



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

MAY 31, 2007

Overview

Diadem Resources Ltd. is focused on acquiring near-production mining opportunities in North America, especially those related to diamonds and gold. Currently, its principal activity is diamond exploration in the Franklin Bay area within the Inuvialuit Settlement Region of the Northwest Territories. On that project Diadem now has identified 28 specific drill targets on the Parry Peninsula, which currently constitutes most of the Franklin Bay project area. A ground magnetic survey and diamond drilling is planned to evaluate these targets and mobilization of the required equipment to the project site has begun.

Selected Financial Information

	2007	2006	2005
Canadian dollars , except share amounts	\$	\$	\$
Cash	592,007	262,756	1,455,535
Mineral interests	2,760,573	2,788,881	2,345,930
Total assets	3,459,242	3,081,951	4,104,112
Working capital (deficiency)	209,530	(271,139)	1,087,239
Cash used in operations	(722,326)	(352,257)	(1,296,621)
Common Shares issued for cash	2,856,052	-	4,677,200
Common Shares outstanding	18,944,647	9,679,394	9,550,038
Revenue	65,984	87,496	6,335
Cost of operations	2,618,398	1,369,092	6,302,510
Net loss	(1,532,728)	(738,351)	(6,009,511)
Net loss per share- basic and diluted	(0.10)	(0.08)	(0.91)

Selected Quarterly Information

2007	Q1	Q2	Q3	Q4
	\$	\$	\$	\$
Revenues	1,726	3,850	9,927	50,481
Expenses	142,562	118,946	216,285	2,140,605
Net income (loss)	(140,835)	(115,096)	813,328	(2,090,125)
Basic and fully diluted income {loss} per share (Note)	(0.01)	(0.01)	0.04	(0.11)

2006	Q1	Q2	Q3	Q4
	\$	\$	\$	\$
Revenues	14,486	3,937	66,092	2,981
Expenses	183,875	518,644	168,857	497,716
Net income (loss)	(169,389)	(514,707)	440,480	(494,735)
Basic and fully diluted income {loss} per share (Note)	(0.02)	(0.05)	0.05	(0.05)

Note: At a special meeting of shareholders held on January 27, 2006, the shareholders approved that the outstanding common shares of the Company be consolidated on a one-for-sixteen basis (1:16). Common Shares outstanding and basic and fully diluted income {loss} per share, in prior periods, have been adjusted to reflect the share consolidation.

Results of Operations

General corporate costs were \$513,849 during 2007 compared to \$469,045 during 2006, excluding the effect of stock-based compensation. The increase results principally from \$105,000 in financial advisory fees paid to two directors in respect of identifying a prospective gold project for the Company which was partially offset by a decrease in management compensation and significantly reduced shareholder relation costs as a result of elimination of the investor relations function. Salaries, excluding the effect of stock-based compensation, approximate 44% (2006-49%) of general corporate costs. Unsettled salary and management fees, which aggregated \$51,005 at May 31, 2006, were settled during fiscal 2007. Costs associated with the shareholder relations and regulatory compliance function approximate 12% (2006-26%) of corporate costs. The Company recognised \$8,593 (2006-\$143,365) in non-cash stock-based compensation. The President of the Company resigned his position in March 2006 resulting in a reduction of recognition of stock compensation related to prior years' awards that were not fully vested.

Interest costs totalled \$94,265 during fiscal 2007 (2006-\$56,081). Interest costs increased as a consequence of the imposition of Part XII.6 tax on larger unexpended Canadian exploration expenditures for flow-through purposes subsequent to February 28 of the year following the year of renouncement.

During fiscal 2007, the Company issued 7,876,403 flow-through shares for proceeds of \$2,823,053. During February 2007, the Company renounced the equivalent expenditure to its investors and recognized a non-cash future income tax recovery of \$1,019,686 (2006-\$543,245).

At May 31, 2007, the Company had provided a valuation allowance of \$5,338,000 (2006-\$5,799,000) 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.

During fiscal 2007, other income decreased to \$65,984 from \$87,496 realized during fiscal 2006. In 2006, the Company received \$73,300 from the sale of a portfolio investment. Interest income increased as a result of holding larger cash balances on flow-through funds raised during July 2006 and November and December 2006.

During the year ended May 31, 2007, Diadem spent \$1,787,742 (2006-\$69,366) on acquisition and exploration of the Duquesne West gold project. The gold resource base was increased nominally but not sufficiently to justify continued exploration and development of the project. Consequently, the Company decided to write off the \$1,857,108 carrying value of its investment in the project. During 2007, the Company elected not to renew certain exploration permits held in respect of Franklin project prospects south of the 68th parallel and allowed the permits to lapse. The Company wrote off the \$144,585 carrying value attributable to the exploration permits.

During 2006, the Company recorded an impairment in carrying value of Otish Mountain in the amount of \$300,000. During fiscal 2006, the Company elected not to proceed further with the Attawapiskat property and allowed the option to lapse and wrote-down the \$352,134 carrying value of deferred exploration and acquisition costs associated with the project. The Company's renewed focus on North American projects resulted in the \$48,467 carrying value of its Mali, West Africa projects being written off.

As a result of its activities, the Company recorded a net loss, before recovery of future income taxes and write-down of mineral interests, of \$550,721 during fiscal 2007 compared to a loss of \$580,995 during fiscal 2006.

After recovery of future income taxes and write-down of mineral interests, the Company recorded a net loss of \$1,532,728 or \$0.10 per share during fiscal 2007 compared to a net loss of \$738,351 or \$0.08 per share during fiscal 2006.

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 reach positive cash flows from operations. As at May 31, 2007, the Company is committed to incur prior to December 31, 2007, on a best efforts basis, approximately \$2,600,000 in qualifying Canadian exploration expenditures ("CEE") pursuant to a private placement for which flow-through proceeds had been received and renounced to the subscribers with an effective date of December 31, 2006. As at July 31, 2007, this commitment is reduced to approximately \$2,463,000.

As a result of environmental permitting delays, Diadem may not incur sufficient CEE in 2007. In order to address the impact on subscribers to the Company's flow-through financings, the Company proposes to seek to enter into amended agreements with the affected subscribers and to approach Canada Revenue Agency and the relevant Quebec tax authorities to confirm the consequence of any amendment to the original subscription agreements.

Diadem may be subject to certain additional taxes as a result of the potential shortfall in CEE expenditures incurred during 2007. Diadem may seek relief to reduce these additional taxes given the specific circumstances of the delays encountered. No accrual has been made as the magnitude of any potential shortfall is not determinable.

Other taxes payable include Part XII.6 tax on flow-through CEE incurred subsequent to the year of renunciation to investors. Should the Company not incur the amount renounced to investors prior to December 31, 2007, the Company may be assessed further penalties.

There is no assurance the Company can continue to finance its operations through the capital markets. Further, the Company needs to fund its administrative activities which constitute non-flow-through expenditures and is actively seeking funding of these expenditures.

The Company has reported significant losses for several years and has no mining operations and is, therefore, considered an exploration stage company. For the years ended May 31, 2007 and 2006, the Company incurred negative operating cash flow. At May 31, 2007, the Company had working capital of \$209,530.

During May 2005, the Company placed 1,880,000 common shares at a price of \$0.80 per share for gross proceeds of \$1,504,000. The funds were used to incur Canadian exploration expense on its Franklin, Attawapiskat and Otish Mountain diamond projects, which expense was renounced to investors. The Company incurred an equivalent amount on qualifying Canadian exploration expenditures before the end of calendar 2006.

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.

During November 2006, the Company placed 4,767,654 Units at a price of \$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 - \$1,251,199; warrants - \$369,403. 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 \$39,173. 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 100%, 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. The gross proceeds were prorated to capital stock and warrants based on the relative fair value of each component, as follows: capital stock - \$305,177; warrants - \$135,223.

Effective August 27, 2003, the Company formed a wholly-owned subsidiary, 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.

During August 2003, DEI issued Series B First Preferred Shares having a value of \$384,248 to the vendors of the Otish Mountain claims. This was equal to the historical staking costs and work carried out by the vendors on those claims. The Series B First Preferred Shares, displayed on the balance sheet under the caption Shares to be issued, were exchangeable, at any time after December 31, 2004 and up to December 31, 2006, into 203,518 Common Shares of the Company at the option of either the Company or the vendor based on a weighted average trading price of \$1.888 per share during the three month period ended December 31, 2004. During 2005, three vendors exchanged 100,049 Series B First Preference Shares for 52,992 common shares of the Company. During fiscal 2006, three vendors exchanged 229,724 Series B First Preference Shares for 121,676 common shares of the Company. During November 2006, the Company exercised its right to effect the exchange of the balance of the Series B First Preference Shares into common shares of the Company.

Consolidation of Issued Common Shares

At a special meeting of shareholders held on January 27, 2006, the shareholders approved that the outstanding common shares of the Company be consolidated on a one-for-sixteen basis (1:16). Subsequently, the TSX Venture Exchange granted its approval for the consolidation of common shares and the Articles of the Company were amended under the Business Corporations Act (Ontario).

On October 22, 2006, 2,239,583 warrants to acquire common shares of the Company expired unexercised. During 2007, 421,875 stock options expired unexercised. At September 19, 2007, there were 18,944,647 post-consolidated shares (fully diluted: 24,544,333) issued and outstanding.

Exploration Programs

	Balance May 31, 2006 \$	Additions \$	Write-downs \$	Balance May 31, 2007 \$
Acquisition costs				
Franklin Project,				
Northwest Territories	1,190,764	-	(48,068)	1,142,696
Duquesne West, Quebec	25,000	563,750	(588,750)	-
	<u>1,215,764</u>	<u>563,750</u>	<u>(636,818)</u>	<u>1,142,696</u>
Deferred exploration costs				
Franklin Project,				
Northwest Territories	1,528,751	185,643	(96,517)	1,617,877
Duquesne West, Quebec	44,366	1,223,992	(1,268,358)	-
	<u>1,573,117</u>	<u>1,409,635</u>	<u>(1,364,875)</u>	<u>1,617,877</u>
	<u>2,788,881</u>	<u>1,973,385</u>	<u>(2,001,693)</u>	<u>2,760,573</u>

Franklin Project

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 68th 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 68th 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 68th parallel and transferred to Diadem 100% ownership in the permits and claims south of the 68th parallel. As at May 31, 2007, the earn-in requirement, on a cash basis, was approximately \$1,011,000. As at July 31, 2007, the amount of earn-in expenditure on a cash basis had been reduced to approximately \$850,000. Once the earn-in is completed DBR will be required to carry its 50% pro rata share of on-going exploration and development expenses or suffer dilution of its interest. Diadem is the operator of the joint venture.

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 each year of \$50,000. The Company and DBR have now met the expenditure requirements of the Cooperation Agreement with the IRC.

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.

The Company has relinquished its permits to explore certain lands south of the 68th parallel. Consequently, the Company wrote off the acquisition costs and exploration expenses associated with these permits.

Duquesne Project

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 was with Jack Stoch Geoconsultant Services Inc. ("Vendor") and Globex Mining Enterprises Inc. ("Globex").

The option agreement became effective July 17, 2006. Under the agreement, Diadem could 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. Diadem made initial cash payments to the Vendor of \$225,000, and issued to the vendor 1,250,000 Diadem common shares valued at \$338,750 based on the quoted, closing market price of the Company's shares on the day of closing the agreement.

During May 2007, the Company elected not to proceed further with the project, allowed the option to lapse and wrote-off the carrying value of the project.

Disclosure Controls and Procedures

Management is responsible for the information disclosed in this management's discussion and analysis and has in place the appropriate information systems, procedures and controls to ensure that information used internally by management and disclosed externally is, in all material respects, complete and reliable. The Company has three officers, the Chief Executive Officer, the Chief Financial Officer, the Corporate Secretary and no employees. The involvement of these officers in all aspects of the design and operation of disclosure controls and procedures was effective as at and for the year ended May 31, 2007 and provides reasonable assurance that all material information relating to the Company is disclosed. The audit committee is actively involved in quarterly reviews and is comprised of three independent directors.

The Company evaluated the design of its internal controls and procedures over financial reporting as defined under Multilateral Instrument 52-109 for the year ended May 31, 2007. Based on this evaluation, management has concluded that the design of these internal controls and procedures over financial reporting was effective.

There were no changes in the operation of disclosure controls and procedures during 2007.

Financial Instruments

Canadian generally accepted accounting principles require that the Company disclose information about the fair value of its financial assets and liabilities effective for financial years commencing on or after October 1, 2007. 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.

Related Party Information

Included in accounts receivable are amounts due from two corporations over which two directors have direction and control.

Included in accounts payable and accrued liabilities is \$12,040 (2006-\$120,167) due, directly and indirectly, to three directors for administrative, financial and geological services rendered to and expenses paid on behalf of the Company. Cost of services rendered to the Company, directly and indirectly, by the three directors was \$312,847 (2006-\$69,486) during 2007. 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.

Rent totalling \$36,000 (2006-\$36,000) was paid to a company controlled by a director of Diadem.

Directors and officers of the Company subscribed for 808,726 common shares of Diadem for gross proceeds of \$309,900 pursuant to the private placements described in notes 7(b) and 7(c) to the financial statements.

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 precious metals and diamonds. The Company is subject to various regulatory risks, many of which also are beyond the control of the Company.

During July, November and December 2006, the Company raised \$761,650, \$1,621,002 and \$440,400, 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.

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 reach positive cash flows from operations. As at May 31, 2007, the Company is committed to incur prior to December 31, 2007, on a best efforts basis, approximately \$2,600,000 in qualifying CEE pursuant to a private placement for which flow-through proceeds had been received in 2006 and renounced to the subscribers with an effective date of December 31, 2006. As at July 31, 2007, this commitment is reduced to approximately \$2,463,000 and will be reduced further by qualifying CEE during the balance of calendar 2007.

As a result of environmental permitting delays, Diadem may not incur sufficient CEE in 2007 to fully satisfy its commitments. The extent of this cannot currently be calculated. In order to address the impact on subscribers to the Company's 2006 flow-through financings, the Company proposes to seek to enter into agreements with the affected subscribers to satisfy the indemnity provisions of the original subscription agreements.

Diadem may be subject to certain additional taxes as a result of the potential shortfall in CEE expenditures incurred during 2007. Diadem may seek relief to reduce these additional taxes given the specific circumstances of the delays encountered. No accrual has been made as the magnitude of any potential shortfall is not determinable.

Other taxes payable include Part XII.6 tax on flow-through Canadian exploration expenditures incurred subsequent to the year of renunciation to investors. Should the Company not incur the amount renounced to investors prior to December 31, 2007, the Company may be assessed further penalties.

There is no assurance the Company can continue to finance its operations through the capital markets. Further, the Company needs to fund its administrative activities which constitute non-flow-through expenditures and is actively seeking funding of these expenditures.

The ability of the Company to develop its properties and the future profitability of the Company is directly related to the market price of exploited minerals and metals.

Paul A. Carroll
Chairman and
Chief Executive Officer

David J. Layman
Vice-President, Finance

October 25, 2007