

# DIADEM

RESOURCES LTD.  
(A Development Stage Company)

## CONSOLIDATED FINANCIAL STATEMENTS (Unaudited - Prepared by Management)

FEBRUARY 28, 2007

**Notice:** The unaudited interim consolidated financial statements of Diadem Resources Ltd. ("Company") as at and for the three and nine months ended February 28, 2007 ("Financial Statements") have been prepared by management and have not been reviewed by the Company's auditors. The Financial Statements should be read in conjunction with the consolidated financial statements for the year ended May 31, 2006 which are available at the SEDAR website at [www.sedar.com](http://www.sedar.com). The Financial Statements are presented in Canadian dollars, unless otherwise indicated, and are prepared in accordance with Canadian generally accepted accounting principles.

**DIADEM RESOURCES LTD.**  
(A Development Stage Company)  
**CONSOLIDATED BALANCE SHEETS**  
(Unaudited)

(Expressed in Canadian Dollars)	February 28 2007	May 31 2006
	\$	\$
<b>ASSETS</b>		
<b>Current</b>		
Cash and term deposits	787,866	262,756
Receivables and prepaid expenses	163,255	23,604
	951,121	286,360
<b>Mineral interests</b> (Note 3)	4,635,393	2,788,881
<b>Equipment</b> (Note 4)	7,347	6,689
<b>Other assets</b>	-	21
	5,593,861	3,081,951
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	524,367	557,499
	524,367	557,499
<b>SHAREHOLDERS' EQUITY</b>		
<b>Capital stock</b> (Note 5)	34,010,873	31,080,221
<b>Warrants</b>	343,799	783,430
<b>Contributed surplus</b>	1,665,695	872,805
<b>Shares to be issued</b>	-	54,475
<b>Deficit</b>	(30,950,873)	(30,266,479)
	5,069,494	2,524,452
	5,593,861	3,081,951

Commitments and contingencies (Notes 1, 3 and 9)

**DIADEM RESOURCES LTD.**

(A Development Stage Company)

**CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT**

(Unaudited)

(Expressed in Canadian Dollars)	Three months ended February 28		Nine months ended February 28	
	2007	2006	2007	2006
	\$	\$	\$	\$
<b>REVENUE</b>				
Interest income	10,127	3,267	15,703	11,065
Gain (loss) on sale of investment	(200)	62,825	(200)	73,300
	9,927	66,092	15,503	84,365
<b>EXPENSES</b>				
Amortization	585	717	1,622	2,181
Interest	14,985	2,076	61,040	6,379
Financial and advisory services	-	-	106,200	-
General corporate costs	146,006	128,989	299,449	373,817
Stock-based compensation	1,894	37,194	9,460	136,887
Foreign exchange (gain) loss	1	(119)	1	(172)
Write-down of mineral interests	52,814	-	-	352,134
Write-off of other investment	-	-	21	-
	216,285	168,857	477,793	871,226
<b>NET (LOSS) before income taxes</b>	(206,358)	(102,765)	(462,290)	(786,861)
Income tax recovery (Note 8)	1,019,686	543,245	1,019,686	543,245
<b>NET INCOME (LOSS) for the period</b>	813,328	440,480	557,396	(243,616)
Costs associated with issuance of capital stock	(1,040,281)	(543,245)	(1,241,791)	(543,245)
<b>DEFICIT, beginning of period</b>	(30,723,921)	(29,643,947)	(30,266,479)	(28,959,851)
<b>DEFICIT, end of period</b>	(30,950,874)	(29,746,712)	(30,950,874)	(29,746,712)
<b>Net income (loss) per share</b> -basic and diluted	0.04	0.05	0.03	(0.03)
<b>Weighted average number of shares</b>	18,656,804	9,700,435	16,472,135	9,700,435

See accompanying notes to the consolidated financial statements

**DIADEM RESOURCES LTD.**  
(A Development Stage Company)  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

(Expressed in Canadian Dollars)	Three months ended February 28		Nine months ended February 28	
	2007	2006	2007	2006
	\$	\$	\$	\$
<b>OPERATING ACTIVITIES</b>				
Net income (loss) for the period	813,328	440,480	557,396	(243,616)
Adjustment for items not affecting cash:				
Amortization	585	717	1,622	2,181
Write-down of mineral interests	-	-	-	352,134
Stock-based compensation	1,894	37,194	9,460	136,887
Gain on sale of investment	-	(62,825)	-	(73,300)
Loss on disposal of equipment	-	175	-	175
Recovery of future income taxes	(1,019,686	(543,245)	(1,019,686)	(543,245)
	)			
Write-off of other investment	-	-	21	-
	(203,879)	(127,504)	(451,187)	(368,784)
Net changes in non-cash working capital balances:				
Prepaid expenses and sundry receivables	(28,040)	17,236	(139,651)	31,565
Accounts payable and accrued liabilities	10,045	(41,649)	(33,131)	(86,869)
Cash flows provided by (used in) operating activities	(221,874)	(151,917)	(623,969)	(424,088)
<b>INVESTING ACTIVITIES</b>				
Equipment	-	-	(2,280)	-
Proceeds from sale of investment	-	62,825	-	73,300
Mineral interests	(615,075)	(38,299)	(1,507,761)	(729,333)
Cash flows (used in) investing activities	(615,075)	24,526	(1,510,041)	(656,033)
<b>FINANCING ACTIVITIES</b>				
Common shares issued for cash	440,400	-	2,856,052	10,000
Costs associated with issuance of capital stock	(20,595)	-	(196,932)	-
	419,805	-	2,659,120	10,000
Change in cash during the period	(417,144)	(127,391)	525,110	(1,070,121)
<b>CASH</b> , beginning of period	1,205,010	512,805	262,756	1,455,535
<b>CASH</b> , end of period	787,866	385,414	787,866	385,414

Supplemental information (Note 7)

**1. NATURE OF OPERATIONS AND GOING CONCERN**

Diadem Resources Ltd. (the "Company" or "Diadem") is in the process of acquiring, exploring and developing its mineral interests in North America and is thus considered to be a development stage company. The business of mining and exploring for minerals involves a high degree of risk and there can be no assurance that current exploration programs will result in profitable mining operations.

Although the Company has taken steps to verify title to the properties on which it is conducting exploration and in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property title may be subject to unregistered prior agreements and non-compliance with regulatory requirements.

The recoverability of the amounts shown for mineral interests is dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of those reserves, upon future profitable production and/or the proceeds from the disposition thereof. To date, the Company has not earned significant revenues.

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and on the assumption that the Company will be able to realize the carrying value of its assets and discharge its liabilities in the normal course of operations 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 achieve positive cash flows from operations.

**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 month periods ended February 28, 2007 are not necessarily indicative of the results expected for the full year.

These interim unaudited 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, 2006 and should be read in conjunction with those audited financial statements and notes thereto.

Certain comparative figures have been reclassified to conform with the current presentation.

**3. MINERAL INTERESTS**

	Balance May 31, 2006	Additions	Writedowns	Balance February 28, 2007
	\$	\$	\$	\$
<b>Acquisition costs</b>				
Franklin Project,				
Northwest Territories	1,190,764	-	-	1,190,764
Duquesne West, Quebec	25,000	563,750	-	588,750
	1,215,764	563,750	-	1,779,514
<b>Deferred exploration costs</b>				
Franklin Project,				
Northwest Territories	1,528,751	124,228	-	1,652,979
Duquesne West, Quebec	44,366	1,158,534	-	1,202,900
	1,573,117	1,282,762	-	2,855,879
	2,788,881	1,846,512	-	4,635,393

**3. MINERAL INTERESTS (Continued)**

	Balance May 31, 2005	Additions	Writedowns	Balance February 28, 2006
	\$	\$	\$	\$
<b>Acquisition costs</b>				
Franklin Project,				
Northwest Territories	1,190,764	-	-	1,190,764
Attawapiskat Project, Ontario	15,000	10,000	(25,000)	-
Tinkeleni, Mali	-	13,636	-	13,636
	<u>1,205,764</u>	<u>23,636</u>	<u>(25,000)</u>	<u>1,204,400</u>
<b>Deferred exploration costs</b>				
Franklin Project,				
Northwest Territories	513,068	736,470	-	1,249,538
Attawapiskat Project, Ontario	327,098	36	(327,134)	-
Otish Mountains, Quebec	300,000	-	-	300,000
Tinkeleni, Mali	-	18,526	-	18,526
Diokeba, Mali	-	665	-	665
	<u>1,140,166</u>	<u>755,697</u>	<u>(327,134)</u>	<u>1,568,729</u>
	<u>2,345,930</u>	<u>779,333</u>	<u>(352,134)</u>	<u>2,773,129</u>

**(a) Franklin Project, Northwest Territories**

Effective November 26, 2003, the Company entered into an agreement to form a joint venture ("Franklin Project") with Darnley Bay Resources Limited ("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 375,000 Diadem common shares, valued at \$600,000. Paul Carroll, Chairman 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 ending 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.

Under the agreement, Diadem was to expend \$5,000,000 on diamond exploration within the Inuvialuit settlement region north of the 68<sup>th</sup> parallel by December 31, 2006. When this earn-in level of expenditure is completed, Diadem will have earned an undivided 50% participating interest in the selected lands, with DBR holding the other 50%. If a decision is made to carry out a feasibility study on the lands, 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%.

Effective March 15, 2005, Diadem's earn-in requirement on the lands north of the 68<sup>th</sup> parallel was reduced to approximately \$3,100,000 and the earn-in period was extended to December 31, 2007. DBR relinquished its participating interest in the joint venture lands south of the 68<sup>th</sup> parallel and transferred to Diadem 100% ownership in the permits and claims south of the 68<sup>th</sup> parallel. Expenditures through February, 2007 were in excess of \$2,250,000.

The Company and DBR entered into a Cooperation Agreement with the Inuvialuit Regional Corporation ("IRC") whereby the IRC agreed to cooperate to develop the diamond potential of certain Inuvialuit and Crown lands. The agreement is for a term of 5 years commencing January 1, 2004 with provisions for renewal and termination. Diadem and DBR are required to obtain all necessary Inuvialuit permits and approvals and will pay the fees and charges under the Inuvialuit Rules with a minimum amount payable

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each year of \$50,000. Diadem and DBR were to incur at least \$2,000,000 of work by June 30, 2005. On March 1, 2005 the Inuvialuit extended the date from June 30, 2005 to September 30, 2005. Expenditures

**3. MINERAL INTERESTS** (Continued)

through February 28, 2007 were in excess of the budgeted field program. Management believes that the main concern of the IRC is the execution of the field program, which, at the time of writing, is on-going, and as such the IRC will look favourably upon the project.

The Inuvialuit will receive a 2% diamond royalty on mining rights exploited by the joint venture. The Inuvialuit can hold certain claims in the area in which there is a 15-year deferral of Crown royalties. In such cases the Inuvialuit will receive an additional 4% royalty while the deferral applies. If a positive feasibility is completed, the Inuvialuit have the right to acquire up to a 10% participating interest by paying the corresponding percentage of the cost of the feasibility study.

**(b) Duquesne West Project, Quebec**

On April 18, 2006, Diadem entered into an option agreement to acquire a 50% vested interest and the right to increase the vested interest to 57.5% in the Duquesne West project ("Project") north of Rouyn-Noranda, Quebec. The option agreement is with Jack Stoch Geoconsultant Services Inc. ("Vendor") and Globex Mining Enterprises Inc. ("Globex"). At the time the agreement was entered into Diadem made an initial cash payment to the Vendor of \$25,000.

A definitive option agreement was entered into, dated July 17, 2006, under which Diadem can earn a 50% fully vested interest in the Project by spending \$6,000,000 over three years on exploration and development, of which \$1,000,000 is to be spent by June 30, 2007, an additional \$2,000,000 is to be spent by June 30, 2008 and an additional \$3,000,000 is to be spent by June 30, 2009. On September 5, 2006, Diadem made an additional cash payment to the Vendor of \$225,000, and issued 1,250,000 Diadem common shares to the Vendor having an assigned value of \$338,750. As at February 28, 2007, Diadem had expended \$1,158,534 on exploration of the project and, therefore has more than satisfied its current exploration requirements. To maintain the option, Diadem also will be required to make additional cash payments of \$150,000 to the Vendor by June 30, 2007 and \$200,000 by June 30, 2008. Upon Diadem acquiring its 50% interest in the Project, Diadem would grant to the Vendor a 2.25% gross metal royalty based on Diadem's 50% interest in the Project. Once the 50/50 joint venture is formed, further exploration and development costs will be shared proportionately by Diadem and Globex.

Upon Diadem earning its 50% fully vested interest in the Project, it will have a one-time option to complete, at its cost, a positive bankable feasibility study required to put the Project into commercial production. Upon completion of a positive bankable feasibility study, or upon Diadem putting the Project into commercial production, including arranging the financing therefore, it will have the right to acquire from Globex an additional 7.5% fully vested interest in the Project upon payment to Globex of \$250,000 cash and the issue to Globex of 5% of the then issued and outstanding common shares of Diadem.

**4. EQUIPMENT**

	February 28, 2007		May 31, 2006	
	Cost	Accumulated Amortization	Net	Net
	\$	\$	\$	\$
Computer and office equipment	15,694	8,347	7,347	6,689

**5. 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.

During 2006, the common shares of Company were consolidated on a 1-for-16 basis. These consolidated financial statements fully reflect this share consolidation.

**(b) Issued and Outstanding Shares**

Details of issued and outstanding common shares are as follows:

	2007		2006	
	#	\$	#	\$
<b>Balance, May 31</b>	9,679,394	31,080,221	9,550,038	30,844,248
<b>Issued pursuant to:</b>				
Conversion of Series B Preference Shares	28,850	54,475	121,675	229,724
Shares issued for cash	110,000	33,000	-	-
Flow-through financings (Note 5(c))	7,876,403	2,823,053	-	-
Acquisition of Duquesne West Project (Note 3(b))	1,250,000	338,750	-	-
Issue of warrants (Notes 5(c)(ii) and 5(d))	-	(233,136)	-	-
Adjustment for rounding due to share consolidation	-	-	(131)	-
<b>Balance, February 28</b>	<b>18,944,647</b>	<b>34,096,363</b>	<b>9,671,582</b>	<b>31,073,972</b>

**(c) Flow-through Financings**

(i) During July 2006, the Company placed 1,813,454 flow-through common shares at a price of \$0.42 per share for gross proceeds of \$761,650.

(ii) During November 2006, the Company placed flow-through common shares and Units at a price of \$0.34 per share and \$0.34 per Unit for aggregate gross proceeds of \$1,621,002. Each Unit consisted of one flow-through common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to purchase one additional common share for a period of one year with an exercise price of \$0.45 per share and thereafter at an exercise price of \$0.60 per share for the period ending 24 months from the date of issuance. The gross proceeds were prorated to capital stock and warrants based on the relative fair value of each component, as follows: capital stock - \$1,387,866; warrants - \$233,136. A total of \$81,050 in cash commissions was paid and 381,412 non-flow-through broker warrants were issued, exercisable for a period of one year with an exercise price of \$0.45 per share and thereafter at an exercise price of \$0.60 per share for the period ending 24 months from the date of issuance. The broker warrants were valued at \$25,173. The fair values of the warrants and broker warrants were estimated using the Black-Scholes option-pricing model with the following weighted average assumptions: expected dividend yield of 0%, expected stock volatility of 50%, risk-free interest rate of 4.18% and an expected warrant life of 2 years.

During December, 2006, the Company placed 1,295,295 Units at a price of \$0.34 per Unit for gross proceeds of \$440,400. Each Unit consisted of one flow-through common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to purchase one additional common share for a period of one year with an exercise price of \$0.45 per share and thereafter at an exercise price of \$0.60 per share for the period ending 24 months from the date of issuance.

5. SHAREHOLDERS' EQUITY (continued)

(d) Warrants

A summary of the Company's warrant activity during the nine months ended February 28, 2007 and 2006 is as follows:

	February 28, 2007		February 28, 2006	
	Warrants	Weighted Average	Warrants	Weighted Average
		Exercise price		Exercise price
	#	\$	#	\$
Outstanding, beginning of period	2,239,583	1.60	2,614,921	1.75
Issued	6,444,361	0.45	-	-
Cancelled	(1,235,300)	(0.45)	-	-
Expired	(2,239,583)	(1.60)	(255,415)	(3.20)
Outstanding, end of period	5,209,061	0.45	2,359,506	1.60

A summary of warrants outstanding at February 28, 2007 is as follows:

Expiry date	Warrants	Exercise Price	Fair Value
	#	\$	\$
November 15, 2008	3,913,766	0.45/0.60	258,309
December 20, 2006	<u>1,295,295</u>	0.45/0.60	<u>85,490</u>
	<u>5,209,061</u>	0.45/0.60	<u>343,799</u>

(e) Stock Option Plan

The Company has a stock option plan to aid in retaining and encouraging directors, senior officers, employees and service providers of the Company. At the annual general meeting of shareholders held November 30, 2006, the shareholders adopted and approved an amendment to Diadem's stock option plan which permits reserving for issuance under the stock option plan, at any time, of a maximum of 10% of the issued and outstanding shares of the Company at the date of grant. 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.

A summary of the Company's stock option activity is as follows:

	Options	Weighted average exercise price
	#	\$
Outstanding, May 31, 2006	812,500	1.62
Expired	(421,875)	1.62
Outstanding, February 28, 2007	390,625	1.62

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**5. SHAREHOLDERS' EQUITY** (continued)

The following is a summary of stock options outstanding at February 28, 2007:

<u>Expiry Date</u>	<u>Exercise Price</u>	<u>Options</u>
	\$	#
February 20, 2008	1.60	46,875
February 21, 2008	1.60	15,625
May 28, 2008	1.60	196,875
October 8, 2008	1.84	6,250
October 8, 2008	1.60	31,250
November 20, 2008	1.60	6,250
October 18, 2009	1.68	15,625
November 1, 2009	1.60	46,875
July 19, 2010	1.60	25,000
		<u>390,625</u>

**(f) Contributed Surplus**

A summary of the Company's contributed surplus activity is as follows:

	<u>2007</u>
	\$
Balance, May 31, 2006	872,805
Expiry of warrants	783,430
Stock-based compensation	9,460
Balance, February 28, 2007	<u>1,665,695</u>

**6. RELATED PARTY TRANSACTIONS AND BALANCES**

Included in accounts payable and accrued liabilities is \$23,180 (May 31, 2006-\$120,167) due to directors for administrative, financial and geological services rendered to and expenses paid on behalf of the Company. Cost of services rendered to the Company by the directors was \$132,000 (2006-\$142,881) during the nine month periods ended February 28. 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.

**7. SUPPLEMENTARY CASH FLOW INFORMATION**

	<u>2007</u>	<u>2006</u>
	\$	\$
Value of Series B first preference shares exchanged for common shares of the Company	54,475	229,724
Issue of 1,250,000 common shares to acquire Duquesne West, Project	338,750	-
Value of warrants charged to cost of equity financing	25,173	-

**8. INCOME TAXES**

As at May 31, 2006, the Company had available for deduction against future taxable income, non-capital losses of approximately \$4,724,000.

In addition, the Company has capital losses aggregating \$115,000, Canadian exploration and development expenditures of \$4,481,000, and foreign exploration and development expenses aggregating \$12,238,000, each of which are available for deduction against future taxable income under certain circumstances. During calendar 2006, the Company issued 7,876,403 flow-through shares for proceeds of \$2,823,053.

**8. INCOME TAXES (continued)**

At May 31, 2006, the Company had provided a valuation allowance of \$6,899,000 (2005 - \$7,550,000) against future tax assets. The recognition of the previously unrecognized future income tax asset results in a credit to the statement of operations in the amount of \$1,019,686 (2005 - \$543,245) with an offsetting charge to deficit as a cost of financing the flow-through share issue.

**9. COMMITMENTS**

During July and November and December 2006, the Company raised \$761,650 and \$2,061,402, respectively, by way of flow-through financings. The Company is committed to incur, prior to December 31, 2007 and on a best efforts basis, \$2,823,052 in qualifying Canadian exploration expenditures which were renounced to the subscribers with an effective date of December 31, 2006.

As at February 28, 2007, the commitment had been reduced to approximately \$2,688,000.

**10. FINANCIAL INSTRUMENTS**

**Fair Value**

Canadian generally accepted accounting principles require that the Company disclose information about the fair value of its financial assets and liabilities. Fair value estimates are made at the balance sheet date based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates. The carrying amounts for sundry receivables and accounts payable and accrued liabilities on the balance sheet approximate fair value because of the limited term of these instruments.

**Commodity Price Risk**

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 and gold.