



ANNUAL REPORT 2004



MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of Diamonds North Resources Ltd. are the responsibility of the Company's management. The consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada and reflect management's best estimates and judgment based on information currently available.

Management has developed and maintains a system of internal controls to ensure that the Company's assets are safeguarded, transactions are authorized and properly recorded and financial information is reliable.

The Board of Directors is responsible for ensuring management fulfills its responsibilities for financial reporting and internal control through an audit committee which is composed primarily of non-management directors. The Audit Committee reviews the results of the audit and the annual financial statements prior to their submission to the Board of Directors for approval.

The consolidated financial statements have been audited by Smythe Ratcliffe, Chartered Accountants, and their report outlines the scope of their examination and gives their opinion on the consolidated financial statements.

"Mark Kolebaba" (signed)

Mark Kolebaba
President

April 8, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE STOCKHOLDERS OF DIAMONDS NORTH RESOURCES LTD.

We have audited the consolidated balance sheet of Diamonds North Resources Ltd. as at December 31, 2004 and the related consolidated statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in Canada and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and the results of its operations and cash flows for the year then ended in conformity with Canadian generally accepted accounting principles. Accounting principles generally accepted in Canada differ in certain significant respects from accounting principles in the United States of America and are discussed in Note 13 to the consolidated financial statements.

The consolidated financial statements as at December 31, 2003 and for the two years then ended were audited by another auditor who expressed an opinion without reservation on those statements in his report dated March 30, 2004.

"Smythe Ratcliffe" (signed)

Chartered Accountants

Vancouver, British Columbia
April 8, 2005

COMMENTS BY AUDITORS FOR U.S. READERS

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going-concern. As discussed in Note 1 to the consolidated financial statements, the Company has incurred significant operating losses over the past three fiscal years and must raise significant capital to develop its business and to fund operation costs. These matters raise substantial doubt about the Company's ability to continue as a going-concern. The financial statements do not include any adjustment that might result from the outcome of this uncertainty.

"Smythe Ratcliffe" (signed)

Chartered Accountants

Vancouver, British Columbia
April 8, 2005

DIAMONDS NORTH RESOURCES LTD.

Consolidated Statements of Operations and Deficit

For the Year Ended December 31, 2004 with comparison to the Year Ended December 31, 2003 and the
Period February 13, 2002 (Date of Incorporation) to December 31, 2002

(expressed in Canadian dollars)

	2004	2003	2002
General and administrative expenses			
Accounting and audit	\$ 60,118	\$ 68,179	\$ 45,941
Administration fees	85,760	70,996	55,797
Amortization	12,893	6,407	1,961
Annual report and meeting	33,086	16,882	-
Bad debts	-	34,319	-
Bank charges and interest	4,855	22,388	15,674
Consulting fees	9,292	31,766	14,184
Filing fees	8,498	6,747	7,997
Insurance	33,064	5,625	-
Investor relations and promotion	266,528	272,270	151,082
Legal fees	46,074	47,075	62,859
Office and miscellaneous	88,193	66,582	49,305
Rent	41,241	49,876	21,414
Stock-based compensation	374,277	451,173	91,939
Transfer agent fees	11,248	14,012	6,909
Wages and benefits	245,382	246,137	107,921
	(1,320,509)	(1,410,434)	(632,983)
Other income (expenses)			
Interest income	60,773	69,982	6,885
Mineral property transactions	171,116	3,119	128,689
Property investigation	(680,701)	(147,293)	(1,349)
Debt financing costs	-	-	(445,000)
Write down of marketable securities	(31,075)	(21,750)	(9,500)
Write down of mineral properties	(279,547)	(505,834)	-
Gain on sale of marketable securities	3,436	-	-
	(2,076,507)	(2,012,210)	(953,258)
Loss before income taxes	(2,076,507)	(2,012,210)	(953,258)
Future income taxes	(365,921)	(471,130)	-
Loss for the period	(2,442,428)	(2,483,340)	(953,258)
Deficit, beginning of period, as previously reported	-	(953,258)	-
Adjustment for stock-based compensation (Note 7 (e))	-	(102,821)	-
Deficit, beginning of period, as restated	(3,539,419)	(1,056,079)	-
Deficit, end of period	\$ (5,981,847)	\$ (3,539,419)	\$ (953,258)
Basic and diluted loss per share	\$ (0.09)	\$ (0.14)	\$ (0.14)
Weighted average number of shares outstanding	26,110,244	17,986,142	6,685,551

See Accompanying Notes to the Consolidated Financial Statements

DIAMONDS NORTH RESOURCES LTD.

Consolidated Statements of Cash Flows

For the Year Ended December 31, 2004 with comparison to the Year Ended December 31, 2003 and the Period February 13, 2002 (Date of Incorporation) to December 31, 2002

(expressed in Canadian dollars)

	2004	2003	2002
Cash flows from (applied to) operating activities			
Loss for the period	\$ (2,442,428)	\$ (2,483,340)	\$ (953,258)
Items not involving cash:			
Amortization	12,893	6,407	1,961
Debt financing costs paid with shares	-	-	445,000
Stock-based compensation	374,277	451,173	91,939
Write down of marketable securities	31,075	21,750	9,500
Write down of mineral properties	279,547	505,834	-
Future income taxes	365,921	471,130	-
Gain on sale of marketable securities	(3,436)	-	-
	(1,382,151)	(1,027,046)	(404,858)
Net change in non-cash working capital items:			
Accounts receivable	(73,070)	275,967	(498,455)
Prepaid expenses	13,026	(95,451)	(9,957)
Field supplies	133,899	(111,530)	(37,161)
Bid deposits	(144,146)	(356,692)	-
Accounts payable and accrued liabilities	(1,561)	(20,552)	75,084
Due to related parties	(20,386)	(134,195)	170,194
	(1,474,389)	(1,469,499)	(705,153)
Cash flows applied to investing activities			
Proceeds from the sale of marketable securities	15,336	-	-
Mineral property acquisition and exploration costs, net of recoveries	(6,958,152)	(3,051,617)	(1,832,366)
Accounts payable and accrued liabilities related to mineral properties	364,188	(408,912)	648,078
Cash, exploration funds	(793,822)	1,498,685	(1,626,135)
Purchase of equipment	(32,232)	(50,138)	(14,989)
	(7,404,682)	(2,011,982)	(2,825,412)
Cash flows from financing activities			
Note payable	-	(13,920)	313,920
Shares issued for cash, net of issue costs	5,164,509	7,315,464	3,431,517
	5,164,509	7,301,544	3,745,437
Increase (decrease) in cash and cash equivalents	(3,714,562)	3,820,063	214,872
Cash and cash equivalents, beginning of period	4,034,935	214,872	-
Cash and cash equivalents, end of period	\$ 320,373	\$ 4,034,935	\$ 214,872

Supplemental Cash Flow Information (Note 11)

See Accompanying Notes to the Consolidated Financial Statements

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

1. Nature of Operations and Going Concern

The Company was incorporated on February 13, 2002 pursuant to the Company Act (British Columbia) and on July 15, 2002 the common shares of the Company were listed for trading on the TSX Venture Exchange. The Company is in the process of actively exploring and developing its mineral properties and has not yet determined whether these properties contain ore reserves which are economically recoverable. The Company is considered to be in the exploration stage.

The recoverability of amounts shown for mineral property interests is dependent upon one or more of the following:

- the discovery of economically recoverable reserves,
- the ability of the Company to obtain financing to complete development, and
- future profitable production from the properties or proceeds from disposition.

At December 31, 2004, the Company had incurred a deficit of \$5,981,847 and had working capital of \$1,487,053 which, without additional financing will not be sufficient to achieve the Company's planned business objectives for fiscal 2005. The Company has been successful in raising funds to date; however, there can be no assurance that additional funding will be available in the future. Subsequent to the year end, the Company completed two private placements for gross proceeds of \$1,060,000 (Notes 14(a) and 14(c)) and received \$801,630 from the exercise of warrants and stock options (Note 14(f)). Management believes that these proceeds, together with working capital at December 31, 2004, will provide the Company with sufficient funds for fiscal 2005 operations.

These consolidated financial statements have been prepared on a going concern basis, which assumes the realization of assets and liquidation of liabilities in the normal course of business. The Company's ability to continue as a going concern is dependent on continued financial support from its shareholders and other related parties, the ability of the Company to raise equity financing, and the attainment of profitable operations, external financings and further share issuances to meet the Company's liabilities as they become payable. These consolidated financial statements do not include any adjustments to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary, should the Company be unable to continue as a going concern.

2. Significant Accounting Policies

(a) Basis of presentation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, which has been inactive since its incorporation on December 17, 2003.

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles, which conform in all material respects to those in the United States, except as disclosed in Note 13.

(b) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

2. Significant Accounting Policies (continued)

(c) Financial instruments

The fair values of the Company's cash, accounts receivable, bid deposits, accounts payable and accrued liabilities and due to related parties approximate their carrying amounts because of the immediate or short-term to maturity of these financial instruments. It is not practical to determine the fair value of the amount due to related parties, due to their related party nature and the absence of a market for such instruments.

The fair value of marketable securities is disclosed in Note 3.

The Company is exposed to credit risk with respect to its cash. To minimize this risk, cash and cash equivalents have been placed with major financial institutions.

(d) Cash and cash equivalents

The Company considers cash and cash equivalents to be cash and short-term investments with original maturities of three months or less from the date of acquisition.

(e) Mineral properties

The Company capitalizes all costs related to investments in mineral property interests on a property-by-property basis. Such costs include mineral property acquisition costs and exploration and development expenditures, net of any recoveries. Costs are deferred until such time as the extent of mineralization has been determined and mineral property interests are either developed or the Company's mineral rights are allowed to lapse.

All deferred mineral property expenditures are reviewed, on a property-by-property basis, to consider whether there are any conditions that may indicate impairment. When the carrying value of a property exceeds its net recoverable amount that may be estimated by quantifiable evidence of an economic geological resource or reserve, expenditure commitments or the Company's assessment of its ability to sell the property for an amount exceeding the deferred costs, a provision is made for the impairment in value.

The amounts shown for acquisition costs and deferred exploration expenditures represent costs incurred to date and do not necessarily reflect present or future values.

These costs are depleted over the useful lives of the properties upon commencement of commercial production or written off if the properties are abandoned or the claims allowed to lapse.

From time to time the Company may acquire or dispose of a mineral property interest pursuant to the terms of an option agreement. As the options are exercisable entirely at the discretion of the optionee, the amounts payable or receivable are not recorded. Option payments are recorded as property costs or recoveries when the payments are made or received. When the amount of recoveries exceeds the total amount of capitalized costs of the property, the amount in excess of costs is credited to income.

Management's estimates of mineral prices, recoverable proven and probable reserves, and operating, capital and reclamation costs are subject to certain risks and uncertainties which may affect the recoverability of mineral property costs. Although management has made its best estimate of these factors, it is possible that changes could occur in the near term that could adversely affect management's estimate of the net cash flow to be generated from its properties.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

2. Significant Accounting Policies (continued)

(e) Mineral properties (continued)

The acquisition of title to mineral properties is a detailed and time-consuming process. The Company has taken steps, in accordance with industry standards, to verify title to mineral properties in which it has an interest. Although the Company has taken every precaution to ensure that legal title to its properties is properly recorded in the name of the Company, there can be no assurance that such title will ultimately be secured.

(f) Environmental expenditures

The operations of the Company may in the future be affected from time to time in varying degrees by changes in environmental regulations, including those for future removal and site restoration costs. Both the likelihood of new regulations and their overall effect upon the Company vary greatly and are not predictable. The Company's policy is to meet or, if possible, surpass standards set by relevant legislation, by application of technically proven and economically feasible measures.

Environmental expenditures that relate to ongoing environmental and reclamation programs are charged against earnings as incurred or capitalized and amortized depending on their future economic benefits. Estimated future removal and site restoration costs, when the ultimate liability is reasonably determinable, are charged against earnings over the estimated remaining life of the related business operation, net of expected recoveries.

(g) Property, plant and equipment

Property, plant and equipment are recorded at cost less accumulated amortization. Amortization is recorded on the declining balance basis at annual rates of 20% on office furniture and 30% on computer equipment, from the date of acquisition. Leasehold improvements are amortized on a straight-line basis over six years, from the start of the lease.

(h) Asset retirement obligations

The Company has adopted the recommendations of the Canadian Institute of Chartered Accountants ("CICA"), Section 3110 "Asset Retirement Obligations". This statement establishes standards for accounting for the recognition and measurement of liabilities for obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operations of the assets.

(i) Impairment of long-lived assets

The Company has adopted CICA Section 3063 "Impairment of Long-Lived Assets". This statement establishes standards for the recognition, measurement and disclosure of the impairment of non-monetary long-lived assets, including property, plant and equipment, intangible assets with finite useful lives, deferred pre-operating costs and long-term prepaid assets. The adoption of this standard did not have a material impact on its financial position or results of operations.

(j) Stock-based compensation

Effective January 1, 2002, the Company adopted CICA Section 3870 "Stock-Based Compensation and Other Stock-Based Payments" for accounting for stock-based compensation expense. Under this standard, stock-based payments to non-employees and employee awards that are direct awards of stock, call for settlement in cash or other assets, or stock appreciation rights that call for settlement by issuance of equity instruments, granted on or after January 1, 2002, are accounted for using the fair value based method and are recorded as an expense in the period the stock-based payments are vested or the awards or rights are granted.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

2. Significant Accounting Policies (continued)

(j) Stock-based compensation (continued)

During 2003, the CICA released amendments to Section 3870 which required an expense to be recognized in the financial statements for all forms of employee stock-based compensation, including stock options, commencing on January 1, 2004. The Company elected for the early adoption of the amendments during the fourth quarter of fiscal 2003. Prior to the adoption, no compensation expense was recognized when stock options were granted to directors and employees if the exercise price of the stock options were granted at market value. However, the effects of accounting for stock-based compensation to directors and employees as compensation expense, using the fair-value based method, was disclosed as pro-forma information in the notes to the financial statements.

(k) Income taxes

Income taxes are calculated using the asset and liability method. Under this method of tax allocation, future income tax assets and liabilities are determined based on differences between the financial statement carrying values and their respective income tax amounts (temporary differences). Future income tax assets and liabilities are measured using the tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantially assured. The amount of future income tax assets recognized is limited to the amount of the benefit that is likely to be realized.

(l) Loss per share

Basic loss per share is calculated based on the weighted average number of common shares outstanding during the period. The Company uses the treasury stock method for calculating diluted earnings per share. However, diluted loss per share has not been presented as the potential exercise of options and warrants outstanding would have the effect of reducing the loss per share. Therefore, basic and diluted loss per share are the same.

(m) Certain comparative figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

3. Marketable Securities

Marketable securities are carried at the lower of cost or quoted market value. When market value is below cost, any unrealized loss is charged to income.

During the year, marketable securities were written down by \$31,075 (2003 - \$21,750; 2002 - \$9,500) to a carrying value of \$65,250 (2003 - \$56,750). The quoted market value of marketable securities at December 31, 2004 is \$155,175 (2003 - \$61,350).

4. Bid Deposits

The Company filed applications for permits with the Mining Recorder's Office in Nunavut and NWT. The Company was required to place bid deposits totalling \$500,838 (2003 - \$356,692). The prospecting permits were not granted and subsequent to December 31, 2004, the Company received a refund of the deposits less application fees.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements

December 31, 2004

(expressed in Canadian dollars)

5. Mineral Properties

As at December 31, 2004 and 2003, the Company's mineral properties are comprised of properties located in Canada. Expenditures incurred on mineral properties are as follows:

	Blue Ice	Hadley Bay	Wellington	Washburn	Kidme	White Ice	Amaruk JV*	Northern Recon.	Other Properties	Total
Balance at										
Dec. 31, 2003	\$ 2,871,345	\$ 310,257	\$ 1,955	\$ 648,287	\$ 190,884	\$ 284,835	\$ 658,641	\$ -	\$ 808,785	\$ 5,774,989
Additions during the year:										
Acquisition:	5,085	3,395	10,366	-	66,026	-	2,225,207	-	1,739,754	4,049,833
Exploration:										
Administration	45	45	15	15	6,804	23	1,215	-	379	8,541
Airborne geo.	9,920	157	172,607	-	18,931	-	526,205	-	263,209	991,029
Drilling	190,623	21,442	-	-	-	-	-	-	-	212,065
Environment	5,066	-	699	-	-	-	-	-	1,398	7,163
Geochemistry	26,152	2,992	185	-	19,397	-	55,424	1,261,669	704,175	2,069,994
Geology	56,607	13,954	10,378	4,089	11,958	8,682	76,107	14,952	33,364	230,091
Geophysics	74,425	6,467	345	1,814	56,096	1,807	2,717	-	8,615	152,286
Mob/Demob	-	-	-	-	-	-	-	33,700	50,217	83,917
Permitting	8,777	72	-	-	-	-	-	216,991	14,569	240,409
Property	19,385	43,302	39,445	30,050	846	-	-	1,191,824	237,237	1,562,089
Trenching	43,008	175	-	-	-	-	-	-	-	43,183
	434,008	88,606	223,674	35,968	114,032	10,512	661,668	2,719,136	1,313,163	5,600,767
Less:										
Recoveries	-	(6,068)	(235,995)	(2,834)	(33,053)	-	(2,039,798)	(18,735)	(335,165)	(2,671,648)
Net additions	439,093	85,933	(1,955)	33,134	147,005	10,512	847,077	2,700,401	2,717,752	6,978,952
Write down	-	-	-	-	-	-	-	-	(279,547)	(279,547)
Balance at										
Dec. 31, 2004	\$ 3,310,438	\$ 396,190	\$ -	\$ 681,421	\$ 337,889	\$ 295,347	\$ 1,505,718	\$ 2,700,401	\$ 3,246,990	\$ 12,474,394

* The Amaruk and Pelly Bay projects, included in Other Properties in 2003, were merged in 2004.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements

December 31, 2004

(expressed in Canadian dollars)

5. Mineral Properties (continued)

	Blue Ice	Hadley Bay	Wellington	Washburn	Holman	Kidme	White Ice	Amaruk	Other Properties	Total
Balance at										
Dec. 31, 2002	\$1,599,906	\$ -	\$ -	\$ 623,444	\$ 30,718	\$ 95,432	\$ -	\$ -	\$ 943,706	\$ 3,293,206
Additions during the year:										
Acquisition:	82,030	333	81,078	-	-	-	192,703	243,278	25,423	624,845
Exploration:										
Administration	3,658	403	58	-	1,276	269	-	-	4,829	10,493
Airborne	389,686	33,416	-	-	47,637	63,781	69,960	-	-	604,480
Drilling	1,687,959	175,168	356,233	-	261,582	-	5,930	-	123,344	2,610,216
Environment	7,972	91	209	-	8,214	-	24	-	7	16,517
Geochemistry	44,221	1,543	16,557	-	-	428	-	182,293	300,761	545,803
Geology	131,463	31,625	22,651	2,315	11,018	1,851	7,356	-	33,740	242,019
Geophysics	329,593	36,938	74,187	409	25,743	593	5,709	8,204	26,981	508,357
Mobilization	12,423	1,665	1,807	-	1,592	-	56	-	11,478	29,021
Permitting	11,808	3,775	514	-	11,743	-	3,035	2,391	49,846	83,112
Property	-	9,709	542	22,119	106	28,530	-	850	15,296	77,152
Trenching	27,192	15,591	-	-	293	-	62	-	14	43,152
	2,645,975	309,924	472,758	24,843	369,204	95,452	92,132	193,738	566,296	4,770,322
Less:										
Recoveries	(1,456,566)	-	(551,881)	-	(268,075)	-	-	-	(67,028)	(2,343,550)
Option payments	-	-	-	-	(43,000)	-	-	-	(21,000)	(64,000)
	(1,456,566)	-	(551,881)	-	(311,075)	-	-	-	(88,028)	(2,407,550)
Net additions	1,271,439	310,257	1,955	24,843	58,129	95,452	284,835	437,016	503,691	2,987,617
Write down	-	-	-	-	-	-	-	-	(505,834)	(505,834)
Balance at										
Dec. 31, 2003	\$2,871,345	\$ 310,257	\$ 1,955	\$ 648,287	\$ 88,847	\$ 190,884	\$ 284,835	\$ 437,016	\$ 941,563	\$ 5,774,989

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

5. Mineral Properties (continued)

(a) Blue Ice, Victoria Island, Nunavut

The Company holds a 100% interest in the Blue Ice Project. On June 18, 2003, the Company entered into a Participation Agreement with Teck Cominco Limited ("Teck Cominco") whereby Teck Cominco completed, on June 25, 2003, a \$1,000,000 private placement of 909,091 units at a price of \$1.10 per unit, with each unit consisting of one common share and one half warrant, and funded 50% of a \$3,000,000 exploration program on the property.

On March 24, 2004, Teck Cominco elected under the Participation Agreement to take up an initial option to earn a 30% interest in the Blue Ice Project by exercising the warrants for a price of \$500,000 and to incur an additional \$9,500,000 in expenditures over 3 years. In addition, the Company and Teck Cominco entered into an agreement (the "2004 Amending Agreement") to allow Teck Cominco, at its option, to expand the Participation Agreement to include the Company's adjoining White Ice and Hadley Bay properties. In consideration, Teck Cominco paid the Company \$55,000 on signing of the 2004 Amending Agreement and increased the 2004 expenditure requirement from \$2,000,000 to \$3,000,000. On December 9, 2004, Teck Cominco elected to include portions of the White Ice and Hadley Bay properties under the Participation Agreement, paid the Company an additional \$55,000 and increased the initial 30% interest aggregate expenditure requirements from \$9,500,000 to \$11,500,000, to be incurred by December 31, 2007.

On earning the initial 30% interest, Teck Cominco shall have the right to earn the following additional interests in the Blue Ice Project:

- (i) an additional 20% interest may be earned (for an aggregate 50% interest) by incurring an additional \$5,000,000 for exploration on the property;
- (ii) on earning a 50% interest, an additional 15% interest may be earned (for an aggregate 65% interest) by funding all continuing exploration expenditures to the completion of a feasibility study with respect to developing a mine on the property; and
- (iii) on earning a 65% interest, an additional 5% interest may be earned (for an aggregate 70% interest) by arranging or providing all financing for a mine on the property.

(b) Hadley Bay, Victoria Island, Nunavut

The Company holds a 100% interest in the Hadley Bay Project. On March 24, 2004, an option was granted to Teck Cominco to earn up to a 70% interest in the property (Note 5(a)).

(c) Wellington, Victoria Island, Nunavut

The Company holds a 100% interest in the Wellington Project. In 2002, an option was granted to Majescor Resources Inc. ("Majescor"), whereby Majescor can earn a 50% interest in the property in consideration of expending \$2,250,000 on the property by December 31, 2006. The remaining expenditures required of Majescor are as follows:

Completion date	Amount
December 31, 2005	\$ 500,000
December 31, 2006	\$ 750,000

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

5. Mineral Properties (continued)

(d) Washburn, Victoria Island, Nunavut

The Company holds a 51.45% interest in the Washburn property.

(e) Kidme, NWT

The Company owns 40% of the 90,000 acre Kidme Project situated adjacent to the eastern border of the Misty Lake property (Note 5(i)(i)). SouthernEra Resources Ltd., the co-owner of the property, owns 60% of the property.

In 2004, the Company staked an additional 80,000 acres of claims to the south of the original block covering prospective geophysical anomalies. This new land position is held on a 50-50 basis by the two companies.

(f) White Ice, Victoria Island, NWT

The Company holds a 100% interest in the White Ice Project, which consists of 239,141 acres located to the west of the Blue Ice Project. On March 24, 2004, an option was granted to Teck Cominco to earn up to a 70% interest in the property (Note 5(a)).

(g) Amaruk, Nunavut

On May 10, 2004, the Company and BHP Billiton Diamonds Inc. ("BHP Billiton") entered into an agreement to merge the Amaruk and Pelly Bay JV Projects along with approximately 3.5 million acres of land held by BHP Billiton. The new project covers approximately 7.0 million acres around the town of Kugaaruk, Nunavut with each party holding a 50% interest in the project.

BHP Billiton has initiated the first option which will allow BHP Billiton to earn an additional 10% interest (for an aggregate 60% interest) by solely funding the project to feasibility on or before May 10, 2011. After completing the first option, BHP Billiton can elect to earn an additional 5% interest (for an aggregate 65% interest) by arranging the Company's portion of financing to production.

As part of the agreement, BHP Billiton reimbursed the Company for \$500,000 in land acquisition costs and for costs associated with a geophysical survey. In addition, BHP Billiton subscribed to a private placement of \$500,000 consisting of 357,143 common shares at a price of \$1.40 per share, see Note 7(c) (i). Over the next three years, at the election of the Company, BHP Billiton may subscribe to three separate private placements of \$1,000,000 each. Each private placement would consist of common shares at a price with a 20% premium to the market price (Note 14(a)).

(h) Northern Recon, Nunavut and NWT

The Northern Recon Initiative comprises numerous Canadian grassroots projects within the Company's property portfolio. In 2003, the initiative resulted in the formation of the Amaruk project. Additional projects formed through the initiative include the Red Ice and Argonaut projects on Victoria Island and claims recently staked in the Melville Peninsula area of Nunavut (Note 14(d)).

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

5. Mineral Properties (continued)

(i) Other Properties

(i) Misty Lake, NWT

The Company holds approximately a 40% interest in the Misty Lake Joint Venture. At December 31, 2004, the carrying value of the Misty Lake property is \$279,204 (2003 - \$279,176).

(ii) GTEN, NWT

The Company held a 35% interest in four claims in the Drybones Bay area. An option was granted to Snowfield Development Corp. ("Snowfield"), whereby the optionee could earn a 50% interest in the Company's interest in the project by expending \$950,000 on the claims by 2004 and issuing 250,000 common shares to the Company over two years. After evaluating the drill program results, both companies mutually agreed not to take the claims to lease and have allowed the claims to lapse.

(iii) Holman, Victoria Island, NWT

The Company holds a 100% interest in the Holman Project. An option had been granted to Serengeti Resources Inc. ("Serengeti"), whereby Serengeti could have earned a 50% interest in the property. On March 15, 2004, by mutual agreement, the companies elected to terminate the option agreement. At December 31, 2004, the carrying value of the Holman Project is \$93,287 (2003 - \$88,847).

(iv) Yankee, Victoria Island, Nunavut

The Company holds a 90% interest in the Yankee Project. By a letter agreement dated April 25, 2003, the Company and Hawkeye Gold & Diamond Inc. ("Hawkeye") agreed to settle a property interest dispute, debt and all other outstanding issues relating to the Yankee Project by Hawkeye agreeing to reduce its interest from 33 1/3% to a 10% carried interest until May 31, 2004. On June 1, 2004, the carried interest was automatically converted to a 10% working interest, which is subject to dilution. During 2004, the carrying value of the Yankee property was written down by \$208,879 to \$Nil (2003 - \$213,127).

(v) Manitoba NE Highlands, Manitoba

On May 7, 2004, the Company acquired eight mineral exploration licenses totaling 873,000 acres in northern Manitoba. Five licenses were granted to the Company through the license application process and a 100% interest in three additional licenses were acquired from a private company, Indicator Explorations Ltd. ("Indicator Explorations"). Consideration for the agreement with Indicator Explorations consists of a cash payment of \$10,000 (paid) and the issuance of 20,000 common shares (issued). Additional cash payments in the aggregate of \$530,000 are payable to Indicator Explorations in stages to May 7, 2008. The Company will also pay up to \$240,000 to Indicator Explorations in respect of bulk samples from the property. Indicator Explorations retains a 1% gross overriding royalty based on diamond production and a 1% net smelter royalty based on metal productions. The Company may purchase 0.75% of both of the royalties for \$5,000,000. At December 31, 2004, the carrying value of the Manitoba NE Highlands project is \$334,876 (2003 - \$Nil).

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

5. Mineral Properties (continued)

(vi) Arnak, NU

On July 8, 2004, the Company entered into an agreement with Kennecott Canada Exploration Inc. ("Kennecott") to merge land holdings in Nunavut. The 956,000-acre property, named "Arnak" is located immediately south of the Company's Amaruk project. The Arnak property now includes 616,000 acres of permits acquired by Kennecott, approximately 140,000 acres of claims (subject to a 2% royalty payable to BHP Billiton) staked by the Company and 200,000 acres of claims staked by the Company and paid for by Kennecott. Under the terms of the agreement, Kennecott holds a 74% interest and the Company holds a 26% interest in the Arnak property.

Kennecott must solely fund the first \$5,500,000 in exploration costs over the next four years or its entire interest reverts to a 1% royalty on the 616,000 acres of permits only. Upon Kennecott completing their commitment, the Company will be required to pay its pro-rata share of expenditures made thereafter or be subject to dilution. This agreement is subject to the Nunavut Mining Recorder awarding the Company 80% or more of the 140,000-acre claim block. At December 31, 2004, the carrying value of the Arnak project is \$49,179 (2003 - \$Nil).

(vii) Other Properties

The Company holds a minimum of 40% to 100% interest in various other properties located in Nunavut and the Northwest Territories. The Company has also conducted exploration work on project areas located in Nunavut, the Northwest Territories and Quebec, with a view to potential acquisition, should the properties prove of merit. At December 31, 2004, the aggregate carrying value of these other properties is \$2,490,444 (2003 - \$449,260).

6. Property, Plant and Equipment

	Cost	Accumulated Amortization	2004 Net Book Value
Furniture and fixtures	\$ 31,317	\$ 5,305	\$ 26,012
Computer equipment	34,447	13,323	21,124
Leasehold improvements	31,595	2,633	28,962
	<u>\$ 97,359</u>	<u>\$ 21,261</u>	<u>\$ 76,098</u>

	Cost	Accumulated Amortization	2003 Net Book Value
Furniture and fixtures	\$ 9,730	\$ 1,501	\$ 8,229
Computer equipment	22,324	6,867	15,457
Leasehold improvements	33,073	-	33,073
	<u>\$ 65,127</u>	<u>\$ 8,368</u>	<u>\$ 56,759</u>

Leasehold improvements costs are in connection with the office premises (Note 9).

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

7. Share Capital**(a) Authorized:**

100,000,000 common shares without par value.

(b) Issued:

	Number of Shares	Amount
Balance at December 31, 2002	12,974,152	\$ 5,513,740
Issued for cash		
Private placements, net of issue costs (Note 7(c))	5,277,716	4,281,868
Exercise of warrants	4,772,635	2,944,406
Issued for cash and other consideration		
Exercise of options, for cash	231,760	89,190
Exercise of options, stock-based compensation	-	55,147
Issued for other consideration		
For loan payment	340,000	170,000
Balance at December 31, 2003	23,596,263	13,054,351
Issued for cash		
Private placement, net of issue costs (Note 7(c))	3,466,857	4,010,709
Exercise of warrants	1,151,151	1,043,237
Issued for cash and other consideration		
Exercise of options, for cash	219,050	110,563
Exercise of options, stock-based compensation	-	73,112
For mineral property	20,000	20,800
Balance at December 31, 2004	28,453,321	\$ 18,312,772

As at December 31, 2004, there were no shares held in escrow (2003 - 447,500 common shares).

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements

December 31, 2004

(expressed in Canadian dollars)

7. Share Capital (continued)

(c) Private Placements

- (i) On June 17, 2004, the Company completed a non-brokered private placement with BHP Billiton and Teck Cominco of 392,857 common shares at a price of \$1.40 per share for gross proceeds of \$550,000. Share issue costs of \$3,250 were paid in connection with this private placement.
- (ii) On July 2, 2004, the Company completed a brokered private placement of 2,400,000 flow-through common shares at a price of \$1.25 per share for gross proceeds of \$3,000,000. An aggregate of 168,000 Agents' Warrants to purchase up to 168,000 common shares at a price of \$1.35 per share for a period of one year were granted to Agents of the financing. Fees totaling \$185,000 and other share issue costs of \$35,540 were paid in connection with the financing.
- (iii) On July 28, 2004, the Company completed a non-brokered private placement with Teck Cominco for 144,000 flow-through common shares at \$1.25 per share for gross proceeds of \$180,000. Share issue costs of \$1,555 were paid in connection with this private placement.
- (iv) On December 23, 2004, the Company completed a non-brokered private placement of 500,000 flow-through common shares and 30,000 common shares both at a price of \$1.00 per share for gross proceeds of \$530,000. Agents' Warrants to purchase up to 23,950 common shares at a price of \$1.00 per share for a period of one year were issued. Fees totaling \$20,220 and other share issue costs of \$3,726 were paid in connection with the financing. All the securities are subject to a hold period and may not be traded until April 24, 2005.
- (v) On March 21, 2003, the Company completed a non-brokered private placement for the issue of 1,400,000 units at \$0.80 per unit for gross proceeds of \$1,120,000. Each unit consisted of one common share and one non-transferable share purchase warrant. Each warrant entitles the holder to acquire one additional common share exercisable at a price of \$0.80 per share for a period of two years. The units will have a forced warrant conversion if the Company's shares trade at \$1.60 or higher for ten consecutive trading days. The warrant holder will then have 30 days thereafter to exercise the warrants and any unexercised warrants will expire unexercised. The Company issued 47,000 shares and paid \$3,200 in finders' fees. The Company also incurred additional share issue costs in the amount of \$14,201 in connection with the private placement.
- (vi) On June 25, 2003, the Company completed a non-brokered private placement for the issue of 909,091 units at \$1.10 per unit for gross proceeds of \$1,000,000. Each unit consisted of one common share and one half of one non-transferable share purchase warrant. Each whole warrant entitled the holder to purchase one common share at a price of \$1.10 per common share until June 29, 2004. The Company also incurred additional share issue costs in the amount of \$5,975 in connection with the private placement.
- (vii) On August 22, 2003, the Company completed a private placement of 2,921,625 flow-through common shares at a price of \$0.80 per share for gross proceeds of \$2,337,300. The Company paid finders' fees in the aggregate of \$138,390 and issued warrants to its agents for the purchase of 157,237 common shares exercisable at a price of \$0.80 per share to August 22, 2004. The Company also incurred additional share issue costs in the amount of \$13,666 in connection with the private placement.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
 December 31, 2004
 (expressed in Canadian dollars)

7. Share Capital (continued)**(d) Stock Options**

Options to purchase common shares have been granted to directors, employees and consultants at exercise prices determined by reference to the market value on the date of the grant. Under the Company's Stock Option Plan, the Company may grant stock options for the purchase of up to 4,938,305 common shares. Vesting of stock options is made at the discretion of the board of directors at the time the options are granted. As at December 31, 2004, the Company had stock options outstanding for the purchase of 3,424,650 common shares with an average remaining contractual life of 3.50 years, of which 2,889,650 stock options were exercisable at December 31, 2004.

	Shares	Weighted Average Exercise Price
Outstanding at December 31, 2002	1,601,910	\$0.47
Granted	968,550	\$0.78
Exercised	(231,760)	\$0.38
Outstanding at December 31, 2003	2,338,700	\$0.60
Granted	1,320,000	\$1.10
Exercised	(219,050)	\$0.50
Cancelled	(15,000)	\$0.70
Outstanding at December 31, 2004	3,424,650	\$0.80

The following summarizes information about stock options outstanding at December 31, 2004:

Number of Shares	Exercise Price	Expiry Date
52,300	\$0.25	September 11, 2006
9,500	\$0.25	January 10, 2007
1,062,300	\$0.50	July 15, 2007
70,000	\$0.50	September 18, 2007
50,000	\$0.80	December 19, 2007
487,200	\$0.80	February 20, 2008
100,000	\$0.80	March 4, 2008
102,350	\$0.80	May 22, 2008
171,000	\$0.70	October 6, 2008
200,000	\$1.19	March 30, 2009
200,000	\$1.19	April 4, 2009
620,000	\$1.10	August 8, 2009
300,000	\$1.00	October 18, 2009
3,424,650		

Subsequent to December 31, 2004, 102,500 stock options were cancelled. For stock options exercised after December 31, 2004, see Note 14(h).

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
 December 31, 2004
 (expressed in Canadian dollars)

7. Share Capital (continued)**(e) Stock-Based Compensation**

In the fourth quarter of fiscal 2003, the Company adopted the CICA released amendments to Section 3870, "Stock Based Compensation and Other Stock-based Payments," which require an expense to be recognized in the financial statements for all forms of employee stock-based compensation, including stock options. Prior to the adoption, the Company disclosed the effects of accounting for stock-based compensation only for directors and employees as compensation expense, using the fair-value based method, as pro-forma information in the notes to the consolidated financial statements.

The fair value of stock options used to calculate compensation expense is estimated using the Black-Scholes Option Pricing Model with the following weighted average assumptions at December 31, 2004:

	2004	2003
Risk-free interest rate	2.98%	3.38%
Expected dividend yield	-	-
Expected stock price volatility	85%	86%
Expected option life in years	2.5	2.5

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options granted/vested during the year.

(f) Warrants

At December 31, 2004, the Company had outstanding warrants to purchase an aggregate of 1,061,590 common shares as follows:

Exercise Price	Expiry Date	Outstanding at December 31, 2003	Issued	Exercised	Expired	Outstanding at December 31, 2004
\$0.505	February 28, 2004	47,619	-	47,619	-	-
\$1.10	June 29, 2004	454,545	-	454,545	-	-
\$0.80	August 22, 2004	157,237	-	118,987	38,250	-
\$0.80	February 28, 2005	955,000	-	460,000	-	495,000
\$0.80	March 19, 2005	445,000	-	70,000	-	375,000
\$1.35	July 4, 2005	-	168,000	-	-	168,000
\$1.00	December 23, 2005	-	23,590	-	-	23,590
		2,059,401	191,590	1,151,151	38,250	1,061,590

For warrants exercised after December 31, 2004, see Note 14(h).

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements

December 31, 2004

(expressed in Canadian dollars)

8. Related Party Transactions

The Company had the following related party transactions and balances:

- (a) Fees in the aggregate of \$16,229 (2003 - \$34,404) for legal services have been paid to a law firm of which a director of the Company is a principal. Of this amount, \$11,229 (2003 - \$28,946) has been charged to legal expense and \$5,000 (2003 - \$5,458) to share capital.
- (b) As at December 31, 2004, two directors of the Company have been paid or are owed a total of \$25,350 (2003 - \$67,200) for consulting fees. Of this amount, \$16,475 (2003 - \$59,000) has been charged to deferred exploration expenditures and \$8,875 (2003 - \$8,200) has been expensed.
- (c) Included in accounts receivable is \$41,700 (2003 - \$Nil) owed by Commander Resources Ltd. ("Commander"), a company related by virtue of a common director, for a work deposit refund on a property purchased from Commander in fiscal 2002 and shared office costs.
- (d) Amounts due to related parties, totalling \$15,613 (2003 - \$35,999), consist of fees and expenses owed to directors and shared administrative expenses owed to a company related by virtue of a common director.
- (e) Commander held a 6.9% (2003 - 7.5%) interest in the Company at December 31, 2004.

9. Commitment

On December 18, 2003, the Company entered into an agreement for the lease of new office premises for a six-year period, commencing on July 1, 2004 and expiring on June 30, 2010. The cost of the entire premises is shared amongst several companies in proportion to the area occupied. One of the companies is related by virtue of a common director. The Company's proportionate share of minimum annual rental payments under this arrangement is approximately \$84,000.

10. Segmented Information

The Company has one operating segment, mineral exploration, and all assets of the Company are located in Canada.

Revenues for the period are derived from interest on deposits and mineral property transactions, which were earned in Canada.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
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 (expressed in Canadian dollars)

11. Supplemental Cash Flow Information

	2004	2003	2002
Significant non-cash operating, investing and financing activities:			
Investing activities			
Marketable securities received in settlement of accounts receivable	\$ 51,475	\$ -	\$ -
Mineral properties acquired with shares	20,800	-	1,484,840
Marketable securities received for option payments	-	(64,000)	(24,000)
	<u>\$ 72,275</u>	<u>\$ (64,000)</u>	<u>\$ 1,460,840</u>
Financing activities			
Debt financing costs paid with shares	\$ -	\$ -	\$ 445,000
Loan payment paid with shares	-	170,000	130,000
Stock-based compensation	73,112	55,147	22,383
	<u>\$ 73,112</u>	<u>\$ 225,147</u>	<u>\$ 597,383</u>
Other cash flow information:			
Interest received	\$ 86,506	\$ 45,024	\$ 5,109
Interest paid	-	18,543	-
Income taxes paid	-	-	-

12. Income Taxes

The Company has accumulated non-capital losses for Canadian income tax purposes of approximately \$1,251,000. The losses may be carried forward to reduce taxable income in future years and, unless utilized, expire in 2010.

2009	\$ 264,000
2010	987,000
	<u>\$ 1,251,000</u>

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements

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(expressed in Canadian dollars)

12. Income Taxes (continued)

The reconciliation of income tax provision computed at statutory rates to the reported income tax provision is as follows:

	2004	2003	2002
	35.62%	37.62%	39.62%
Income tax computed at Canadian statutory rates	\$ 739,652	\$ 756,993	\$ 377,681
Temporary differences not recognized in period	(187,444)	(385,780)	(42,720)
Tax losses not recognized	-	-	(334,961)
Change in tax rates	(186,287)	99,917	-
Future income tax liabilities, net	\$ (365,921)	\$ (471,130)	\$ -

Future income tax assets and liabilities are recognized for temporary differences between the carrying amount of the balance sheet items and their corresponding tax values as well as for the benefit of losses available to be carried forward to future years for tax purposes that are likely to be realized. Significant components of the Company's future tax assets and liabilities, after applying enacted corporate income tax rates, are as follows:

	2004	2003	2002
Future income tax assets (liabilities)			
Non-capital losses carried forward	\$ 445,593	\$ 661,150	\$ 309,672
Temporary differences on mineral properties	(1,307,109)	(1,146,392)	(12,659)
Temporary differences on other assets	24,465	14,112	51,333
	(837,051)	(471,130)	348,346
Valuation allowance	-	-	(348,346)
Future income tax liabilities, net	\$ (837,051)	\$ (471,130)	\$ -

The Company's future income tax liability arises primarily from the renunciation of mineral exploration costs on flow-through shares issued to investors.

Flow-through shares entitle a company that incurs certain resource expenditures in Canada to renounce them for tax purposes allowing the expenditures to be deducted for income tax purposes by the investors who purchased the shares. A future income tax liability arises from the renunciation of mineral exploration costs to investors of flow-through shares.

Funds raised through the issuance of flow-through shares are required to be expended on qualified Canadian mineral exploration expenditures, as defined pursuant to Canadian income tax legislation. The flow-through gross proceeds less the qualified expenditures made to date, represent the funds received from flow-through share issuances which have not been spent as at December 31, 2004 and which are held in trust for such expenditures. As at December 31, 2004 the amount of flow-through proceeds remaining to be expended is \$921,272 (2003 - \$127,450).

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements

December 31, 2004

(expressed in Canadian dollars)

13. Differences between Canadian and United States Generally Accepted Accounting Principles (GAAP)

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. Except as set out below, these financial statements also comply, in all material aspects, with accounting principles generally accepted in the United States and the rules and regulations of the U.S. Securities and Exchange Commission. The differences between Canadian and U.S. GAAP are summarized as follows:

(a) Mineral Properties

Under Canadian GAAP acquisition costs and exploration expenditures are deferred as explained in note 2(e).

Under U.S. GAAP, exploration costs incurred in locating areas of potential mineralization are expensed as incurred. Commercial feasibility is established in compliance with Industry Guide 7 which consists of identifying that part of a mineral deposit that could be economically and legally extracted or produced at the time of the reserve determination. After an area of interest has been assessed as commercially feasible, expenditures specific to the area of interest for further development are capitalized. In deciding when an area of interest is likely to be commercially feasible, management may consider, among other factors, the results of prefeasibility studies, detailed analysis of drilling results, the supply and cost of required labour and equipment, and whether necessary mining and environmental permits can be obtained.

Under U.S. GAAP, mining projects and properties are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. If estimated future cash flows expected to result from the use of the mining project or property, an impairment is recognized based upon the estimated fair value of the mining project or property. Fair value generally is based on the present value of estimated future net cash flows for each mining project or property, calculated using estimated mineable reserves and mineral resources based on engineering reports, projected rates of production over the estimated mine life, recovery rates, capital requirements, remediation costs and future prices considering the Company's hedging and marketing plans.

(b) Available-for-sale Securities

Under U.S. GAAP, securities that are available-for-sale are recorded at fair value and unrealized gains or losses are excluded from earnings and recorded as a separate component of shareholders' equity. Securities that experience a decline in fair value that is other than temporary are written down. Under Canadian GAAP, investments in marketable securities are carried at the lower of cost and estimated fair market value.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
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13. Differences between Canadian and United States Generally Accepted Accounting Principles (GAAP) (continued)

(c) Flow-through shares

Under Canadian income tax legislation, corporations are permitted to issue shares whereby the corporation agrees to incur qualifying expenditures as defined under the Canadian Income Tax Act, and renounce the related income tax deductions to the investors.

Canadian GAAP treatment of flow-through shares changed during 2004. Before March 2004, the funds received through the issuance of flow-through shares were recorded as share capital. Once the qualifying expenditures were made, the carrying values of both the unproven mineral property and the share capital were reduced by the amount of the tax benefit renounced, calculated at the Company's effective tax rate. As the Company's effective tax rate was 0% for 2004, 2003 and 2002, no adjustment of this nature was required.

In March, 2004, the Canadian Institute of Chartered Accountants ("CICA") released EIC - 146 "Flow-Through Shares", which requires the future income tax liability resulting from the timing differences on exploration expenditures renounced to investors and the resulting draw down of such future income tax liability be recorded as a credit to income upon renunciation of the exploration expenditures by the Company. EIC - 146 is effective for all flow-through share transactions initiated after March 19, 2004.

Canadian GAAP does not require a separate allocation of the amount of funds received by the Company attributable to the flow-through feature at the time of issue. However, the Company has elected not to classify the unspent portion of funds received as cash and cash equivalents. The Company has disclosed the amount as a separate line item on the balance sheet and on the statement of cash flows, as cash exploration funds. Adequate disclosure of the commitment to incur qualifying expenditures and renounce the related tax deductions is required under Canadian GAAP.

U.S. GAAP requires the premium or discount from the market trading price at the time an irrevocable agreement to issue the flow-through shares exists, to be accounted for separately on the balance sheet. At the time the expenditures are renounced, the previously recorded premium or discount is reversed and offset against the tax provision on the income statement, and the deferred income tax liability on the balance sheet recorded. Also notwithstanding whether there is a specific requirement to segregate the funds, the flow-through share funds which are unexpended at the balance sheet date are considered to be restricted and are not considered to be cash or cash equivalents under U.S. GAAP.

(d) Impact of recent United States Accounting Pronouncements

- (i) In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51, Consolidated Financial Statements. Interpretation 46 establishes accounting guidance for consolidation of variable interest entities that function to support the activities of the primary beneficiary. Interpretation 46 applies to any business enterprise both public and private that has a controlling interest, contractual relationship or other business relationship with a variable interest entity. The Company has no investment in or contractual relationship or other business relationship with a variable interest entity and therefore the adoption did not have any impact on the Company's consolidated financial position, results of operations or cash flows.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
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13. Differences between Canadian and United States Generally Accepted Accounting Principles (GAAP) (continued)

(d) Impact of recent United States Accounting Pronouncements (continued)

- (ii) On April 30, 2003, the FASB issued Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. Statement 149 is intended to result in more consistent reporting of contracts as either freestanding derivative instruments subject to Statement 133 in its entirety, or as hybrid instruments with debt host contracts and embedded derivative features. In addition, Statement 149 clarifies the definition of a derivative by providing guidance on the meaning of initial net investments related to derivatives. Statement 149 is effective for contracts entered into or modified after June 30, 2003. The adoption of Statement 149 did not have any effect on its consolidated financial position, results of operations or cash flows.
- (iii) In May 2003, the FASB issued SFAS No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or asset in some circumstances). These requirements of SFAS No. 150 apply to issuers' classification and measurement of freestanding financial instruments, including those that comprise more than one option or forward contract. SFAS No. 150 does not apply to features that are embedded in a financial instrument that is not a derivative in its entirety. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatory redeemable financial instruments of non-public entities. The adoption of Statement 150 did not have any effect on its consolidated financial position, results of operations or cash flows.
- (iv) FAS 153, Exchanges of non monetary Assets. The provisions of this Statement are effective for non monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for non monetary asset exchanges occurring in fiscal periods beginning after December 16, 2004. The provisions of this Statement should be applied prospectively. There is no impact on the Company's financial statements.
- (v) FIN 46(R), Consolidation of Variable Interest Entities, applies at different dates to different types of enterprises and entities, and special provisions apply to enterprises that have fully or partially applied Interpretation 46 prior to issuance of Interpretation 46(R). Application of Interpretation 46 or Interpretation 46(R) is required in financial statements of public entities that have interests in variable interest entities or potential variable interest entities commonly referred to as special purpose entities for periods ending after December 15, 2003. Application by public entities (other than small business issuers) for all other types of entities is required in financial statements for periods ending after March 15, 2004. Application by small business issuers to entities other than special-purpose entities and by nonpublic entities to all types of entities is required at various dates in 2004 and 2005. In some instances, enterprises have the option of applying or continuing to apply Interpretation 46 for a short period of time before applying Interpretation 46(R). There is no impact on the Company's financial statements.
- (vi) In 2004, FASB issued a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. This Statement supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. This revised pronouncement requires that all stock options and warrants be accounted for using the Fair Value Method. This pronouncement will have no impact on the Company, as the Company accounts for all options and warrants using the Fair Value Method under Canadian GAAP.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
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(expressed in Canadian dollars)

13. Differences between Canadian and United States Generally Accepted Accounting Principles (GAAP) (continued)

(e) Reconciliation

The effect of the differences between Canadian GAAP and U.S. GAAP on the consolidated balance sheets and consolidated statements of operations and deficit and cash flows is summarized as follows:

Consolidated Balance Sheets

Increase (decrease) in accounts to comply with U.S. GAAP:

	2004	2003
Total assets under Canadian GAAP	\$ 14,709,482	\$ 10,884,162
Adjustment to reconcile to U.S. GAAP		
Write-off of capitalized mineral property costs	(12,474,394)	(5,774,989)
Unrealized gain on available-for-sale securities	89,925	4,600
Total assets under U.S. GAAP	\$ 2,325,013	\$ 5,113,773
Shareholders' equity under Canadian GAAP	\$ 13,200,494	\$ 10,083,335
Adjustments to reconcile to U.S. GAAP		
Add: Deficit under Canadian GAAP	5,981,847	3,539,419
Less: Deficit under U.S. GAAP	(18,366,316)	(9,309,808)
Total shareholder's equity under U.S. GAAP	\$ 816,025	\$ 4,312,946

Consolidated Statements of Operations and Deficit

	2004	2003	2002
Loss for the period, under Canadian GAAP	\$ (2,442,428)	\$ (2,483,340)	\$ (953,258)
Adjustments to reconcile to U.S. GAAP			
Option payments and recoveries received in the year	2,671,648	2,407,550	1,902,817
Mineral property costs incurred in the year	(9,650,600)	(5,395,167)	(5,214,023)
Reversal of write-off of mineral properties	279,547	505,834	-
Loss under U.S. GAAP	(9,141,833)	(4,965,123)	(4,246,464)
Unrealized gain on available-for-sale securities	85,325	1,600	3,000
Loss for the period, under U.S. GAAP	(9,056,508)	(4,963,523)	(4,243,464)
Deficit under U.S. GAAP – beginning of period, as previously reported	(9,309,808)	(4,243,464)	-
Adjustment for stock-based compensation (Note 7 (e))	-	(102,821)	-
Deficit under U.S. GAAP – beginning of period, as restated	(9,309,808)	(4,346,285)	-
Deficit under U.S. GAAP – end of period	\$ (18,366,316)	\$ (9,309,808)	\$ (4,243,464)
Basic and diluted earnings (loss) per share under U.S. GAAP	\$ (0.35)	\$ (0.28)	\$ (0.63)
Weighted average number of shares outstanding	26,110,244	17,986,142	6,685,551

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2004
(expressed in Canadian dollars)

13. Differences between Canadian and United States Generally Accepted Accounting Principles (GAAP) (continued)

(e) Reconciliation (continued)

Consolidated Statements of Cash Flows

	2004	2003	2002
Cash from (applied to) operating activities under Canadian GAAP	\$ (1,474,389)	\$ (1,469,499)	\$ (705,153)
Adjustment to reconcile to U.S. GAAP			
Option payments and recoveries received in the period	2,671,648	2,343,550	1,920,817
Mineral property costs incurred in the period	(9,650,600)	(5,395,167)	(3,753,183)
Cash applied to operating activities under U.S. GAAP	\$ (8,453,341)	\$ (4,521,116)	\$ (2,537,519)
Cash applied to investing activities under Canadian GAAP	\$ (7,404,682)	\$ (2,011,982)	\$ (2,825,412)
Adjustments to reconcile to U.S. GAAP			
Mineral property costs, net of recoveries, incurred in the period	6,958,152	3,051,617	1,832,366
Cash from (applied to) investing activities under U.S. GAAP	\$ (446,530)	\$ 1,039,635	\$ (993,046)

14. Subsequent Events

- (a) On January 21, 2005, the Company completed a \$1,000,000 non-brokered private placement with BHP Billiton consisting of 970,874 common shares at a \$1.03 per share. The shares are subject to a hold period and may not be traded until May 22, 2005.
- (b) On January 26, 2005, the Company staked the 162,000 acre Kennap property located 235 kilometres northeast of Yellowknife, Northwest Territories. The Kennap property is the second project acquired as part of the Company's 2004 Northern Recon Initiative.
- (c) On February 9, 2005, the Company completed a \$60,000 non-brokered private placement with Teck Cominco consisting of 58,253 common shares at a price of \$1.03 per share. The shares are subject to a hold period and may not be traded until June 4, 2005.
- (d) On February 7, 2005, the Company was awarded 12 million acres of exploration permits in Nunavut and the Northwest Territories that had been identified during the Company's 2004 Northern Recon Initiative program.
- (e) On January 28, 2005, the Company granted stock options to an employee for the purchase of up to 50,000 common shares at a price of \$1.00 per share to January 27, 2010.
- (f) On March 23, 2005, the Company granted stock options to employees for the purchase of up to 252,500 common shares at a price of \$1.15 per share to March 22, 2010.
- (g) On April 1, 2005, the Company completed a major land acquisition program in the NWT and Nunavut, 300 kilometres north of Yellowknife. A total of 1.5 million acres were staked adjacent to 2.1 million acres of permits that were awarded to the Company in February, 2005 (Note 14(d)). Collectively, the 3.6 million acre claim and permit block form the Hepburn project and is the third project developed from the Company's 2004 Northern Recon Initiative.
- (h) Subsequent to December 31, 2004, the Company issued 159,850 common shares for proceeds of \$105,630 pursuant to the exercise of stock options and 870,000 common shares for proceeds of \$696,000 pursuant to the exercise of warrants.

**Description of Business and Report Date**

Diamonds North Resources Ltd. ("the Company") is an exploration-stage company engaged in the acquisition and exploration of diamond mineral properties in Canada. The principal properties are located in northern Canada throughout Nunavut ("NU") and the Northwest Territories ("NWT"). The Company is a reporting issuer in British Columbia and Alberta, and trades on the TSX Venture Exchange under the symbol DDN. The following discussion and analysis of the financial position and results of operations for the Company should be read in conjunction with the audited consolidated financial statements and the notes thereto for the year ended December 31, 2004.

Forward-Looking Information

This MD&A may contain forward-looking statements that involve risks and uncertainties. Words such as "anticipate," "believe," "estimates," "expects," and similar expressions are used throughout this report to identify these statements. (Forward-looking statements in this MD&A are only made as of April 14, 2005 (the "Report Date"). Please keep in mind that statements which describe the Company's *proposed* plans, objectives, and budgets may differ materially from actual results.

Highlights for the Year Ended December 31, 2004

- On March 24, 2004, Teck Cominco Limited ("Teck Cominco") elected to take up the initial option on the Blue Ice Project, and added the Hadley Bay and White Ice properties under an amended agreement. In 2004, Teck Cominco completed 2,967 line kilometres of airborne geophysics and 605 line kilometres of ground geophysics (including quality control resurveys), collected 217 till samples, and drilled 12 holes on the Blue Ice, Hadley Bay and White Ice properties. The estimated cost of the field program was \$3.38 million.
- On May 7, 2004, the Company acquired eight mineral exploration licenses in northern Manitoba totalling 873,000 acres. Five licenses were granted to the Company through the license application process, and a 100% interest in three additional licenses were acquired from a private company, Indicator Explorations Ltd. In August, a 14,950 line kilometres fixed wing airborne geophysics survey was flown over the property.
- On May 10, 2004, the Company entered into an agreement with BHP Billiton Diamonds Inc. ("BHP Billiton") to merge the Amaruk and Pelly Bay JV Projects along with 3.5 million acres of land held by BHP Billiton. The Amaruk JV covers approximately 8.0 million acres around the town of Kugaruk, Nunavut. In 2004, BHP Billiton completed 11,401 line kilometres of airborne geophysics and collected 3,205 till samples on the Amaruk JV property. The estimated cost of the field program was \$4.5 million.
- On June 17 2004, the Company completed a non-brokered private placement of 392,857 common shares at a price of \$1.40 per share, for proceeds of \$550,000.
- On July 2 2004, the Company completed a brokered private placement of 2,400,000 flow-through common shares at a price of \$1.25 per share, for gross proceeds of \$3,000,000.
- On July 8 2004, the Company entered into a joint venture agreement with Kennecott Canada Exploration Inc. ("Kennecott") to merge land holdings in Nunavut. The 956,000-acre property, named "Arnak," is located immediately south of the Company's Amaruk JV project. Kennecott completed 20,621 line kilometres of fixed wing airborne geophysics and collected 223 heavy mineral samples. The estimated cost of the field program is \$600,000.



Management Discussion and Analysis
For the Year Ended December 31, 2004

- On July 28 2004, the Company completed a non-brokered private placement for 144,000 flow-through common shares at \$1.25 per share, for proceeds of \$180,000.
- On October 19 2004, Terry Lyons was appointed to the Board of Directors of the Company. Mr. Lyons brings over 30 years of business experience in natural resources, manufacturing, real estate, merchant banking and corporate restructuring activities.
- On November 29 2004, the Company reported the acquisition of the Tasiq Project through the staking of 300,000 acres approximately 100 kilometres south of Baker Lake in Nunavut. Tasiq is the first project developed as part of the Company's 2004 Northern Recon Initiative.
- On December 23 2004, the Company completed a non-brokered private placement of 500,000 flow-through common shares and 30,000 common shares, both at a price of \$1.00 per share, for gross proceeds of \$530,000.
- The Company's Northern Recon Initiative collected 1,683 till samples from its Canadian projects. The Company also completed an additional 1,830 and 1,475 line kilometres of airborne geophysics on the Red Ice, NU and Argonaut, NU properties respectively.
- During 2004, the Company raised \$1.15 million dollars through the exercise of warrants and stock options.

During 2004, three key projects were operated and funded by major exploration companies: Teck Cominco, BHP Billiton, and Kennecott. This allowed the Company's exploration team to focus on the 2004 Northern Recon Initiative. Northern Recon Initiative projects included airborne surveys on Victoria Island and in Manitoba and the collection of till samples in Canada. Previously, the Company's 2003 Northern Recon Initiative had been instrumental in the discovery of Amaruk.

Based on the recovery of kimberlite indicator minerals from several till samples collected under the Company's 2004 Northern Recon Initiative program, the Company staked 2 million acres and acquired 12 million acres of exploration permits in Nunavut and NWT. To date, three new projects have been reported: Hepburn, Kennap and Tasiq. Management is optimistic about Hepburn, as first pass mineral chemistry results are better than the first pass results at Amaruk. The Hepburn project covers 3.6 million acres and is located on the west margin of the Slave Craton.

In 2005, the Company will advance these projects through additional till sampling and airborne geophysics. Management has already undertaken steps to prepare for the 2005 exploration season:

Events Subsequent to December 31, 2004

- On January 21, 2005, the Company completed a \$1,000,000 non-brokered private placement with BHP Billiton consisting of 970,874 common shares at \$1.03 per share. These shares are subject to a hold period and may not be traded until May 22, 2005.
- On January 26, 2005, the Company reported the staking of the 162,000-acre Kennap property located 235 kilometres northeast of Yellowknife, NWT. This property is strategically located between two known diamond deposits, and was staked in order to cover several known unresolved kimberlite indicator mineral anomalies. The Kennap property is the second project developed as part of the Company's 2004 Northern Recon Initiative.



Management Discussion and Analysis
For the Year Ended December 31, 2004

- On February 7, 2005, the Company reported it had been awarded 12 million acres of exploration permits in Nunavut and the Northwest Territories. The permits cover multiple kimberlite indicator mineral occurrences and strategic land positions identified by the Company's 2004 Northern Recon Initiative.
- On February 8, 2005, the Company reported the development of a new diamond project on the northeast side of Banks Island, NWT. Based on indicator mineral recoveries, Majescor Resources Inc. and the Company jointly acquired 1,203,493 acres of permits over a two-year period on a 50:50 basis. Kimberlite indicator minerals, including a G10 garnet, were recovered from stream sediment samples.
- On February 9, 2005, the Company completed a \$60,000 non-brokered private placement with Teck Cominco consisting of 58,253 common shares at a price of \$1.03 per share. These shares are subject to a hold period and may not be traded until June 4, 2005.
- On February 28, 2005, the Company reported that planning for the 2005 Blue Ice exploration program was underway. The bulk of the program will comprise drill testing of approximately 75-100 targets and airborne magnetic surveying over two areas on the property. The \$3 million program is being funded and operated by Teck Cominco.
- On April 1, 2005, the Company reported the completion of a major land acquisition program in the NWT and Nunavut, 300 kilometres north of Yellowknife. A total of 1.5 million acres have been staked adjacent to 2.1 million acres of permits that were awarded to the Company (see above). Collectively, the 3.6 million-acre claim and permit block forms the Hepburn project, and is the third project developed from the Company's 2004 Northern Recon Initiative.
- On April 5, 2005, the Company adopted a set of Corporate Governance policies which included a Code of Business Conduct and Ethics, Audit Committee Charter, Disclosure Policy, and Whistleblower Policy. The Corporate Governance policies can be found at the Company's website.
- On April 12, 2005, the Company announced that an estimated \$1 million exploration program on the Arnak property in Nunavut is underway. Kennecott, the project operator is currently mobilizing for a geophysical ground surveying program designed to prioritize targets for drilling. Interpretation of 20,000 line kilometres of magnetic airborne data has been completed and 89 geophysical anomalies have been identified of which 20 of the anomalies have been selected for ground geophysical surveying.
- On April 14, 2005, the Company announced it has signed a memorandum of understanding ("MOU") with Pathfinder Resources Ltd. ("Pathfinder"), whereby Pathfinder can earn an 80% interest in uranium rights in the Company's Thelon exploration permits (3.5 million acres) by making a cash payment of \$100,000; staged issuance of 2 million shares; and exploration expenditures of \$4 million over 3 years. The Company will retain a 20% interest which is carried to completion of a bankable feasibility study on any uranium deposits found on the property.
- Subsequent to December 31, 2004. On January 28, 2005, 50,000 stock options were granted at an exercise price of \$1.00 for five years expiring on January 27, 2010. On March 23, 2005, 252,500 stock options were granted at an exercise price of \$1.15 for five years expiring on March 22, 2010.
- Subsequent to December 31, 2004, the Company issued 159,850 common shares for proceeds of \$105,630 pursuant to the exercise of stock options, and 870,000 common shares for proceeds of \$696,000 pursuant to the exercise of warrants.



Management Discussion and Analysis
For the Year Ended December 31, 2004

Mineral Properties

The Company's principal properties are located in Canada's far north, which poses an inherent risk for mineral exploration due to the remoteness from populated areas, lack of surface infrastructure, and availability of skilled labour, fuel and supplies. Exploration is heavily dependent on air transportation (both fixed wing and helicopter), which is susceptible to bad weather; the unpredictability of the weather can cause delays in carrying out a planned exploration program resulting in cost overruns.

At December 31, 2004, the carrying value of mineral properties was \$12,474,394 -- an increase of \$6,699,405 from December 31, 2003. The Company's mineral property expenditures for the year included \$4,049,833 in acquisition costs and \$5,600,767 in exploration costs. Deductions from mineral property included \$2,671,648 in recoveries from project partners and \$279,547 in write downs.

The Company's mineral projects are comprised of properties located in Canada:

	Blue Ice	Hadley Bay	Wellington	Washburn	Kidme	White Ice	Amaruk JV*	Northern Recon.	Other Properties	Total
Balance at										
Dec. 31, 2003	\$ 2,871,345	\$ 310,257	\$ 1,955	\$ 648,287	\$ 190,884	\$ 284,835	\$ 658,641	\$ -	\$ 808,785	\$ 5,774,989
Additions during the year:										
Acquisition:	5,085	3,395	10,366	-	66,026	-	2,225,207	-	1,739,754	4,049,833
Exploration:										
Administration	45	45	15	15	6,804	23	1,215	-	379	8,541
Airborne geo.	9,920	157	172,607	-	18,931	-	526,205	-	263,209	991,029
Drilling	190,623	21,442	-	-	-	-	-	-	-	212,065
Environment	5,066	-	699	-	-	-	-	-	1,398	7,163
Geochemistry	26,152	2,992	185	-	19,397	-	55,424	1,261,669	704,175	2,069,994
Geology	56,607	13,954	10,378	4,089	11,958	8,682	76,107	14,952	33,364	230,091
Geophysics	74,425	6,467	345	1,814	56,096	1,807	2,717	-	8,615	152,286
Mob/Demob	-	-	-	-	-	-	-	33,700	50,217	83,917
Permitting	8,777	72	-	-	-	-	-	216,991	14,569	240,409
Property	19,385	43,302	39,445	30,050	846	-	-	1,191,824	237,237	1,562,089
Trenching	43,008	175	-	-	-	-	-	-	-	43,183
	434,008	88,606	223,674	35,968	114,032	10,512	661,668	2,719,136	1,313,163	5,600,767
Less:										
Recoveries	-	(6,068)	(235,995)	(2,834)	(33,053)	-	(2,039,798)	(18,735)	(335,165)	(2,671,648)
Net additions	439,093	85,933	(1,955)	33,134	147,005	10,512	847,077	2,700,401	2,717,752	6,978,952
Write down	-	-	-	-	-	-	-	-	(279,547)	(279,547)
Balance at										
Dec. 31, 2004	\$ 3,310,438	\$ 396,190	\$ -	\$ 681,421	\$ 337,889	\$ 295,347	\$ 1,505,718	\$ 2,700,401	\$ 3,246,990	\$ 12,474,394

*The Amaruk and Pelly Bay projects (included under "Other Properties" in 2003) were merged in 2004.

**Blue Ice, Hadley Bay and White Ice Projects, Victoria Island, NU/NWT**

The Blue Ice Project is located 240 kilometres west-northwest of Cambridge Bay, in the Central portion of Victoria Island. The Hadley Bay Project is located to the north and east of Blue Ice, and the White Ice Project is located to the west of Blue Ice. The new Blue Ice Project hosts three known kimberlite trends: the Galaxy, King Eider and Apollo structural trends. All three kimberlite trends form NW - SE oriented linear features along which kimberlite dykes, blows and pipes have been emplaced. All three projects are 100% owned by the Company.

On June 18, 2003, the Company entered into a Participation Agreement with Teck Cominco, in which they can earn up to a 70% interest in the Blue Ice Project. On March 24, 2004, Teck Cominco elected, under the June 18, 2003 Participation Agreement, to take up the initial option to earn a 30% interest. In addition, the Company and Teck Cominco entered into an agreement (the "2004 Amending Agreement") to allow Teck Cominco to expand the Participation Agreement to include the Company's adjoining Hadley Bay and White Ice properties. In consideration, Teck Cominco paid the Company \$55,000 and increased the 2004 expenditure requirement from \$2,000,000 to \$3,000,000. On November 22, 2004, Teck Cominco elected to include the Hadley Bay and White Ice properties under the Participation Agreement, and paid the Company an additional \$55,000 and increased the initial 30% interest aggregate expenditure requirements from \$9,500,000 to \$11,500,000.

Although Teck Cominco funded the 2004 program, the Company still incurred costs on the Blue Ice property due to a 2003 budget shortfall. The Company contributed \$148,691 in field inventory to the 2004 exploration program, \$109,268 of which was allocated to drilling and \$39,423 to geophysics. In addition, the Company assisted with the 2004 till sampling program, which is part of the \$26,099 spent in geochemistry. Other 2003 carry-over expenditures include SGS Lakefield Research lab processing costs and kimberlite interpretation, which are reflected in drilling and trenching expenditures. (The 2003 full square mesh sieve results can be found in the Company's 2003 Annual MD&A and the March 31, 2004 MD&A.)

Blue Ice, Hadley Bay, White Ice Exploration Program for 2004

The objectives of the 2004 exploration program were to gain further information on the distribution of larger diamonds in the Victoria Island kimberlites and to add potential tonnage to the project by drilling new kimberlites on the property. Teck Cominco, the Operator, completed a two phase exploration program at an estimated cost of \$3.38 million. The spring phase operated from May 12 to July 6 and consisted of ground and airborne geophysics. The summer phase operated from July 26 to September 24 and consisted of ground geophysics, till sampling and drilling.

The ground geophysics program operated from May 12 to June 12 and again from July 26 to mid-August and consisted of the collection of 605 line kilometres (including quality control resurveys) of data. Ground geophysics programs were conducted over 60 targets delineated from the 2003/2004 airborne surveys.

From June 14 to July 5, Fugro Airborne Survey Corp. flew 2,967 line kilometres of airborne electromagnetic ("EM") and magnetic surveying. The EM airborne survey detected some of the known kimberlite bodies along the King Eider and Galaxy kimberlite trends, and also identified several new anomalies proving that EM provides the project with another effective method of targeting potential kimberlite bodies.

The Canadian resource exploration sector was extremely busy in 2004, which caused a late start to the drill program. A total of 12 diamond drill holes, representing 1,318 metres of drilling, returned approximately 895 kilograms (field weight) of kimberlite. In addition, another 225 kilograms (field weight) was collected by trenching.

Management Discussion and Analysis
For the Year Ended December 31, 2004

In August, a till geochemical sampling was completed over areas that contained little or no regional data, and focused primarily on the prospective ground located between the Galaxy and King Eider structural trends. A total of 217 till samples were collected.

Blue Ice, Hadley Bay, White Ice Exploration Results for 2004

Diamond results for kimberlite recovered from the King Eider and Turnstone kimberlites are expected in the spring of 2005. Diamond results have already been received for two dykes located 25 metres east of the main Snow Bunting kimberlite and a new kimberlite called H-1, located along the central portion of the King Eider kimberlite structure.

Four core samples collected from two hypabyssal kimberlite dykes, east of the main Snow Bunting kimberlite, were combined to form two composite samples. Sample SB04-1, weighing 46.66 kilograms, yielded three diamonds, while sample SB04-2 returned two diamonds from a 24.6 kilogram sample, with one stone measuring 0.94mm x 0.46mm x 0.31mm.

A 21.07-kilogram core sample from the previously untested H-1 kimberlite returned one stone. The sample was mainly comprised of kimberlite recovered from a 1.72 metre (true width) drill intercept. Table 1 below shows Full Square Mesh Sieve diamond results for the Snow Bunting dykes and H-1 kimberlite samples:

Kimberlite	Sample Weight (kgs)	Sample			Total
		+0.106 mm	+0.150 mm	+0.300 mm	
SB 04-1	46.66	3	-	-	3
SB 04-2	24.60	-	1	1	2
H-1	21.07	1	-	-	1
Total	92.33	4	1	1	6

Due to a favorable diamond size distribution returned from drill core during 2003 (see NR #03-37), the 2004 drill program at Snow Bunting was designed to further test the geometry and diamond potential of the kimberlite to the east of the 2003 drill site. The two holes drilled in 2004 intersected two fine grained hypabyssal kimberlite dykes, ranging from 0.60 metres to 5.26 metres true width (assuming a vertical body), with few indicator minerals. These lithologies are markedly different from the 2003 kimberlite intersections. The contrasting diamond counts between the 2003 and 2004 results can likely be attributed to different kimberlite phases.

Future Developments for Blue Ice, Hadley Bay, White Ice Exploration Program for 2004

The 2005 Blue Ice exploration program is budgeted at \$3.0 million, and will be funded and operated by Teck Cominco. The program will include drill testing of approximately 75 to 100 targets and airborne magnetic surveying over two previously untested areas on the property.

From the 2004 airborne survey, approximately 30 targets have been prioritized for core drilling, and more than 75 targets have been identified for possible testing using a reverse circulation drill rig. Selected targets include magnetic anomalies and several recently identified EM anomalies. This is an aggressive drill program, designed to test a large number of targets over a relatively short period of time. To maximize the drill season, mobilization of equipment and supplies is scheduled to start in April 2005.



Management Discussion and Analysis
For the Year Ended December 31, 2004

Wellington, Victoria Island, NU

The Company holds a 100% interest in the Wellington Project located to the east of the Blue Ice Project Area. An option has been granted to Majescor Resources Inc. ("Majescor"), whereby Majescor can earn a 50% interest in the property in consideration of expending \$2,250,000 on the property by December 31, 2006. During 2004, Majescor spent \$235,995 on the project which, combined with previous over expenditures, has satisfied the 2004 expenditure requirement of \$450,000. The remaining expenditure requirements are:

Completion date	Amount
December 31, 2005	500,000
December 31, 2006	750,000

Wellington Exploration Program

The 2004 exploration program was designed to identify drill targets along the potential eastward extensions of the known diamondiferous kimberlite trends on the Blue Ice Project. The final data has been interpreted, and several anomalies have been identified for further follow-up work. An airborne EM/Mag survey was completed over part of the Wellington claims to southeast of the Galaxy kimberlite trend. Airborne magnetic surveying was completed over the northern Wellington claim block southeast of the King Eider kimberlite trend. A total of 2,378 line kilometres of airborne geophysics was flown, at a cost of \$172,607.

Future Developments for Wellington

The Company and Majescor are discussing whether a one to two-hole drill program is merited, due to the costs of mobilizing a drill for such a short program.

Amaruk JV, NU

On May 10, 2004, the Company and BHP Billiton entered into an agreement to merge the Amaruk and Pelly Bay JV Projects, along with approximately 3.5 million acres of land held by BHP Billiton. The new project covers approximately 8.0 million acres near the town of Kugaaruk, Nunavut, with each party holding a 50% interest in the project.

BHP Billiton has initiated the first option, which will allow BHP Billiton to earn an additional 10% interest (for an aggregate of 60% interest) by solely funding the project to feasibility by May 10, 2011. After completing the first option, BHP Billiton can elect to earn an additional 5% interest (for an aggregate of 65% interest) by arranging the Company's portion of financing to production.

As part of the agreement, BHP Billiton reimbursed the Company for \$500,000 in land acquisition costs and for costs associated with an airborne geophysical survey. In addition, BHP Billiton subscribed to a private placement of \$500,000 consisting of 357,143 common shares at a price of \$1.40 per share. Over the next three years and at the election of the Company, BHP Billiton may subscribe to three separate private placements of up to \$1,000,000 each. Each private placement would consist of common shares at a 20% premium to the market price. (See Subsequent Events.)



Management Discussion and Analysis
For the Year Ended December 31, 2004

Amaruk JV Exploration Program

The 2004 exploration objectives for the Amaruk JV were to identify drill targets in the central portion of the project and further evaluate areas with known indicator mineral occurrences within the overall property. BHP Billiton completed 11,401 line kilometres of airborne magnetics and EM over the central part of the property and collected 3,205 till samples from the entire project area. The indicator mineral chemistry received to date from the till samples shows a potential for highly diamondiferous kimberlites in multiple clusters on the property. The estimated cost of the 2004 exploration program is \$4.5 million.

During a routine site visit in early September, Mark Kolebaba, the Company's president, discovered kimberlite in the form of coarse boulders and fragments in two areas on the property. In the first area, approximately 350 kilograms (field weight) of kimberlite material was collected for diamond analysis, from five discrete sites forming a 2.3 kilometres northwest trend. This area is on trend with a 2003 till sample that returned 1,350 kimberlite indicator minerals.

Numerous kimberlite fragments were also recovered from a second site on the property, approximately 10 kilometres east of Area 1, where no 2003 sample data was available.

Amaruk JV Exploration Results for 2004

The kimberlite float collected from Area 1 was split into four groups based on subtle lithological variations. A portion of each sample was submitted for micro diamond recovery and indicator mineral analysis. Seven diamonds were recovered from the 212.6 kilogram sample of kimberlite float, indicating that Amaruk is potentially a new diamond district in Canada.

Future Developments for Amaruk JV

BHP Billiton has proposed a 2005 exploration program that will include additional follow-up till sampling using a tighter one-kilometre grid, prospecting to follow indicator trains up-ice, additional airborne surveying and detailed ground geophysics over targets identified from the 2004 airborne survey.

Arnak JV, NU

On July 8, 2004, the Company entered into a joint venture agreement with Kennecott Canada Exploration Inc. ("Kennecott") to merge land holdings in Nunavut. The 956,000-acre property, named "Arnak", is located immediately south of the Company's Amaruk project in the eastern Arctic. The Arnak property now includes 616,000 acres of permits acquired by Kennecott, approximately 140,000 acres of claims (subject to a 2% royalty payable to BHP Billiton) staked at the Company's cost, and 200,000 acres of claims acquired at a cost to Kennecott. Under the terms of the agreement, Kennecott holds 74% of the Arnak property and the Company, 26%. Kennecott must solely fund the first \$5,500,000 in exploration costs over the next four years, or its entire interest reverts to a 1% royalty on the 616,000 acres of permits only. Upon Kennecott completing their commitment, the Company will be required to pay its pro-rata share of expenditures made thereafter or be subject to dilution. This agreement is subject to the Nunavut Mining Recorder awarding the Company 80% or more of the 140,000-acre claim block.

During the first year of the joint venture, Kennecott committed to spending a minimum of \$1,000,000 on the property by 2005. The estimated cost to date for the 2004 field program is approximately \$600,000, which includes 20,621 line kilometres of fixed wing airborne geophysical surveying and the collection of 223 heavy mineral samples.



Management Discussion and Analysis
For the Year Ended December 31, 2004

Future Developments for Arnak

Kennecott has proposed a 2005 exploration program that will include ground geophysics and drilling. Details of this program are still being developed.

Kidme Project, NWT

The Company owns 40% of the 90,000-acre Kidme Project, situated adjacent to the eastern border of the Misty Lake Property and to the south of the De Beers/Mountain Province Gahcho Kué property. In the spring of 2004, the Company and SouthernEra Resources Limited ("SouthernEra") staked an additional 90,754 acres of claims to the south of the original Kidme property on a 50/50 basis.

Kidme Exploration Program

In March 2004, a ground geophysics program was conducted by SouthernEra which identified five potential drill targets. However, the 2004 drill program was postponed to the spring of 2005 as SouthernEra, the Operator, was in the process of a lengthy corporate reorganization.

Manitoba NE Highlands Project, Manitoba

On May 7, 2004, the Company entered into an agreement with Indicator Explorations Ltd. ("Indicator Explorations") to acquire three Mineral Exploration Licenses ("MEL") and interpretative geological data. In addition, the Company acquired five MEL, resulting in a combined land position of approximately 873,000 acres. Under the agreement, the Company paid \$10,000 in cash and issued 20,000 common shares to Indicator Explorations. Staged over a four-year period and assuming the Company continues with the project, Indicator Explorations will receive cash payments totaling \$530,000 and a 1% royalty on any production from the property.

Manitoba NE Highlands Exploration Program

The Company had proposed collecting 145 till and stream samples to test the Highland area for diamond-bearing kimberlite potential. From July 10 to 16, the field crew collected a total of 12 till samples. The sampling program encountered difficult over-burden, and management elected to implement an airborne geophysical survey which would cover the ground more effectively.

From August 10 to 26, a fixed wing horizontal gradient magnetic survey was flown collecting 14,950 line kilometres of data. The traverse line spacing was 250 metres. Several bad-weather days were encountered, which added to the time and cost of the survey. The estimated cost is \$164,532, which will be partially offset with a \$14,278 grant received under the Manitoba Government Exploration Assistance Program.

Northern Recon Initiative

The Company budgeted \$2,000,000 to develop new diamond projects through Canadian regional exploration initiatives. In 2003, the initiative resulted in the discovery of the Amaruk project. The Company's 2004 Northern Recon Initiative collected 1,683 till samples. In addition, the Company completed 1,830 and 1,475 line kilometres of airborne geophysics on the Red Ice, NU and Argonaut, NU properties respectively.

The Northern Recon Initiative cost \$2,700,401, which was more than originally budgeted. Additional costs were incurred to perform follow-up sampling on prospective projects to confirm initial results. Based on the confirmation of the initial results, the Company acquired two projects through staking. Other Northern Recon data was instrumental in the Company's decision to acquire 12 million acres of exploration permits.



Management Discussion and Analysis
For the Year Ended December 31, 2004

Selected Annual Information

Selected annual information from the Company's audited financial statements for the years ended December 31, 2004 and 2003 and the period February 13, 2002 ("Date of Incorporation") to December 31, 2002:

	2004	2003	2002
Total Revenues	\$ Nil	\$ Nil	\$ Nil
General and administrative expense	\$ (1,320,509)	\$ (1,410,434)	\$ (632,983)
Loss for the year	\$ (2,442,428)	\$ (2,483,340)	\$ (953,258)
Basic and diluted loss per share	\$ (0.09)	\$ (0.14)	\$ (0.14)
Total Assets	\$ 14,709,482	\$ 10,884,162	\$ 5,707,314
Total Long-term liabilities	\$ Nil	\$ Nil	\$ 183,920
Cash dividends per share	\$ Nil	\$ Nil	\$ Nil

Results of Operations

-Fourth Quarter Results

At December 31, 2004, the Company had cash of \$320,373 (Q3 - \$3,155,322) and exploration funds of \$921,272 (Q3 - \$1,363,609), both down from the previous quarter. Mineral properties expenditures used \$2,399,086 in cash and exploration funds, increasing the carrying value of mineral properties to \$12,474,394 (Q3 - \$10,284,186). During the fourth quarter, the Company began the process of acquiring new land through staking and permitting. Bid deposits of \$500,838 (Q3 - \$Nil) reflect permits that were withdrawn or denied and will be refunded in the 2005 fiscal year. Eligible flow-through expenditures used \$942,337 in exploration funds. In December, a 500,000 flow-through common share financing helped to replenish exploration funds by \$500,000 and a 30,000 non flow-through common share financing increased cash \$30,000. Other cash activities include a \$368,876 reduction in accounts payable to \$656,324 (Q3 - \$1,025,200).

General and administrative expenses of \$436,890 (Q3 - \$301,242) represent a \$135,648 increase over the previous quarter. Since the adoption of new accounting policy for stock-based compensation, the Company has experienced large quarterly fluctuations in general and administrative expenses atypical of normal operations. Management is aware of this problem and has instituted a vesting policy on the granting of new stock options. This vesting policy will help to reduce the size of fluctuations, but it will not eliminate them. Other changes in expenses from the previous quarter are:

- Audit and accounting expenses of \$27,290 (Q3 - \$9,788) increased due to an \$18,000 accrual for the 2004 year-end audit.
- Increased investor relations and promotion activity of \$83,307 (Q3 - \$48,530) due to the Company attending three conferences during the quarter.
- Legal expenses of \$10,411 (Q3 - \$17,767) for work on the Company's Corporate Governance policies. The previous quarter's legal expenses were higher due to costs associated with Joint Venture Agreement work.
- A stock-based compensation expense of \$156,982 (Q3 - \$84,753) reflects the vesting of an additional 195,000 stock options. The previous quarter's expenses reflected the vesting of 20,000 stock options. (Stock-based compensation is a non-cash expense and is computed by the Black-Scholes Option pricing method.)



Management Discussion and Analysis
For the Year Ended December 31, 2004

- Wages and benefits expenses of \$71,206 (Q3 - \$59,223) for geological administrative staff costs that were not chargeable to mineral properties.
- Write down of mineral properties expense of \$208,878 (Q3 - \$Nil) for the write down of the Yankee, NU project to \$Nil, as management does not feel that further exploration is warranted.

Year ended December 31, 2004 compared with the Year Ended December 31, 2003

The general and administrative expenses of \$1,320,509 (2003 - \$1,410,434) were an \$89,925 decrease from the 2003 fiscal year. Over the comparative period, the largest decrease was in stock-based compensation expense. Other fluctuations are:

- Annual general meeting expense of \$33,086 (2003 - \$16,882), which includes additional costs for the use of a hotel room and a Shareholder Report.
- Bank charges and interest expenses of \$4,855 (2003 - \$22,388) decreased, as the 2003 expense included interest paid on a note payable.
- Consulting expenses of \$9,292 (2003 - \$31,766) decreased, as the 2003 expense included a part-time controller who later became a part-time employee of the Company.
- Insurance expense of \$33,064 (2003 - \$5,625) reflects increased coverage as required by the lease agreement for the new office premise and additional coverage for directors, officers and employees.
- Stock-based compensation expense of \$374,277 (2003 - \$451,173) related to the vesting of 585,000 stock options that have been granted to employees, directors, and consultants of the Company.
- Interest income of \$60,773 (2003 - \$69,982), which reflects interest earned on deposits in the normal course of business. The Company invests its excess cash in redeemable guaranteed investment certificates issued by chartered Canadian banks.
- Property investigation expense of \$680,701 (2003 - \$147,293) for regional exploration, to identify new diamondiferous areas.
- Write down of mineral properties expense of \$279,547 (2003 - \$505,834) includes \$1,314 for the Banning Lake, NU Project, \$51,588 for the Blue Nose, NU Project and \$17,767 for the Stefansson, NU Project. These regional projects did not warrant further exploration, and were written off accordingly. In addition, management does not feel that further exploration on the Yankee Project is warranted, and has reduced the carrying value to \$Nil.

The Company's loss before taxes was \$2,076,507 (2003 - \$2,012,210). The loss after a future income taxes of \$365,921 (2003 - \$471,130) was \$2,442,428 (2003 - \$2,483,340).

The Company did not pay cash dividends during the 2004 fiscal year, and does not anticipate paying them in the 2005 fiscal year either. The Company does not have positive operating cash flow, so the payment of dividends at this time would not be prudent.

From the Company's statement of cash flow, cash requirements for operating and investing activities exceeded cash flows from financing activities. For the year ended December 31, 2004, the Company's operating activities required \$1,474,389 and investing activities required \$7,404,682, while financing activities



Management Discussion and Analysis
For the Year Ended December 31, 2004

provided \$5,164,509 in cash. The net effect was a \$3,714,562 decrease in cash for the year. On December 31, 2004, cash and cash equivalents totaled \$320,373 (2003 - \$4,034,935).

Mineral property acquisition and exploration costs were the largest use of cash, at \$6,958,152. Investing activities provided \$364,188 in cash through an increase in accounts payable related to mineral properties, and financing activities provided \$5,164,509 in cash through the issuance of common shares. The difference was funded by cash carried forward from 2003.

Summary of Quarterly Results

	Mar. 31 2003 Q1	Jun. 30 2003 Q2	Sept. 30 2003 Q3	Dec. 31 2003 Q4	Mar. 31 2004 Q1	Jun. 30 2004 Q2	Sept. 30 2004 Q3	Dec. 31 2004 Q4
Mineral expenditures, net	\$ 269,041	\$ 1,097,710	\$ 1,172,043	\$ 512,823	\$ 2,002,690	\$ (59,660)	\$ 2,616,036	\$ 2,399,086
G&A Expense	\$ 273,080	\$ 257,761	\$ 162,672	\$ 791,364	\$ 326,945	\$ 255,432	\$ 301,242	\$ 436,890
Stock-based comp. exp.	\$ 66,683	\$ 7,760	\$ -	\$ 376,730	\$ 120,020	\$ 12,522	\$ 84,753	\$ 156,982
Loss	\$ (261,672)	\$ (230,206)	\$ (349,089)	\$ (1,642,373)	\$ (335,986)	\$ (385,964)	\$ (796,268)	\$ (924,210)
Loss per share								
-basic and diluted	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ (0.08)	\$ (0.01)	\$ (0.02)	\$ (0.03)	\$ (0.03)
Weighted avg. common shares outstanding								
-basic and diluted	13,614,307	14,406,042	16,361,471	17,986,142	23,912,695	24,762,980	27,758,161	26,110,244

The Company conducts exploration in Canada's far north, and mineral exploration is subject to seasonal conditions. In 2003, the majority of exploration expenditures occurred from April to September, which is reflected in Q2 and Q3. The 2004 fiscal year was different since Q1 reflected land acquisition costs for Amaruik which were later recovered from project partner BHP Billiton in Q2. Q3 includes exploration costs for the Northern Recon Initiative. However, the traditional decrease in Q4 did not occur, since the Company incurred land acquisition costs as a result of the Northern Recon during that quarter.

In Q4 of the 2003 fiscal year, the Company adopted the new recommendations regarding accounting for stock-based compensation. Since this adoption, quarterly general and administrative expenses have experienced large fluctuations due to the inclusion of this non-cash expense. The granting of stock options is at the Board's discretion, and recognition of the expense is subject to the vesting periods of the granted options. To show the effects of this accounting policy, the Company has included the cost of stock-based compensation in the table above.

In Q1 of the 2004 fiscal year, the Company adopted EIC 146 "Flow-Through Shares" (see Changes in Accounting Policies), which has caused fluctuations in quarterly losses. In Q1 and Q4, the Company had future income tax credits of \$45,372 and \$564,522 respectively while in Q3, a future income tax expense of \$421,364 was recognized. In Q4, future income taxes included an adjustment to reconcile the renunciation of flow-through expenditures throughout the year to the annual corporate tax return.



Management Discussion and Analysis
For the Year Ended December 31, 2004

Liquidity

At December 31, 2004, the Company had \$1,487,053 in working capital, which without additional financing would not have been sufficient to achieve the Company's business objectives for fiscal 2005. After the year-end, the Company completed two financings for gross proceeds of \$1,060,000. In addition, \$801,630 was received from the exercise of warrants and stock options.

Project partners will again fund the major exploration projects for 2005. Teck Cominco has proposed a \$3.0 million program for Blue Ice, Hadley Bay and White Ice; BHP Billiton has proposed a \$2.0 to \$4.0 million program for Amaruk; and Kennecott Canada has proposed a \$1.0 million program for Arnak. The 2004 Northern Recon Initiative land acquisition will require a minimum of \$1.6 million in exploration work, and the Company may raise additional funds to increase the proposed exploration program.

During the 2004 fiscal year, the Company raised \$5,164,509 via equity financings:

- On June 17, 2004, the Company completed a non-brokered private placement of 392,857 common shares at \$1.40 per share, for gross proceeds of \$550,000. BHP Billiton subscribed to 357,143 common shares and Teck Cominco subscribed to 35,714 common shares under its financing rights in the Blue Ice participation agreement.
- On July 2, 2004, the Company completed a brokered private placement of 2,400,000 flow-through common shares at a price of \$1.25 per share, for gross proceeds of \$3,000,000. An aggregate of 168,000 Agents' Warrants to purchase up to 168,000 common shares at a price of \$1.35 per share for a period of one year were granted to a syndicate led by Canaccord Capital Corporation, and included Dundee Securities Corporation. Cash fees totaling \$185,000 were paid in connection with this financing.
- On July 28, 2004, the Company completed a non-brokered private placement with Teck Cominco for 144,000 flow-through common shares at \$1.25 per share.
- On December 23, 2004, the Company completed a non-brokered private placement of 500,000 flow-through common shares and 30,000 common shares, both at a price of \$1.00 per share, for gross proceeds of \$530,000. An aggregate of 23,950 Agents' Warrants to purchase up to 23,950 common shares at a price of \$1.00 per share for a period of one year were granted. Cash fees totaling \$20,220 were paid in connection with this financing. All these securities are subject to a hold period and may not be traded until April 24, 2005.
- During 2004, the exercise of stock options and warrants provided a total of \$1,153,800 in cash.

Capital Resources

The Company does not have operating cash flow and has relied on equity financings to meet its cash requirements. Although the Company has been successful in the past in obtaining financing through the sale of equity securities, there can be no assurance that the Company will be able to obtain adequate financing in the future, or that the terms of such financings will be favourable.

Under an agreement with BHP Billiton and at the election of the Company, BHP Billiton may subscribe to three separate private placements of common shares to a maximum investment of \$3,000,000. Between July 1 to April 30 in each of 2005, 2006 and 2007, the Company can request BHP Billiton to subscribe to a non-brokered private placement of up to \$1,000,000. The Company may make only one election per year, and the share issuance shall not cause BHP Billiton to hold greater than 9.9% of the Company's issued share capital. The price per share will be equal to 120% of the average closing price of the Company's common shares over ten trading days. On January 21, 2005, the Company elected to have BHP Billiton subscribe to a \$1,000,000 private placement.



Management Discussion and Analysis
For the Year Ended December 31, 2004

In the 2005 fiscal year, the Company has a future mineral property commitment cash payment of \$40,000 to maintain the Manitoba NE Highlands Agreement in good standing. The Company must elect to make this payment to Indicator Explorations on or before July 1, 2005.

Off-Balance Sheet Arrangements

The Company has not entered into any off-balance sheet financing arrangements.

Related Party Transactions

A personal law corporation owned by Maynard Brown, a director of the Company, provided legal services to the Company. During the year, the Company paid legal fees to this related party in the aggregate of \$16,229 (2003 - \$34,404).

The Company has engaged a business owned by Bernard Kahlert, a director of the Company, to provide project management and geological consulting. During the year, the Company paid or accrued fees to this related party in the aggregate of \$21,750.

Given that the Company's directors and officers are engaged in a wide range of activities, the Company operates under the conflict of interest provisions found within the Business Corporations Act of British Columbia. Management is in the process of adopting a set of Corporate Governance policies which propose incorporating language from these provisions into the Company's Code of Business Conduct and Ethics.

Proposed Transactions

The Company has had discussions with third parties who are interested in optioning portions of the 12 million acres of exploration permits acquired in 2004/2005. These discussions are part of the normal course of the Company's business in seeking joint venture partners to share risk and advance projects.

Critical Accounting Estimates

The most significant accounting estimates for the Company relate to the carrying value of its mineral property assets. All deferred mineral property expenditures are reviewed, on a property-by-property basis, to identify any conditions that may indicate impairment. A provision is made for impairment in value when the carrying value of a property exceeds its net recoverable amount, estimated by quantifiable evidence of an economic geological resource or reserve joint venture expenditure commitments, or the Company's assessment of its ability to sell the property for an amount exceeding the deferred costs.

Management's estimates of mineral prices, recoverable proven and probable reserves, and operating, capital and reclamation costs are all subject to certain risks and uncertainties that may affect the recoverability of mineral property costs. Although management has made its best estimates of these factors, it is possible that changes could occur in the near term that could adversely affect the Company's estimates of the net cash flow to be generated from its properties.

Another significant accounting estimate relates to accounting for stock-based compensation. The Company uses the Black-Scholes Option Pricing Model. Option pricing models require the input of highly subjective assumptions, including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a single, reliable measure of the fair value of the Company's stock options granted/vested during the year.

**Changes in Accounting Policies**

During the year, the Company adopted the Canadian Institute of Chartered Accountants (CICA) EIC 146 "Flow-Through Shares" policy, which defines when a company should recognize the tax effect related to the renounced deductions and requires recognition of previously-unrecorded future income tax assets caused by the renouncement of expenditures relating to flow-through shares. Since the adoption of the EIC 146, the Company has recorded \$1,310,080 in future income tax expense and \$1,453,238 in future income tax credits.

In June 2003, the CICA issued Accounting Guideline 15, "Consolidation of Variable Interest Entities," which requires the consolidation of Variable Interest Entities ("VIE") by the primary beneficiary. (The primary beneficiary is the enterprise that will absorb or receive the majority of the VIE expected losses, expected residual returns, or both.) Accounting Guideline 15 is effective for fiscal years beginning on or after November 1, 2004. As such, the effect of Accounting Guideline 15 on the 2005 financial statements cannot be reasonably determined at this time.

Recent Changes in Accounting Standards

The CICA has issued Section 1530, "Comprehensive Income," which introduces new standards for reporting and display of comprehensive income. (Comprehensive income is the change in equity (net assets) of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distribution to owners.) This Section applies to fiscal years beginning on or after October 1, 2006, but early adoption is permitted at the beginning of a fiscal year after December 31, 2004. The Company has not elected the early adoption of this Section for the 2005 fiscal year.

The CICA has issued Section 3855, "Financial Instruments – Recognition and Measurement," which prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and at what amount – sometimes using fair value, other times using cost-based measures. The Section also specifies how financial instrument gains and losses are to be presented. This Section applies to fiscal years beginning on or after October 1, 2006, but early adoption is permitted at the beginning of a fiscal year after December 31, 2004. The Company has not elected the early adoption of this Section for the 2005 fiscal year.

Financial Instruments

Marketable securities are carried at the lower of cost or quoted market value. When the market value is below cost, any unrealized loss is charged to income. During the year, marketable securities write down by \$31,075 (2003 - \$21,750). The quoted market value of marketable securities at December 31, 2004 was \$155,175 (2003 - \$61,350).

The Company is exposed to credit risk with respect to its cash. To minimize this risk, cash and cash equivalents have been placed with major financial institutions.



Management Discussion and Analysis
For the Year Ended December 31, 2004

Other MD&A Requirements

Additional information relating to the Company is available on SEDAR at www.sedar.com.

From the consolidated statement of operations, here is a breakdown of investor relations and promotion expense:

Administration	\$	5,098
Conferences and trade shows		130,965
Consulting, wages and benefits		77,880
Media		21,358
Promotion and advertising		31,227
	\$	<u>266,528</u>

As of the Report Date, the Company had 30,512,298 issued common shares outstanding and the following unexercised stock options and warrants:

-Stock Options

Expiry Date	Exercise Price	Number of Shares
September 11, 2006	\$0.25	52,300
January 10, 2007	\$0.25	9,500
July 15, 2007	\$0.50	1,062,300
December 19, 2007	\$0.80	50,000
February 20, 2008	\$0.80	477,200
March 4, 2008	\$0.80	100,000
May 22, 2008	\$0.80	65,000
October 6, 2008	\$0.70	136,000
March 30, 2009	\$1.19	200,000
April 4, 2009	\$1.19	100,000
August 8, 2009	\$1.10	610,000
October 18, 2009	\$1.00	300,000
January 27, 2010	\$1.00	50,000
March 22, 2010	\$1.15	252,500
		<u>3,464,800</u>

-Warrants

Expiry Date	Exercise Price	Number of Shares
July 4, 2005	\$1.35	168,000
December 23, 2005	\$1.00	23,950
		<u>191,950</u>

CORPORATE INFORMATION

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Janice Davies
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LISTINGS

TSX Venture Exchange: DDN
Tier One

CAPITALIZATION

(as at December 31, 2004)

Shares Authorized: 100,000,000

Shares Issued: 28,453,321

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