

DIADEM RESOURCES LTD.

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

February 28, 2005

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.

Since year end, Diadem has raised a further \$3,201,200 through the private placement of 34,133,331 Common Shares and exercise of warrants. These funds have improved working capital and funded the Company's on-going exploration and corporate costs. Management is in discussions to avail the Company of further flow-through placements to finance exploration of its Franklin, Attawapiskat and Otish Mountain Diamond Projects.

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 February 28, 2005, the Company had expended \$395,203 to acquire and \$803,885 to explore and assess its Otish Mountains claims.

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 459 claims comprising an area of approximately 1,120,071 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 \$1,250,958 through May 31, 2004. A further amount of \$340,544 has been expended on exploration during fiscal 2005. Approximately, \$953,000 of these costs are considered part of the Company's cost of earn-in on the Franklin Project

During December 2004, the Company paid \$15,000 to enter into an option agreement to acquire a 51% interest in the entire Attawapiskat diamond property of Vault Minerals Inc. The property consists of 219 contiguous claims (3,403 claim units) covering over 53,000 hectares located from 40 to 70 kms southeast of the Attawapiskat cluster of 19 kimberlite pipes (16 held by De Beers) in the James Bay Lowlands area of Northern Ontario. The largest pipe in the cluster, *Victor*, has undergone final feasibility studies and is awaiting De Beers' production decision.

During December 2004, the Company made the decision to proceed with phased exploration of the Attawapiskat property. Diadem is required to expend at least \$500,000 by December 1, 2005 (of which \$300,000 was committed to be spent by April 1, 2005, which was done) on exploration and related costs with a further \$500,000 to be expended after that date and by December 1, 2006. If Diadem exercises its option on or before December 1, 2006, a 51/49 joint venture will be formed and Diadem will be the operator.

General corporate costs were \$94,933 during the third quarter of fiscal 2005 compared to \$183,625 during the third quarter of fiscal 2004. For nine months, general corporate costs were \$347,018, excluding a charge of \$257,500 in respect of value attributed to stock options granted, compared to \$401,485 during the corresponding period of fiscal 2004. The increase principally results from renewed financing and acquisition activity. Management compensation approximates 69% (2004-61%) of general corporate costs, excluding the non-cash stock option benefit. Although certain management salaries have been raised closer to industry norms as a consequence of increased activity and the need to retain experienced management, a significant portion is accrued and deferred until such time as the Company can afford to pay. Costs associated with the shareholder relations and regulatory compliance function approximate 33% (2004-24%) of general corporate costs.

Interest and debt financing costs totalled \$41,652 during the first nine months of fiscal 2005 (2004-\$43,846). Interest costs decreased as a consequence of settling the debenture and the long-term debt incurred during 2003; and, on a go-forward basis the Company has eliminated the associated interest expense

Financial advisory fees aggregated \$240,553 for nine months (2004-\$31,922) and \$78,052 for the quarter (2004-\$26,078)). Cost of financial advisory services during fiscal 2005 includes a non-cash charge of \$62,500 resulting from the valuation of warrants issued to acquire 2,500,000 common shares of the Company, the issuance of 300,000 common shares valued at \$0.06 per share and cash compensation of \$160,052. Approximately \$80,000 was paid to the financial consultant while a director of the Company.

Effective March 15, 2005, Diadem restructured the terms of its option and joint venture agreement with Darnley Bay Resources Ltd. Consequently, Diadem and Darnley Bay Resources Ltd. ("Darnley Bay") renounced amounts owing to each other. The effect of this joint venture restructuring has been recorded in the accounts as if it had occurred on February 28, 2005.

As a result of its activities, the Company recorded a net loss, before recovery of future income taxes, of \$168,813 during the third quarter of fiscal 2005 compared to a net loss of \$170,031 during the third quarter of fiscal 2004. For nine months, the Company recorded a net loss, before recognition of recovery of future income taxes, of \$861,332 compared to \$352,779 for the comparable period of fiscal 2004.

After recovery of future income taxes, the Company recorded net income of \$117,851 or \$0.001 per share during the third quarter of fiscal 2005 compared to net income of \$191,119 or \$0.003 per share during the third quarter of fiscal 2004. The Company recorded a net loss of \$574,668 or \$0.006 per share during the first nine months of fiscal 2005 compared to a net income of \$8,371 or \$Nil per share during the comparable period 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. During the second quarter of 2004, the Company eliminated \$790,000 of debt from its balance sheet and reduced outstanding current claims against the Company. This was accomplished following a successful private placement for gross proceeds of \$2,068,000.

The Company has reported significant losses for several years and has no mining operations and is considered a development stage company. At February 28, 2005, the Company has working capital of \$186,358 and an accumulated deficit of \$23,080,700. There is no assurance the Company can continue to finance its operations through the capital markets.

During December 2004, the Company placed 7,554,670 Units at a price of \$0.15 per Unit for gross proceeds of \$1,133,200. Each Unit consisted of one flow-through common share and one-half of one flow-through common share purchase warrant. Each warrant entitles the holder to purchase one additional flow-through common share at a price of \$0.20 per share for a period of nine months after the closing of the private placement. A total of \$46,396 in cash commissions was paid and 309,307 non flow-through broker warrants were issued, exercisable for a period of nine months from the date of closing. The funds will be used to incur Canadian exploration expense on its Franklin, Attawapiskat and Otish Mountain diamond projects, which expense will be renounced to investors.

During August 2003, a wholly-owned subsidiary of the Company issued Series B First Preferred Shares having a value of \$384,248, which was equal to the historical staking costs and work carried out by vendors of the Otish Mountain claims. The Series B First Preferred Shares, displayed on the balance sheet under the caption *Shares to be issued*, are exchangeable, at any time after December 31, 2004 and up to December 31, 2006, into 3,256,338 Common Shares of the Company at the option of either the Company or the vendor based on a weighted average trading price of \$0.118 per share during the three month period ended December 31, 2004. During January and February 2005, three vendors exchanged 100,049 Series B First Preference Shares for 847,875 common shares of the Company.

Exploration Projects

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 evaluated a total of at least 8 high priority drill targets have been identified 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 existence of kimberlite targets of varying magnetic signatures is consistent with known kimberlite fields elsewhere in the Canadian Shield and whereas drilling to date has focussed on the most obvious targets every effort will be directed at establishing an inventory of kimberlite targets prior to the next phase of drilling. Accordingly, Fugro Airborne Surveys were engaged in late December 2004, to complete a planned 50,000 line km airborne magnetic gradiometer survey, at a cost of approximately \$889,175, over selected portions of the project area including infill surveying of the Parry Peninsula kimberlite cluster to improve resolution and definition of the known kimberlite field as well as to explore those areas where previous till sampling had yielded anomalous geochemistry, suggestive of the presence of kimberlites, but without adequate aeromagnetic coverage. In this regard, infill flying of the Parry Peninsula kimberlite cluster will provide survey coverage at a 100 m flight line spacing as compared to 200 m and in the other areas flight line coverage will be at 200 m versus existing coverage at 800 m or more. Aeromagnetic surveying of the property commenced on April 11th, 2005. Management anticipates funding further exploration of the Franklin Diamond Project primarily through the issuance of flow-through shares.

Attawapiskat Diamond Project

On November 29, 2004 Diadem announced that it had entered into an option agreement to acquire a 51% interest in the entire Attawapiskat diamond property of Vault Minerals Inc. The property consists of 219 contiguous claims (3,403 claim units) covering over 53,000 hectares located from 40 to 70 kilometres southeast of the Attawapiskat cluster of 19 kimberlite pipes (16 held by De Beers) in the James Bay Lowlands area of Northern Ontario. Diadem is required to expend at least \$500,000 by December 1, 2005 (of which \$300,000 was committed to be spent by April 1, 2005, which has been done) on exploration and related costs with a further \$500,000 to be expended after that date and by December 1, 2006. Furthermore, option payments of \$100,000 are required during the option period including \$15,000 paid during December, 2004. If Diadem exercises its option on or before December 1, 2006, a 51/49 joint venture will be formed and Diadem will be the operator. In late December 2004 Fugro Airborne Surveys were contracted to complete a detailed aeromagnetic gradiometer survey over the property which was executed and completed late in the first quarter. Subsequent to February 28th, 2005 preliminary and final data products were received and are being processed to identify targets for follow-up. Expenditures aggregating \$339,683 were made on the project prior to April 1st, 2004 fulfilling the aforementioned \$300,000 minimum expenditure commitment. Management anticipates funding further exploration of the Attawapiskat Diamond Project primarily through the issuance of flow-through shares.

Otish Diamond Project

Additional work on the Otish Mountains project in the third quarter consisted of a 6900 line km fixed wing airborne magnetic gradiometer survey at a 100 m line spacing over selected areas in an attempt to define discrete magnetic targets for follow-up. Expenditures of \$71,214 in the quarter were largely related to the aforementioned survey. Evaluation of till sample results collected in late 2003 and processed in 2004 confirmed the regional diamond prospectivity of the area. However, till samples were not successful in highlighting any specific pre-existing public data magnetic targets for follow-up. Within the context of the broad area covered by the Diadem till sampling program, the airborne geophysical survey was designed to cover specific areas considered to have structural elements that may have favoured kimberlite emplacement. Paterson, Grant and Watson Limited (PGW) was retained to complete a Kimberlite Target Interpretation of the survey data. Targets were chosen using an automated Keating correlation method as well as manually using total magnetic field and other derivative grids. Targets were reviewed manually with individual line profile data and ranked according to importance. The Keating Correlation method uses a model of a desired size and depth kimberlite pipe and passes it over the survey data to determine those points that are similar to the model's characteristics. Output consists of those points where there is a positive or negative correlation and the degree of that correlation. In summary, 20 targets were picked from the

targets computed from the automated Keating correlation method. Of these PGW identified 18 first priority targets. These targets are worthy of further investigation and additional work will be performed to identify targets for follow-up work in the field. Management anticipates funding further exploration of the Otish Diamond Project primarily through the issuance of flow-through shares.

Leek Springs Diamond Project

The Company currently has a 43.8% vested interest in and held, until December 31, 2004, an option to acquire up to a 57.9% 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.

The Company is in discussions with SPS to restructure ownership of the project.

Risks

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. 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. 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
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April 28, 2005