

DIADEM RESOURCES LTD.

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

AUGUST 31, 2004

Overview

During the fiscal year ended May 31, 2004, management was successful in funding the Company's re-directed exploration programs and day-to-day operations with over \$1.9 million of fresh capital.

Subsequent to the quarter end, August 31, 2004, Diadem raised a further \$2,000,000 through the private placement of 33,333,331 Common Shares. These funds will be used to improve working capital and fund the Company's on-going corporate costs. Management is in discussions to avail the Company of flow-through placements to finance exploration of its Franklin and Otish Mountain holdings.

Results of Operations

The Company commenced its Otish Mountains exploration program during August 2003 under the direction of Roscoe Postle & Associates Inc. A total of 518 till samples were taken and were processed to determine the presence of kimberlite indicator minerals and diamonds. Through May 31, 2004, the Company had expended \$395,203 to acquire and \$655,332 to explore and assess its Otish Mountains claims. A further amount, aggregating \$6,541, was expended during the first quarter.

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. During March and April 2004, the Company staked 510 claims comprising an area of approximately 1,252,000 acres. During May and June 2004, the Company completed a ground magnetic survey over 22 potential kimberlite targets, as well as one known kimberlite, in the Parry Peninsula kimberlite field. The cost of the land assembly and exploration was \$620,958. These costs are considered part of the Company's cost of earn-in on the Franklin Project. A further amount of \$25,758 was expended during the first quarter of fiscal 2005.

General corporate costs were \$114,157 during the first quarter of fiscal 2005 compared to \$74,787 during the first quarter of fiscal 2004. The increase results from renewed financing and acquisition activity. Management fees, which approximate 82% (2004-81%) of general corporate costs, are accrued for management who have made nominal cash draws. At August 31, 2004, unsettled management fees aggregated \$311,661. Costs associated with the shareholder relations and regulatory compliance function approximate 13% (2004-8%) of corporate costs. The Company does not recognize compensation expense for its stock-based compensation issued to employees and directors. No stock options were granted during the first quarter of fiscal 2005.

Interest and debt financing costs totalled \$22,624 during the first quarter of fiscal 2005 (2004-\$15,872), including \$13,839 (2004-\$12,288) of interest accrued in respect of the debenture. Interest costs increased as a consequence of borrowing \$290,000 to finance the acquisition of Franklin Project exploration rights during November 2003 and compounding of interest on the debenture as a consequence of being in default of settling the debenture. Interest payable in respect of the debenture and long-term debt can be settled in shares of the Company rather than cash at the option of the Company. Subsequent to August 31, 2004, the Company settled the debenture.

As at August 31, 2004, the loan receivable from DBR, aggregating \$64,086, is comprised of recoverable interest and finance fees and DBR's share of joint venture costs. Approximately \$1,139 of interest costs associated with long-term debt were charged to the loan receivable from DBR.

As a result of its increased activities, the Company recorded a net loss of \$136,598 or \$0.002 per share during the first quarter of fiscal 2005 compared to a net loss of \$90,898 or \$0.002 per share during the first quarter of fiscal 2004.

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 and maintain positive cash flows from operations. At August 31, 2004, the Company was in default of the debenture. Subsequent to August 31, 2004, the Company completed a private placement Common Share financing for gross cash proceeds aggregating \$2,000,000. There is no assurance the Company can continue to finance its operations through the capital markets.

The Company has reported significant losses for several years and has no mining operations and is considered a development stage company. At August 31, 2004, the Company has a significant working capital deficiency of \$1,355,737 and an accumulated deficit of \$22,252,897.

The \$500,000 debenture was 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. Effective October 22, 2004, the debenture plus interest accrued was paid in full.

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 of \$384,248, which was equal to the historical staking costs and work carried out on the claims by the vendors. 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 the weighted average price of the Company's Common Shares during the three month period ended December 31, 2004.

Private Placement

Subsequent to the quarter end, August 31, 2004, the Company completed a private placement of 33,333,331 Units at \$0.06 per Unit, for gross proceeds of \$2,000,000. Each Unit consists of one Common Share and one Common Share Purchase Warrant. Each whole Common Share Purchase Warrant entitles the holder to purchase one additional Common Share up to October 22, 2006 at a price of \$0.10. In addition, the agent received 300,000 Common Shares for arranging the private placement.

These funds will be used to improve working capital and fund the Company's on-going corporate costs. Management of Diadem is in discussions to further avail the Company of the equity markets and sources of flow-through financing to fund its obligations in respect of the Franklin Project and to continue exploration in the Otish Mountain region. Management continues with efforts to restructure its holding of the Leek Springs Project. 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.

Financial Commitments to Exploration Programs

Franklin Diamond Project

In May, 2004 twenty-two airborne targets, including one known kimberlite and three previously surveyed targets that were not GPS referenced, were surveyed by ground magnetometer by JVX Ltd. using the JVX ROVER sled-mounted magnetometer system towed behind a snowmobile. Horizontal control was provided by differential GPS and positioning accurate within 2 meters. A total of 19 grids were established and a total of 487.5 km of line surveyed with readings obtained every 2.5 meters. Of the targets recently evaluated a total of at least 8 high priority drill targets have been indentified including the three targets that had been previously magnetically surveyed but not GPS located. Three of the targets exhibit geophysical characteristics consistent with known kimberlites on the property. Of particular interest are the five remaining targets, of which three exist as circular magnetic lows and two as circular magnetic highs. The inference of the occurrence of both magnetic lows and

high is there may be potential for kimberlites of differing ages. Survey data continues to be further processed and evaluated. Geophysical modelling of selected priority targets will be completed as a prelude to drill testing targets. Management anticipates funding further exploration of the Franklin Diamond Project primarily through the issuance of flow-through shares.

Otish Diamond Project

Diadem's widespread property package offers an opportunity to assess the prospectivity of the entire Otish region which has established diamond potential. Outside of Ashton Mining's Foxtrot property area, little in the way of intensive exploration work has been carried out. Follow-up work is budgeted for the testing of 10 anomalous targets. This work would initially include detailed airborne magnetometer surveys to identify priority targets for detailed ground work to include ground geophysics and diamond drilling. Management anticipates funding further exploration of the Otish Diamond Project primarily through the issuance of flow-through shares.

Leek Springs Diamond Project

Diadem has an approximate 44% interest in the property, with an option to increase this to an approximately 58% interest for total expenditure of US\$ 5 million on exploration. To date, exploration expenditures total over C\$ 4.3 million. Discussions are being held with Diadem's partner in the project to restructure the joint venture with a view to farming out the property to a new partner that would expend exploration funds to earn an interest in the project.

Debt Reduction

Diadem will use approximately \$960,000 of the proceeds received from the new equity financing to reduce accounts payable and to retire all of its funded debt. On a pro forma basis, if the new equity financing had occurred on August 31, 2004, Diadem's working capital deficiency would have been eliminated and the Company would have working capital of \$644,263.

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. Diadem is subject to various regulatory risks, many of which also are beyond the control of the Company.

Paul A. Carroll
Chairman of the Board and
Chief Executive Officer

David J. Layman
Vice-President, Finance

October 29, 2004