE/POSTAL CODE		ISSUER FAX NO.	ISSUER TELEPHONE NO.
TORONTO, ON M1C 1S1		416-286-0975	416-284-5959
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<b>CERTIFICATE</b>			
The three schedules required to complete this Report are attached and the disclosure contained therein has been approved by the Board of Directors. A copy of this Report will be provided to any shareholder who requests it.			
DIRECTOR'S SIGNATURE	PRINT FULL NAME	DATE SIGNED YY/MM/DD	
➤ "AIME BERTRAND"	AIME BERTRAND	2004/04/23	
DIRECTOR'S SIGNATURE	PRINT FULL NAME	DATE SIGNED YY/MM/DD	
➤ "PAUL A. CARROLL"	PAUL A. CARROLL	2004/04/23	

# **SCHEDULE A**

**DIADEM RESOURCES LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**FEBRUARY 29, 2004**

**DIADEM RESOURCES LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
(Unaudited)

(Expressed in Canadian Dollars)	February 29 2004	May 31 2003
	\$	\$
<b>ASSETS</b>		
<b>Current</b>		
Cash and term deposits	464,546	3,820
Marketable securities	36	260
Prepaid expenses and sundry receivables	49,859	7,313
Security deposit	203,725	-
	718,166	11,393
<b>Loan receivable</b> (Note 3)	73,970	-
<b>Mineral interests</b> (Note 4)	8,975,753	7,281,214
<b>Investment in mining syndicate and company</b> (Note 5)	20,000	20,000
<b>Capital assets</b> (Note 6)	2,796	3,511
<b>Other assets</b>	21	21
	9,790,706	7,316,139
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	630,132	435,104
Convertible debenture (Note 8)	500,000	500,000
	1,130,132	935,104
<b>Long-term debt</b> (Note 7)	290,000	-
	1,420,132	935,104
<b>CAPITAL STOCK AND DEFICIT</b>		
<b>Capital stock</b> (Note 9)	26,782,899	24,721,494
<b>Contributed surplus</b>	23,200	23,200
<b>Series B First Preferred Shares</b> (Note 4(c))	384,248	-
<b>(Deficit)</b>	(18,819,773)	(18,363,659)
	8,370,574	6,381,035
	9,790,706	7,316,139

**DIADEM RESOURCES LTD.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT**  
(Unaudited)

(Expressed in Canadian Dollars)	Three months ended February 29		Nine months ended February 29	
	2004	2003	2004	2003
	\$	\$	\$	\$
<b>REVENUE</b>				
Gain on sale of investment	-	33,200	125,000	34,635
Interest income	1,901	(6)	2,052	52
	1,901	33,194	127,052	34,687
<b>EXPENSES</b>				
Amortization	239	331	716	996
Capital tax	-	(4,000)	-	18,000
Costs associated with debt financing	(26,078)	-	31,922	7,761
Interest	12,251	15,496	43,846	46,177
General corporate costs	183,625	52,784	401,485	99,243
Other	1,895	-	2,194	-
Foreign exchange (gain) loss	-	-	(332)	-
	171,932	64,611	479,831	172,177
<b>Net (loss) before taxes</b>	(170,031)	(31,417)	(352,779)	(137,490)
Recovery of future income taxes	361,150	-	361,150	-
<b>NET INCOME (LOSS) for the period</b>	191,119	(31,417)	8,371	(137,490)
Costs associated with issuance of capital stock	(434,485)	-	(464,485)	-
<b>(DEFICIT), beginning of period</b>	(18,576,407)	(14,530,930)	(18,363,659)	(14,424,857)
<b>(DEFICIT), end of period</b>	(18,819,773)	(14,562,347)	(18,819,773)	(14,562,347)
<b>Net income (loss) per share</b>	0.003	(0.001)	0.000	(0.002)
<b>Weighted average number of shares</b>	75,169,611	57,904,592	65,401,881	55,695,392

**DIADEM RESOURCES LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

(Expressed in Canadian Dollars)	Three months ended February 29		Nine months ended February 29	
	2004	2003	2004	2003
	\$	\$	\$	\$
<b>CASH FLOWS (USED IN) PROVIDED BY:</b>				
<b>OPERATING ACTIVITIES</b>				
Net (loss) for the period	191,119	(31,417)	8,371	(137,490)
Adjustment for items not affecting cash:				
Amortization	239	331	716	996
Gain on sale of investment	-	(33,200)	(125,000)	(34,635)
Issuance of shares to settle costs associated with debt financing	-	-	58,000	-
Issuance of shares to settle interest expense	7,456	12,288	7,456	41,188
Recovery of future income taxes	(361,150)	-	(361,150)	-
	(162,336)	(51,998)	(411,607)	(129,941)
Net changes in non-cash working capital balances:				
Prepaid expenses and sundry receivables	(42,778)	817	(42,547)	618
Marketable securities	224	-	224	-
Accounts payable and accrued liabilities	(74,108)	31,968	225,026	91,611
Cash flows provided by (used in) operating activities	(278,998)	(19,213)	(228,904)	(37,712)
<b>FINANCING ACTIVITIES</b>				
Common shares issued for cash	895,950	5,000	1,395,950	115,000
Long-term debt	-	-	290,000	-
Proceeds on disposal of marketable securities	-	33,400	-	35,115
Costs associated with issuance of capital stock	(133,334)	-	(133,334)	-
Cash flows from financing activities	762,616	38,400	1,552,616	150,115
<b>INVESTING ACTIVITIES</b>				
Loan receivable	12,305	-	(277,695)	-
Proceeds from sale of investment	100,000	-	125,000	-
Mineral interests	(186,854)	(18,054)	(710,291)	(105,519)
Cash flows (used in) investing activities	(74,549)	(18,054)	(862,986)	(105,519)
Change in cash during the period	409,069	1,133	460,726	6,884
<b>CASH, beginning of period</b>	55,477	7,579	3,820	1,828
<b>CASH, end of period</b>	464,546	8,712	464,546	8,712

**DIADEM RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
 FEBRUARY 29, 2004  
 (Unaudited)

**1. GOING CONCERN**

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and on the assumption that Diadem Resources Ltd. ("Diadem" or the "Company") will be able to realize the carrying value of its assets and discharge its liabilities in the normal course of business as a going concern.

There is uncertainty about the Company's ability to discharge its liabilities as they come due. The ability of the Company to continue as a going concern is dependent upon, among other things, being able to obtain additional financing, collection of outstanding loans, and attaining and maintaining positive operating cash flows.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

These interim unaudited consolidated financial statements include all adjustments that are, in the opinion of management, necessary for fair presentation. The results of operations for the three and nine months ended February 29, 2004 are not necessarily indicative of the results expected for the full year.

These interim consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and follow the same accounting policies and methods set forth in the Company's audited consolidated financial statements as at and for the year ending May 31, 2003 and should be read in conjunction with those audited financial statements and notes thereto.

**3. LOAN RECEIVABLE**

As at February 29, 2004, the loan receivable from Darnley Bay Resources Ltd. ("DBR") is comprised of recoverable interest and finance fees and DBR's share of joint venture costs.

**4. MINERAL INTERESTS**

	February 29, 2004	May 31, 2003
	\$	\$
<i>Acquisition costs</i>		
Franklin Diamond Project, Northwest Territories	630,968	
Leek Springs, California	3,007,211	3,007,211
Otish Mountains, Quebec	406,303	-
	<u>4,044,482</u>	<u>3,007,211</u>
<i>Deferred exploration costs</i>		
Franklin Diamond Project, Northwest Territories	46,093	
Leek Springs, California	4,300,145	4,274,003
Otish Mountains, Quebec	585,033	-
	<u>4,931,271</u>	<u>4,274,003</u>
	<u>8,975,753</u>	<u>7,281,214</u>

- (a) Franklin Diamond Project, Northwest Territories  
 Effective November 26, 2003, the Company entered into an agreement to form a joint venture ("Franklin Diamond Project") with DBR for diamond exploration in an area near Paulatuk in the Northwest Territories. The transaction results from an acquisition from Carnarvon Capital Corporation ("CCC") of that company's right to enter into the joint venture. To acquire the rights to form the joint venture, Diadem issued to CCC six million Diadem treasury shares, valued at \$600,000

**DIADEM RESOURCES LTD.**  
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Paul Carroll, President and CEO of Diadem, also is President of CCC and all of its share capital is owned by members of his immediate family. As part of the transfer to Diadem of the transaction with DBR, CCC and Mr. Carroll have agreed that during the period until December 31, 2008 neither CCC nor Mr. Carroll would acquire a controlling interest in any diamond exploration or development project in Canada (or in California) other than through Diadem or with the consent of Diadem. This agreement would end if there is a change of control of Diadem or if Mr. Carroll is dismissed as President without cause or involuntarily ceases to be a director of Diadem.

Under the joint venture, Diadem must expend \$5 million on diamond exploration north of the 68<sup>th</sup> parallel during the period to December 31, 2006. When that level of expenditure is completed, Diadem will be entitled to select up to 2.5 million acres of the project area for further exploration, and Diadem will have earned an undivided 50% participating interest in the selected lands, with DBR holding the other 50%. The Inuvialuit Development Corporation has the right to back into the Franklin Diamond Project for a 10% working interest (with dilution to be shared equally by Diadem and DBR) when a decision is made to place a diamond mine into production and a positive feasibility study is completed.

If a decision is made to carry out a feasibility study on the lands selected by Diadem, it will have the right to fund the feasibility study, and if the property is placed into commercial production Diadem's interest will increase to 75% and DBR's interest will decrease to 25%.

When Diadem has selected the area to which the 50/50 joint venture will apply, the parties will allocate at least \$2.5 million of the \$5 million to the selected lands. Diadem will be entitled to convert the balance of the \$5 million into treasury common shares of DBR at the then market price, subject to regulatory approval, or to convert that amount (in increments of at least \$1 million) into a diamond royalty equal to 1% for each full \$1 million spent and not allocated to the selected lands, with the balance to be taken in DBR shares. DBR will have the right to purchase any such royalty for \$1.5 million for each 1% of the royalty if the purchase is made within 90 days of completion of a bankable feasibility study, or thereafter for \$2.5 million if the purchase is within 90 days of the start of commercial production.

(b) Leek Springs, California

The Company currently has a 45% vested interest in and holds an option to acquire up to a 59% interest in 125 unpatented mining claims covering approximately 2,500 acres in the Leek Springs area of Eldorado County, California. This option was granted by the Silverstone Prospecting Syndicate ("SPS") which holds the remaining interest in the mining claims.

(c) Otish Mountains, Quebec

Effective August 27, 2003, the Company formed a wholly-owned subsidiary, Diadem Explorations Inc. ("DEI"), to implement agreements entered into by the Company on July 24, 2003 with several companies to acquire an aggregate of 2,064 mining claims in the Otish Mountains region of Quebec. The acquisition of the claims was effected by issuing Series B First Preference Shares of DEI having a value equal to the staking costs and work carried out on the claims by the vendors. In addition, if a diamond mine is brought into commercial production on any claim, the Company will pay a 2% gross royalty to the vendor that vended in that claim. The Company has the right to acquire the royalty for \$1.5 million, if acquired within 90 days after completion of a bankable feasibility study or for \$2.5 million, if acquired within 12 months after commencement of commercial production.

The Series B First Preference Shares are exchangeable, at any time after December 31, 2004 and up to December 31, 2006, into common shares of the Company at the option of either the Company or the vendor. The exchange price would be based upon the weighted average price of the Company's common shares during the three month period ended December 31, 2004.

**DIADEM RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**5. INVESTMENT IN MINING SYNDICATE AND COMPANY**

At February 29, 2004, Diadem owned 4.0 units (May 31, 2003-4.0 units) representing 8% (May 31, 2003-8%) of the outstanding units of the Silverstone Prospecting Syndicate.

Effective October 10, 2003, the Company sold 2,890,000 common shares of Waseco Resources Inc. ("Waseco") and \$225,000 of a \$450,000 demand note payable by Waseco to the Company. Cash consideration received \$125,000. After completion of this transaction, the Company owns 500,000 common shares of Waseco.

The Company converted an additional \$225,000 note, plus interest accrued on both notes, into (i) a 2% NSR on production derived from the Tewah alluvial gold project in Indonesia to the extent of Waseco's 60% interest therein and (ii) a 2% gross diamond royalty on production derived from the Attawapiskat diamond claims to the extent of Waseco's interest therein. Waseco may re-purchase each NSR at any time up to commencement of commercial production of a mining operation for consideration of \$500,000 or thereafter up to the first anniversary of commercial production for consideration of \$1,000,000. Should Waseco decide to sell its interest in the Attawapiskat diamond claims, or to joint venture exploration or development thereof, it shall first offer it to Diadem.

**6. CAPITAL ASSETS**

	February 29, 2004		May 31, 2003	
	Cost	Accumulated amortization	Net	Net
	\$	\$	\$	\$
Furniture and fixtures	24,992	24,151	841	989
Computer and office equipment	5,246	3,291	1,955	2,522
	<u>30,238</u>	<u>27,442</u>	<u>2,796</u>	<u>3,511</u>

**7. LONG-TERM DEBT**

The long-term debt was incurred to fund a security deposit lodged in support of assessment work to be conducted on the Franklin Diamond Project in the Northwest Territories. The Lender has a first security interest in all of the assets of Diadem including its joint venture with DBR. The loan bears simple interest, at 10% per annum, which is payable monthly in Diadem treasury common shares valued at \$0.10 per share. The loan will be repaid out of refunds of the security deposit or from corporate funds.

**8. CONVERTIBLE DEBENTURE**

The debenture is convertible in whole or in part at the option of the holder into common shares at any time on or before June 2, 2004 at a conversion price of \$0.10 per share. The debenture bears simple interest payable at the annual rate of 9.75%, payable monthly in cash or, at the option of the Company, in common shares valued at the greater of \$0.10 per share and the 10-trading day weighted average price of the common shares immediately prior to the payment date.

Included in interest expense is \$36,585 (2003-\$36,534) incurred in respect of the convertible debenture.

**9. SHAREHOLDERS' EQUITY**

(a) **Capital Stock**

Authorized capital stock of the Company consists of an unlimited number of special shares, redeemable and retractable at paid-up value and an unlimited number of common shares.

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(b) **Issued and outstanding shares**

Details of issued and outstanding common shares are as follows:

	<u>Common shares</u>	
	<u>Number</u> #	<u>Amount</u> \$
<b>Balance, May 31, 2003</b>	58,376,546	24,721,494
Flow-through share issues	11,650,000	1,165,000
Private placement	1,309,500	130,950
Conversion of warrants	1,000,000	100,000
Loan arrangement fee	580,000	58,000
Acquisition of Franklin Diamond Project	6,000,000	600,000
Interest paid	74,555	7,455
<b>Balance, February 29, 2004</b>	<b>78,990,601</b>	<b>26,782,899</b>

(c) **Flow-through share issues**

During September and December 2003, the Company placed 11,650,000 flow-through Common Shares at a price of \$0.10 per share for gross proceeds of \$1,165,000. The net proceeds from the placements are being expended on exploration that qualifies for Canadian exploration expenses as defined in the Income Tax Act (Canada). The Company's exploration projects qualifying for these expenditures are described in Notes 4(a) and 4(c).

(d) **Private placement**

During December 2003, the Company completed a private placement of 1,309,500 Units at \$0.10 per Unit, for gross proceeds of \$130,950. Each Unit consists of one Common Share and one half of one Common Share Purchase Warrant. Each whole Common Share Purchase Warrant entitles the holder to purchase one additional Common Share up to December 31, 2004 at a price of \$0.13 per share and \$0.17 thereafter up to December 31, 2005.

(e) **Warrants**

At May 31, 2003, the debenture holder held 5,000,000 warrants entitling the holder to acquire up to 5,000,000 Common Shares of the Company at an exercise price of \$0.10 per share. During February 2004, the holder exercised 1,000,000 warrants to acquire 1,000,000 Common Shares. Subsequent to February 29, 2004, the holder exercised a further 1,000,000 warrants to acquire 1,000,000 Common Shares. As a consequence of the two exercises of warrants, the Company realized cash proceeds of \$200,000.

Broker warrants to acquire 850,000 Common Shares for a period of one year, were issued as compensation to the agents that arranged the September and December 2003 flow-through placements.

(f) **Share option plan**

The Company has a share option plan. At the annual general meeting of shareholders held November 27, 2003, the shareholders approved an increase in the aggregate number of common shares reserved for issuance under the stock option plan to 12,500,000 of which an aggregate of 7,410,000 are subject to options granted pursuant to the plan. The options are non-assignable and may be granted for a term not exceeding five years. The exercise price is fixed by the board of directors of the Company at the time of grant, subject to all applicable regulatory requirements. The following is a summary of the common shares that are subject to options currently outstanding:

**DIADEM RESOURCES LTD.**  
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<b>Expiry Date</b>	<b>Option Price</b> \$	<b>Number of Shares</b>
March 20, 2005	0.25	210,000
April 30, 2005	0.25	50,000
April 30, 2005	0.20	400,000
December 31, 2005	0.10	1,400,000
February 20, 2008	0.10	1,000,000
May 28, 2008	0.10	3,400,000
October 8, 2008	0.115	850,000
November 20, 2008	0.10	100,000
	0.112	7,410,000

On September 28, 2003, 150,000 options, exercisable at \$0.25 per share, expired without being exercised. On October 8 and October 16, 2003, the board of directors granted options to purchase 750,000 and 100,000 common shares, respectively, exercisable at \$0.115 per share over five year terms. On November 20, 2003, the board of directors granted options to purchase 100,000 common shares at an exercise price of \$0.10 per share.

(g) **Stock-based compensation**

The Company does not recognize compensation expense for its stock-based compensation issued to employees. Had the Company elected to recognize of its stock-based compensation to employees based on estimated fair market value of stock options granted, the Company's results of operations would have been as follows:

	Three months ended February 29, 2004 \$	Nine months ended February 29, 2004 \$
Net income (loss) for the period	191,118	8,371
Unrecorded stock option compensation adjustment	-	(106,400)
<b>Pro forma net income (loss) for the period</b>	<b>191,118</b>	<b>(98,029)</b>
<b>Pro forma fully diluted net income (loss) per share</b>	<b>0.003</b>	<b>(0.001)</b>

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in the periods indicated: dividend yield of 0%, expected stock volatility of 200%, risk free interest rate of 5.2% and an expected option life of 60 months.

**10. RELATED PARTY INFORMATION**

Included in accounts payable and accrued liabilities is \$177,241 due to three directors for administrative services rendered to and expenses paid on behalf of the Company. Cost of services rendered to the Company were \$131,167 during the nine month period compared to \$Nil during the nine months ended February 28, 2003.

These related party transactions are in the normal course of business and are measured at the exchange amount which is the amount of consideration established and agreed to by the related parties. (See also Note 4(a)).

**DIADEM RESOURCES LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
FEBRUARY 29, 2004  
(Unaudited)

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**11. SUPPLEMENTARY CASH FLOW INFORMATION**

The Company did not pay any income taxes during the respective nine month periods ended February 29, 2004 and February 28, 2003. During the quarter and nine months ended February 29, 2004 the Company issued 74,555 treasury Common Shares to settle interest aggregating \$7,455.

Effective August 29, 2003, the Company's wholly-owned subsidiary issued 384,248 Series B First Preferred Shares to acquire 2,064 claims in the Otish Mountains region of Quebec (See Note 4(c)).

During November 2003, the Company issued 580,000 common shares, valued at \$58,000, as compensation for arranging a loan to the Company (See Note 7). During November 2003, the Company issued 6,000,000 common shares to CCC, valued at \$600,000, to acquire the rights to form a joint venture with DBR for diamond exploration in an area near Paulatuk in the Northwest Territories. (See Note 4(a)).

During the nine month period ended February 28, 2003, the Company issued 4,585,643 common shares to settle \$468,884 of amounts owing to creditors.

**12. INCOME TAXES**

During the nine months ended February 29, 2004, the Company issued 11,650,000 flow-through shares for proceeds of \$1,165,000. During the third quarter 2004, the Company renounced the equivalent expenditure to its investors and recognized a non-cash future income tax recovery of \$361,150 during the period.

At May 31, 2003, the Company had provided a valuation allowance of \$4,800,000 against future tax assets. As a consequence of issuing flow-through shares the Company created taxable temporary differences which can be reduced by previously unrecognized future tax assets. The recognition of the previously unrecognized future income tax asset results in a credit to the statement of operations with an offsetting charge to deficit as a cost of financing the flow-through share issue.

**13. LOSS PER SHARE**

Loss per share is computed by dividing the loss for the nine month period by the weighted average number of common shares outstanding during the nine month period. The existence of stock options and warrants may affect the calculation of loss per share on a fully diluted basis. As the effect of this dilution is anti-dilutive, fully diluted earnings per share has not been disclosed.

## **SCHEDULE B**

### **SUPPLEMENTARY INFORMATION**

The reader is directed to the financial statements and the attached notes to the financial statements ("Schedule A") for a full description of supplementary information. Below are items that are not covered in Schedule A.

#### **ITEM 5. List of Officers and Directors as at April 23, 2004**

<b><u>Name</u></b>	<b><u>Position</u></b>
Derek Bartlett	Director
Aime Bertrand	Director
Paul A. Carroll	President, CEO and Director
Maurice J. Colson	Director
A. C. A. Howe	Chairman and Director
David J. Layman	Vice-President Finance
William McKnight	Director
Lina Noble	Corporate Secretary
John M. Potwin	Vice-President Government Affairs
George C. Silverman	Director
Thomas Skimming	Vice-Chairman and Director
Rodney N. Thomas	Vice-President Exploration

# **SCHEDULE C**

## **DIADEM RESOURCES LTD.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FEBRUARY 29, 2004**

#### **Overview**

During the year ended May 31, 2003, Diadem Resources Ltd. ("Diadem" or the "Company") conducted a review of its mineral projects and corporate structure. As a result of this review, the Company recorded an impairment in carrying value of its non-diamond related mineral projects and disposed of all its non-North American assets and non-diamond assets to a related party. The Company will focus on diamond projects in North America.

Management's efforts to achieve the Company's goals are manifested as follows:

- Effective August 29, 2003, Diadem acquired from several companies, an aggregate of 2,064 mining claims in the Otish Mountains region of Quebec.
- During November 2003, Diadem entered into an agreement to form a joint venture with Darnley Bay Resources Ltd. ("DBR") for diamond exploration in an area near Paulatuk in the Northwest Territories. Previous exploration work by DBR resulted in the discovery of kimberlite in 10 pipes of which 6 contain diamonds. A mini-bulk sample resulted in the recovery of 157 micro diamonds.
- The Company has earned a 45% vested interest in and holds an option to acquire up to a 59% interest in 125 unpatented mining claims covering approximately 2,500 acres in the Leek Springs area of Eldorado County, California.

During the first nine months of fiscal 2004, management was successful in funding the Company's exploration programs and day-to-day operations. Financing of the Company's operations was achieved as follows:

- On September 8, 2003, the Company placed 5,000,000 flow-through common shares at a price of \$0.10 per share to raise gross proceeds of \$500,000.
- On October 10, 2003, the Company sold a non-core asset to raise \$125,000.
- On December 31, 2003, Diadem placed 6,650,000 flow-through Common Shares at a price of \$0.10 per share for gross proceeds of \$665,000.
- On December 31, 2003, Diadem closed a private placement of 1,309,500 Units at \$0.10 per Unit, for gross proceeds of \$130,950.
- During February and March 2004, 2,000,000 warrants were converted into 2,000,000 Common Shares at a price of \$0.10 per share for gross proceeds of \$200,000.

#### **Results of Operations**

The Company commenced its Otish Mountains exploration program during August 2003 under the direction of Roscoe Postle Associates. A total of 518 till samples were taken and are being processed to determine the presence of kimberlite indicator minerals and diamonds. Through February 29, 2004, the Company had expended \$585,033 on exploring and assessing its Otish Mountains claims.

General corporate costs were \$183,625 during the third quarter 2004 compared to \$52,784 during the comparable period of fiscal 2003. Year-to-date general corporate costs aggregated \$401,485 compared to \$99,243 during the comparable period of fiscal 2003. The increase results from renewed financing and acquisition activity. Salaries, which approximate 61% of general corporate costs, are accrued for management who make nominal cash draws. Costs associated with the shareholder relations function approximate 24% of corporate costs.

Interest costs totalled \$43,846 for nine months (2003-\$46,177), including \$36,585 (2003-\$36,534) of interest accrued in respect of the debenture. Interest payable in respect of the debenture can be settled in shares of the Company rather than cash.

During the nine months ended February 29, 2004, the Company issued 11,650,000 flow-through shares for proceeds of \$1,165,000. During the third quarter 2004, the Company renounced the equivalent expenditure to its investors and recognized a non-cash future income tax recovery of \$361,150 during the period.

At May 31, 2003, the Company had provided a valuation allowance of \$4,800,000 against future tax assets. As a consequence of issuing flow-through shares the Company created taxable temporary differences which can be reduced by previously unrecognized future tax assets. The recognition of the previously unrecognized future income tax asset results in a credit to the statement of operations with an offsetting charge to deficit as a cost of financing the flow-through share issue.

As at February 29, 2004, the loan receivable from DBR, aggregating \$73,970, is comprised of recoverable interest and finance fees and DBR's share of joint venture costs.

During February 2004, Diadem and DBR were notified that they had not acquired all exploration permits sought in the Northwest Territories. During March 2004, the Company and DBR recovered \$203,725 of the \$290,000 bond posted with DIAND.

As a result of its increased activities, the Company recorded a net loss, before recovery of future income taxes, of \$170,032 during the third quarter of fiscal 2004 compared to a net loss of \$31,417 per share during the third quarter of fiscal 2003. For nine months, the Company recorded a net loss, before recognition of recovery of future income taxes, of \$352,779 compared to \$137,490 for the comparable period of fiscal 2003.

After recovery of future income taxes, the Company recorded net income of \$191,118 or \$0.003 per share during the third quarter 2004 compared to a net loss of \$31,417 or \$0.001 per share during the third quarter 2003. For nine months, the Company recorded net income of \$8,371 or \$0.000 per share compared to a net loss of \$137,490 or \$0.002 per share for the comparable nine months of fiscal 2003.

### **Capital Resources and Liquidity**

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and on the assumption that Diadem will be able to realize the carrying value of its assets and discharge its liabilities in the normal course of business as a going concern.

There is uncertainty about the Company's ability to realize the carrying value of its assets and discharge its liabilities as they come due. The ability of the Company to continue as a going concern is dependent upon, among other things, being able to obtain additional financing, collection of outstanding loans, and attaining and maintaining positive operating cash flows.

The Company has reported significant losses for several years and has no mining operations. The Company manages operating cash flow through continued support of senior management which draws nominal salary. The Company has a significant working capital deficiency of \$1.1 million and an accumulated deficit of \$18.85 million.

The \$500,000 debenture is convertible in whole or in part at the option of the holder into common shares at any time on or before June 2, 2004 at a conversion price of \$0.10 per share. The debenture bears simple interest payable at the annual rate of 9.75%, payable monthly in cash or, at the option of the Company, in common shares valued at the greater of \$0.10 and the 10-trading day weighted average price of the common shares immediately prior to the payment date. The Company is entitled to redeem the debenture on 30 days notice at any time after June 2, 2003, provided that the common shares have traded for at least \$0.50 per share during the 10 trading days ending two days prior to the date of the redemption notice. The Company's shares have not traded at above \$0.50 per share and are presently trading below \$0.20 per share. Management has entered into negotiations to alter the terms of the debenture with the debenture holder. At April 21, 2003, the debenture holder held 3,000,000 warrants entitling the holder to acquire up to 3,000,000 common shares of the Company at an exercise price of \$0.10 per share on or before June 2, 2004.

During September and December 2003, the Company placed 11,650,000 flow-through Common Shares at a price of \$0.10 per share for gross proceeds of \$1,165,000. The net proceeds from the placements are being expended on exploration that qualifies for Canadian exploration expenses as defined in the Income Tax Act (Canada).

During December 2003, the Company completed a private placement of 1,309,500 Units at \$0.10 per Unit, for gross proceeds of \$130,950. Each Unit consists of one Common Share and one half of one Common Share Purchase Warrant. Each whole Common Share Purchase Warrant entitles the holder to purchase one additional Common Share up to December 31, 2004 at a price of \$0.13 and \$0.17 thereafter up to December 31, 2005.

Effective August 27, 2003, the Company formed a wholly-owned subsidiary, Diadem Explorations Inc. ("DEI"), to implement the acquisition of an aggregate of 2,064 mining claims in the Otish Mountains region of Quebec. The acquisitions were effected August 29, 2003 by issuing Series B First Preferred Shares of DEI having a value equal to the staking costs and work carried out on the claims by the vendors. In addition, if a diamond mine is brought into commercial production on any claim, the Company will pay a 2% gross royalty to the vendor that vended in that claim. The Company has the right to acquire the royalty for \$1.5 million, if acquired within 90 days after completion of a bankable feasibility study or for \$2.5 million, if acquired within 12 months after commencement of commercial production.

The Series B First Preferred Shares are exchangeable, at any time after December 31, 2004 and up to December 31, 2006, into common shares of the Company at the option of either the Company or the vendor. The exchange price will be based upon the weighted average price of the Company's common shares during the three month period ended December 31, 2004

During October 2003, the Company sold 2,890,000 common shares of Waseco Resources Inc. ("Waseco") and converted a \$450,000 demand note payable by Waseco to the Company into cash of \$125,000 and royalties on certain gold and diamond interests of Waseco. After completion of this transaction, the Company owns 500,000 common shares of Waseco.

### **Franklin Diamond Project**

Effective November 26, 2003, the Company entered into an agreement to form a joint venture ("Franklin Diamond Project") with Darnley Bay Resources Ltd. ("DBR") for diamond exploration in an area near Paulatuk in the Northwest Territories. The transaction results from an acquisition from Carnarvon Capital Corporation ("CCC") of that company's right to enter into the joint venture. To acquire the rights to form the joint venture, Diadem issued to CCC six million Diadem treasury shares, valued at \$600,000.

Paul Carroll, President and CEO of Diadem, also is President of CCC and all of its share capital is owned by members of his immediate family. As part of the transfer to Diadem of the DBR transaction, CCC and Mr. Carroll have agreed that during the period until December 31, 2008 neither CCC nor Mr. Carroll would acquire a controlling interest in any diamond exploration or development project in Canada (or in California) other than through Diadem or with the consent of Diadem. This agreement would end if there is a change of control of Diadem or if Mr. Carroll is dismissed as President without cause or involuntarily ceases to be a director of Diadem.

To earn its 50% interest in the Franklin Diamond Project, Diadem must expend \$5 million on diamond exploration north of the 68<sup>th</sup> parallel during the period to December 31, 2006. When that level of expenditure is completed, Diadem will be entitled to select up to 2.5 million acres of the project area for further exploration, and Diadem will have earned an undivided 50% participating interest in the selected lands, with DBR holding the other 50%. The Inuvialuit Development Corporation has the right to back into the project for a 10% working interest (with dilution to be shared equally by Diadem and DBR) when a decision is made to place a diamond mine into production and a positive feasibility study is completed.

If a decision is made to carry out a feasibility study on the lands selected by Diadem, it will have the right to fund a feasibility study, and if the property is placed into commercial production Diadem's interest will increase to 75% and the DBR's interest will decrease to 25%.

When Diadem has selected the area to which the 50/50 joint venture will apply, the parties will allocate at least \$2.5 million of the \$5 million to the selected lands. Diadem will be entitled to convert the balance of the \$5 million into treasury common shares of DBR at the then market price, subject to regulatory approval, or to convert that amount (in increments of at least \$1 million) into a diamond royalty equal to 1% for each full \$1 million spent and not allocated to the selected lands, with the balance to be taken in DBR shares. DBR will have the right to purchase any such royalty for \$1.5 million for each 1% of the royalty if the purchase is made within 90 days of a bankable feasibility study, or thereafter for \$2.5 million if the purchase is within 90 days of the start of commercial production.

## Risks

The Company's assets are subject to the risk of increases in taxes and royalties, renegotiation of contracts and currency exchange fluctuations. Operational risks include finding and developing economic ore reserves. Financial risks include interest and U.S. dollar exchange rates, which are beyond the control of the Company. The Company is subject to various regulatory risks, many of which also are beyond the control of the Company.

Management has raised equity and debt financing or funded, by way of sale of non-strategic assets, approximately \$1,861,000. In addition, the Company acquired a strategic land position in the Otish Mountains, at a non-cash cost of \$384,248, through the issuance of Series B First Preferred Shares and a known diamond-bearing land position in the Northwest Territories at a non-cash cost of \$600,000 through the issuance of Common Shares. The flow-through funds enable the Company to conduct exploration; however, the Company must find other funding for its general administrative costs. There is no assurance that management can continue to finance its operations. The consolidated financial statements do not reflect adjustments to the carrying value of assets and liabilities that would be necessary if the going concern assumption were not appropriate.

*Paul A. Carroll*  
President and  
Chief Executive Officer

*David J. Layman*  
Vice-President, Finance

April 23, 2004