

DIADEM RESOURCES LTD.

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

AUGUST 31, 2005

Overview

Diadem is a Canadian diamond exploration and development company primarily focused on its Franklin Project in the Lena West Area, Northwest Territories. Diadem also has land holdings in the Attawapiskat area near De Beers' soon-to-be-developed Victor diamond mine, in the James Bay Lowlands region of Ontario, and in the Otish Mountains region of Quebec where Ashton is advancing its Renard diamond property that continues to provide encouraging results. Going forward Diadem continues to focus on advancing its Franklin Project, which at present is the Company's principal exploration asset. The Company is also actively seeking other opportunities to complement its exploration and development property portfolio. During the fiscal years ended May 31, 2004 and 2005, Management was successful in funding the Company's diamond exploration programs and day-to-day operations with over \$6.5 million of fresh capital.

Results of Operations

General corporate costs were \$180,883 (2005-\$114,193) during the first quarter. The increase results principally from a charge of \$73,440 in respect of options granted and vesting during the period. The increase is partly mitigated by lower salaries and management fees. Management fees, including the valuation of employee stock options, approximate 77% (2005-82%) of general corporate costs and are accrued for Management who have made nominal cash draws while the Company remains in the development stage. At August 31, 2005, unsettled management fees aggregated \$80,916. Costs associated with the shareholder relations and regulatory compliance function approximate 12% (2005-13%) of corporate costs.

Interest and debt financing costs totalled \$2,260 (2005-\$22,624) during the first quarter of fiscal 2006. Interest cost was incurred on vendor-financed obligations.

As a result of its increased activities, the Company recorded a net loss of \$169,389 or \$0.001 per share during the first quarter of fiscal 2006 compared to a net loss of \$136,634 or \$0.002 per share during the first quarter of fiscal 2005.

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, 2005, the Company had \$821,264 in cash. On May 31, 2005, the Company had raised \$1,504,000 by way of flow-through financing. The Company must incur an equivalent amount on qualifying Canadian exploration expenditures before the end of calendar 2006. 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. For the three months ended August 31, 2005, the Company recorded a loss of \$169,389 (2005 - \$136,634) and had negative operating cash flow for the three months ended August 31, 2005. At August 31, 2005, the Company had working capital of \$543,702 and an accumulated deficit of \$29.1 million.

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 mining claims in the Otish Mountains region of Quebec. The acquisition of the claims was effected by issuing 384,248 First

Preferred Series B Shares of DEI having a value equal to the staking costs and cost of work carried out on the claims by the vendors.

The First Preferred Series B 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 at a price of \$0.118 per common share, being the weighted average trading price of the common shares during the three-month period ended December 31, 2004. Since the Company plans to issue its common shares in exchange for the First Preferred Series B Shares, they are reflected as shares to be issued.

During the three months ended August 31, 2005, three vendors exchanged 229,724 First Preferred Series B Shares for 1,946,810 common shares of the Company. As at August 31, 2005, 54,475 First Preferred Series B Shares were outstanding and which will be converted into 461,453 common shares of Diadem.

Exploration Programs

Management's efforts to achieve the Company's goals are demonstrated by the Company's acquisition of interests in areas having or being close to known kimberlite, diamond-bearing structures. The Company is active in the Franklin Bay area of the Northwest Territories and the Attawapiskat region of Ontario. On the former exploration property, airborne geophysical surveys are ongoing and on the Parry Peninsula, which constitutes roughly one third of the Franklin Bay project area, the Company has identified 21 potential drill targets and subsequent to August 31, 2005 has completed till sampling on and down ice from these targets in order to determine targets worthy of follow-up by core drilling in 2006.

Franklin 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 metres. A total of 19 grids were established and a total of 487.5 kilometres of line surveyed with readings obtained every 2.5 metres. 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 focused 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 kilometres 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 metre flight line spacing as compared to 200 metres and in the other areas flight line coverage will be at 160 metre or 200 metre versus existing coverage at 800 metres or more. Aeromagnetic surveying of the property commenced on March 27, 2005. Subsequent to August 31, 2005 preliminary results from the survey of the Parry Peninsula Kimberlite Cluster are very encouraging and a total of 21 potential drill targets, including two previously drilled targets, were followed up by surface till sampling in September 2005. Results are pending. Management anticipates funding further exploration of the Franklin Project primarily through the issuance of flow-through shares.

Attawapiskat 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 in early 2005. Survey results were processed, interpreted and modeled with the result that a total of 10 potential first priority targets have been identified. 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. Through August 31, 2005 Diadem had expended \$352,000 on the property including option payments aggregating \$25,000 pursuant to the option agreement. Management anticipates funding further exploration of the Attawapiskat Project primarily through the issuance of flow-through shares.

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 ability of the Company to develop its properties and the future profitability of the Company are directly related to the market price of diamonds. The Company is subject to various regulatory risks, many of which also are beyond the control of the Company.

Rodney N. Thomas
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David J. Layman
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