



**DIAMONDS NORTH**  
RESOURCES LTD.

**ANNUAL REPORT 2006**

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## **DIAMONDS NORTH RESOURCES LTD.**

**Consolidated Financial Statements  
December 31, 2006**

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## **MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS**

The consolidated financial statements of Diamonds North Resources Ltd. have been prepared by management in accordance with Canadian generally accepted accounting principles. The financial information contained elsewhere in this report has been reviewed to ensure consistency with the consolidated financial statements.

Management maintains systems of internal control designed to provide reasonable assurance that the assets are safeguarded. All transactions are authorized and duly recorded, and financial records are properly maintained to facilitate financial statements in a timely manner. The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements. The Board carries out this responsibility principally through its Audit Committee.

The Audit Committee of the Board of Directors has reviewed the consolidated financial statements with management and the external auditors. Smythe Ratcliffe LLP, an independent firm of chartered accountants, appointed as external auditors by the shareholders, have audited the consolidated financial statements and their report is included herein.

*"Mark Kolebaba" (signed)*

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Mark Kolebaba  
President and Chief Executive Officer

Vancouver, British Columbia  
March 23, 2007

## AUDITORS' REPORT

### To the Shareholders of Diamonds North Resources Ltd.

We have audited the balance sheets of Diamonds North Resources Ltd. as at December 31, 2006 and 2005 and the statements of operations and deficit and cash flows for the years ended December 31, 2006, 2005 and 2004. 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 audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. 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 financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years ended December 31, 2006, 2005 and 2004 in accordance with Canadian generally accepted accounting principles.

*"Smythe Ratcliffe LLP" (signed)*

Chartered Accountants

Vancouver, British Columbia  
March 23, 2007



# **Consolidated Financial Statements**

**Year Ended December 31, 2006**

**DIAMONDS NORTH RESOURCES LTD.**

Consolidated Balance Sheets  
December 31  
(expressed in Canadian dollars)

|  | <b>2006</b>   | <b>2005</b>   |
|--|---------------|---------------|
| <b>ASSETS</b>                            |               |               |
| Current assets                           |               |               |
| Cash and cash equivalents                | \$ 4,340,398  | \$ 3,715,861  |
| Cash, exploration funds (Note 12)        | 7,315,991     | 2,500,175     |
| Marketable securities (Note 3)           | 566,201       | 166,275       |
| Accounts receivable (Note 8(a))          | 1,376,034     | 523,229       |
| Prepaid expenses                         | 217,331       | 87,882        |
| Field supplies                           | 93,201        | -             |
| Deposits, in-trust                       | 15,000        | -             |
|  | 13,924,156    | 6,993,422     |
| Loan and interest receivable (Note 4)    | 311,596       | -             |
| Mineral properties (Note 5)              | 16,023,782    | 14,400,479    |
| Property, plant and equipment (Note 6)   | 117,408       | 70,417        |
|  | \$ 30,376,942 | \$ 21,464,318 |
| <b>LIABILITIES</b>                       |               |               |
| Current liabilities                      |               |               |
| Accounts payable and accrued liabilities | \$ 585,734    | \$ 459,950    |
| Due to related parties (Note 8(c))       | 51,359        | 9,946         |
|  | 637,093       | 469,896       |
| Future income taxes (Note 12)            | 753,385       | 389,681       |
|  | 1,390,478     | 859,577       |
| <b>SHAREHOLDERS' EQUITY</b>              |               |               |
| Share capital (Note 7(b))                | 34,713,764    | 25,894,621    |
| Contributed surplus                      | 126,133       | 63,522        |
| Option compensation (Note 7(f))          | 1,677,584     | 1,211,198     |
| Deficit                                  | (7,531,017)   | (6,564,600)   |
|  | 28,986,464    | 20,604,741    |
|  | \$ 30,376,942 | \$ 21,464,318 |

Nature of Operations and Going Concern (Note 1)  
Commitment (Note 9)  
Subsequent Events (Note 13)

Approved by the Directors:

“Mark Kolebaba”  
Mark Kolebaba

“Bernard H. Kahlert”  
Bernard H. Kahlert

See Accompanying Notes to the Consolidated Financial Statements

**DIAMONDS NORTH RESOURCES LTD.**

Consolidated Statements of Operations and Deficit  
For the Years Ended December 31  
(expressed in Canadian dollars)

|   | 2006           | 2005           | 2004           |
|---|----------------|----------------|----------------|
| <b>General and administrative expenses</b>  |                |                |                |
| Accounting and audit*   | \$ 90,817      | \$ 72,465      | \$ 68,786      |
| Administration fees*  | 53,071         | 122,423        | 107,429        |
| Amortization  | 28,067         | 18,672         | 12,893         |
| Annual report and meeting   | 37,617         | 27,417         | 33,086         |
| Bank charges and interest   | 19,523         | 3,135          | 4,855          |
| Consulting fees*  | 72,673         | 14,405         | 23,738         |
| Directors' fees*  | 162,267        | 227,271        | 28,890         |
| Filing fees   | 11,111         | 13,283         | 8,498          |
| Insurance   | 54,895         | 52,139         | 33,064         |
| Investor relations and promotion*   | 303,496        | 349,396        | 295,419        |
| Legal fees  | 64,945         | 31,427         | 46,074         |
| Office and miscellaneous  | 105,282        | 62,326         | 76,889         |
| Rent and storage  | 99,675         | 100,239        | 52,545         |
| Transfer agent fees   | 35,553         | 14,935         | 11,248         |
| Wages and benefits*   | 713,240        | 457,805        | 517,095        |
|   | (1,852,232)    | (1,567,338)    | (1,320,509)    |
| <b>Other income (expenses)</b>  |                |                |                |
| Interest income   | 216,054        | 47,788         | 60,773         |
| Mineral property transactions   | 135,301        | -              | 171,116        |
| Property investigation  | (3,591)        | (95,405)       | (680,701)      |
| Write down of marketable securities   | (30,000)       | (3,975)        | (31,075)       |
| Write down of mineral properties  | (385,841)      | (722,009)      | (279,547)      |
| Gain on sale of marketable securities   | 464,536        | -              | 3,436          |
| <b>Loss before income taxes</b>   | (1,455,773)    | (2,340,939)    | (2,076,507)    |
| <b>Future income tax recovery (expense) (Note 12)</b>                             | 489,356        | 1,758,186      | (365,921)      |
| <b>Loss for the year</b>  | (966,417)      | (582,753)      | (2,442,428)    |
| <b>Deficit, beginning of year</b>   | (6,564,600)    | (5,981,847)    | (3,539,419)    |
| <b>Deficit, end of year</b>   | \$ (7,531,017) | \$ (6,564,600) | \$ (5,981,847) |
| <b>Basic and diluted loss per share</b>   | \$ (0.02)      | \$ (0.02)      | \$ (0.09)      |
| <b>Weighted average number of shares outstanding</b>                              | 42,451,985     | 32,349,717     | 26,110,244     |
| <b>* Stock-based compensation expense (Note 7(f)) included above, as follows:</b> |                |                |                |
| Accounting and audit  | \$ 20,152      | \$ 2,890       | \$ 8,668       |
| Administration fees   | 17,561         | 47,927         | 21,669         |
| Consulting fees   | 54,410         | 4,815          | 14,446         |
| Directors' fees   | 122,267        | 227,271        | 28,890         |
| Investor relations and promotions   | 49,804         | 77,114         | 28,891         |
| Wages and benefits  | 291,092        | 92,356         | 271,713        |
|   | \$ 555,286     | \$ 452,373     | \$ 374,277     |

See Accompanying Notes to the Consolidated Financial Statements

**DIAMONDS NORTH RESOURCES LTD.**

Consolidated Statements of Cash Flows  
For the Years Ended December 31  
(expressed in Canadian dollars)

|  | <b>2006</b>  | <b>2005</b>  | <b>2004</b>    |
|--|--------------|--------------|----------------|
| <b>Cash flows from (applied to) operating activities</b>               |              |              |                |
| Loss for the year  | \$ (966,417) | \$ (582,753) | \$ (2,442,428) |
| Items not involving cash:  |              |              |                |
| Amortization   | 28,067       | 18,672       | 12,893         |
| Stock-based compensation   | 555,286      | 452,373      | 374,277        |
| Write down of marketable securities                                    | 30,000       | 3,975        | 31,075         |
| Write down of mineral properties                                       | 385,841      | 722,009      | 279,547        |
| Future income taxes  | (489,356)    | (1,758,186)  | 365,921        |
| Gain on sale of marketable securities                                  | (464,536)    | -            | (3,436)        |
|  | (921,115)    | (1,143,910)  | (1,382,151)    |
| Net change in non-cash working capital items:                          |              |              |                |
| Accounts receivable  | (852,805)    | (279,146)    | (73,070)       |
| Prepaid expenses   | (129,449)    | 4,500        | 13,026         |
| Field supplies   | (93,201)     | 14,792       | 133,899        |
| Deposits   | (15,000)     | 500,838      | (144,146)      |
| Accounts payable and accrued liabilities                               | 206,052      | 30,803       | (1,561)        |
| Due to related parties   | 41,413       | (5,667)      | (20,386)       |
|  | (1,764,105)  | (877,790)    | (1,474,389)    |
| <b>Cash flows from (applied to) investing activities</b>               |              |              |                |
| Cash, flow-through exploration funds                                   | (4,815,816)  | (1,578,903)  | (793,822)      |
| Proceeds from sale of marketable securities, net                       | 559,610      | -            | 15,336         |
| Mineral property acquisition and exploration costs, net of recoveries  | (3,599,339)  | (2,753,094)  | (6,958,152)    |
| Accounts payable and accrued liabilities related to mineral properties | (80,267)     | (227,178)    | 364,188        |
| Loan and interest receivable   | (311,596)    | -            | -              |
| Purchase of equipment  | (75,058)     | (12,991)     | (32,232)       |
|  | (8,322,466)  | (4,572,166)  | (7,404,682)    |
| <b>Cash flows from financing activity</b>                              |              |              |                |
| Shares issued for cash, net of issue costs                             | 10,711,108   | 8,845,444    | 5,164,509      |
| <b>Increase (decrease) in cash and cash equivalents</b>                | 624,537      | 3,395,488    | (3,714,562)    |
| <b>Cash and cash equivalents, beginning of year</b>                    | 3,715,861    | 320,373      | 4,034,935      |
| <b>Cash and cash equivalents, end of year</b>                          | \$ 4,340,398 | \$ 3,715,861 | \$ 320,373     |

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, 2005 and 2006  
(expressed in Canadian dollars)

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### 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 ("Exchange"). The Company is in the process of actively exploring its mineral properties and has not yet determined whether these properties contain ore reserves that 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, 2006, the Company had an accumulated deficit of \$7,531,017 (2005 - \$6,564,600) and had working capital of \$13,287,063 (2005 - \$6,523,526), which will be sufficient to achieve the Company's planned business objectives for fiscal 2007.

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.

On March 16, 2006, the Company announced a proposal to form a separate company, Uranium North Resources Corp. ("Uranium North"), to focus on exploring approximately 3 million acres of prospective uranium land then held by the Company. Under the terms of the arrangement, it was agreed that the Company's shares would be restructured into New Common Shares and Reorganization Shares on the basis that for each six common shares held on the completion date, six New Common Shares and one Reorganization Share be issued to the shareholder. Through a concurrent share exchange, the holders of the Company's Reorganization Shares would then receive shares in Uranium North on the basis that one share of Uranium North be issued to the shareholder for each Reorganization Share exchanged. The arrangement was completed on July 28, 2006, at which time the foregoing uranium land was transferred to Uranium North (see Note 5) and the registered holders of common shares, stock options and share purchase warrants of the Company received 7,264,164 common shares, 937,898 stock options and 870,054 share purchase warrants, in Uranium North.

Initial working capital to Uranium North was provided by a \$300,000 loan from the Company (Note 4), which, at the option of the Company may be convertible in whole or in part into Uranium North securities at a conversion price equal to the PP (see below) or may be repaid in cash. The Company was issued 1,500,000 shares of Uranium North as a bonus for the foregoing loan and to provide a measure of control over this new company.

Matters relating to the reorganization were approved by shareholders at the annual general meeting held on May 10, 2006. The reorganization was approved by the Supreme Court of British Columbia and the Exchange. On December 6, 2006, Uranium North completed a brokered private placement financing (the "PP") consisting of 9,492,900 units consisting of one common share and one-half of one transferable share purchase warrant (the "Units") at price of \$0.75 per Unit. On December 7, 2006, Uranium North common shares were listed for trading on the Exchange under the symbol UNR.

## DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements  
December 31, 2005 and 2006  
(expressed in Canadian dollars)

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### 2. Significant Accounting Policies

#### (a) Basis of presentation

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. 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. All material intercompany transactions and balances have been eliminated.

#### (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. Significant areas of estimate include the impairment of assets and rates for amortization, accrued liabilities, future income tax balances and the inputs used in calculating stock-based compensation. Actual results may differ from those estimates and may impact future results of operations and cash flows.

#### (c) Financial instruments

The fair values of the Company's cash and cash equivalents, cash exploration funds, accounts receivable, loan and interest receivable, accounts payable and accrued liabilities approximate their carrying amounts because of the immediate or short-term to maturity of these financial instruments. Due to their nature and the absence of a market for such instruments, it is not practical to determine the fair value of the amounts due to related parties.

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, cash equivalents and cash exploration funds 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 or redeemable features of three months or less from the date of acquisition.

#### (e) Marketable securities

Marketable securities are carried at the lower of cost or quoted market value on a specific stock basis. When market value of a security is below its cost, any unrealized loss is charged to income.

#### (f) 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.

## DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements  
December 31, 2005 and 2006  
(expressed in Canadian dollars)

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### 2. Significant Accounting Policies (continued)

#### (f) Mineral properties (continued)

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.

#### (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 and field 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 accounts for the recognition and measurement of liabilities for obligations associated with the retirement of property, plant and equipment, and mineral properties when those obligations result from the acquisition, construction, development or normal operations of the assets. As at December 31, 2006, the Company did not have any asset retirement obligations.

#### (i) Flow-through shares

Under the terms of Canadian flow-through share legislation, pursuant to the Canadian *Income Tax Act*, the tax attributes of qualifying expenditures are renounced to the subscribers. The tax impact to the Company of the renouncement is recorded on the date the renunciation is filed with taxation authorities, through a decrease in share capital and the recognition of a future tax liability.

## DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements  
December 31, 2005 and 2006  
(expressed in Canadian dollars)

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### 2. Significant Accounting Policies (continued)

#### (j) Stock-based compensation

The Company accounts for stock-based compensation expense using the fair value based method with respect to all stock-based payments to directors, employees and non-employees, including awards that are direct awards of stock and call for settlement in cash or other assets, or stock appreciation rights that call for settlement by the issuance of equity instruments. Under this standard, stock-based payments are recorded as an expense in the period the option vests or when the awards or rights are granted, with a corresponding increase to option compensation under shareholders' equity. When stock options are exercised, the corresponding fair value, previously recognized, is transferred to share capital or when stock options are forfeited, cancelled or expire, the corresponding fair value is transferred to contributed surplus.

Stock-based and option compensation are disclosed in Note 7(f).

#### (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 more likely than not to be realized.

#### (l) Consolidation of variable interest entities

The Company will follow guidelines that address the application of consolidation principles to entities that are subject to control on a basis other than ownership based on voting equity. As at December 31, 2006, the Company did not have any variable interest entities.

#### (m) 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.

### 3. Marketable Securities

During the year, marketable securities were written down by \$30,000 (2005 - \$3,975; 2004 - \$31,075) to a carrying value of \$566,201 (2005 - \$166,275). The quoted market value of marketable securities at December 31, 2006 is \$1,784,300 (2005 - \$385,050).

## DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements  
December 31, 2005 and 2006  
*(expressed in Canadian dollars)*

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### 4. Loan and Interest Receivable

The Company advanced a working capital loan in the amount of \$300,000 to Uranium North (Note 1). The loan is repayable in whole or in part on demand and bears interest at 5% per annum. The entire loan plus accrued interest shall be repaid in cash on March 15, 2008, or at the option of Uranium North, may be repaid earlier, provided 30 days notice is given to the Company.

At any time prior to repayment, whether before or after a notice of prepayment has been given, the loan and accrued interest or any portion thereof, may be convertible at the sole discretion and option of the Company into securities of Uranium North as follows:

- i) prior to December 7, 2007, the loan and accrued interest or any portion thereof may be converted into units ("Unit") at a price of \$0.75 per Unit, with each Unit consisting of one common share of Uranium North and one share purchase warrant entitling the Company to purchase one additional common share of Uranium North at a price equal to \$0.90, up to December 6, 2007, whereupon any unexercised warrants will expire; and
- ii) on and after December 7, 2007, the loan and accrued interest or any portion thereof may be converted into common shares of Uranium North at a per share conversion price equal to \$0.75 per share.

## DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements  
December 31, 2005 and 2006  
(expressed in Canadian dollars)

### 5. Mineral Properties

As at December 31, 2006 and 2005, the Company's mineral properties are comprised of properties located in Canada. Expenditures incurred on mineral properties are as follows:

|                            | Amaruk JV,<br>NU | Tasiq<br>NU | Thelon<br>NU/NWT(2) | Victoria<br>Island<br>NU/NWT(1) | Banks<br>Island,<br>NWT | Hepburn,<br>NWT | Kennap<br>NWT | Kidme,<br>NWT | Northern<br>Recon. | Other<br>Properties | Total        |
|----------------------------|------------------|-------------|---------------------|---------------------------------|-------------------------|-----------------|---------------|---------------|--------------------|---------------------|--------------|
| Balance at                 |                  |             |                     |                                 |                         |                 |               |               |                    |                     |              |
| December 31, 2005          | \$1,540,014      | \$ 527,050  | \$ 315,300          | \$4,776,347                     | \$ 205,157              | \$ 2,714,932    | \$ 340,524    | \$ 415,170    | \$2,306,644        | \$ 1,259,341        | \$14,400,479 |
| Additions during the year: |                  |             |                     |                                 |                         |                 |               |               |                    |                     |              |
| Acquisition costs          | 27,629           | -           | -                   | -                               | -                       | -               | -             | -             | -                  | -                   | 27,629       |
| Exploration:               |                  |             |                     |                                 |                         |                 |               |               |                    |                     |              |
| Project admin.             | 16,041           | 174         | -                   | -                               | 1,684                   | 1,420           | -             | -             | -                  | -                   | 19,319       |
| Airborne geoph.            | 479,500          | -           | -                   | 5,902                           | 121,569                 | 515,532         | -             | -             | -                  | 163                 | 1,122,666    |
| Camp costs                 | 605,312          | -           | -                   | -                               | 27                      | 153,588         | -             | -             | 5,780              | -                   | 764,707      |
| Drilling                   | 453,494          | -           | -                   | 118,299                         | -                       | -               | -             | 31,197        | -                  | -                   | 602,990      |
| Geochemistry               | 1,097,222        | 25,852      | 1,022               | 19,622                          | 23,929                  | 478,100         | 24,110        | -             | 159,761            | 6,197               | 1,835,815    |
| Geology                    | 420,740          | -           | 3,846               | 40,064                          | 6,022                   | 108,462         | 1,024         | 1,059         | 5,319              | 1,452               | 587,988      |
| Ground geoph.              | 70,663           | -           | -                   | 366                             | -                       | 63,029          | -             | -             | -                  | 1,743               | 135,801      |
| Mobilization               | 66,122           | -           | -                   | -                               | -                       | 24,281          | -             | -             | -                  | -                   | 90,403       |
| Permitting                 | 17,464           | -           | -                   | 2,186                           | -                       | 1,396           | -             | -             | 100                | 1,564               | 22,710       |
| Property                   | 1,278,862        | 50          | 221,898             | 20,499                          | 60                      | 55,283          | -             | -             | 159,781            | 16,470              | 1,752,903    |
| Trenching                  | 95,437           | -           | -                   | 6,044                           | -                       | -               | -             | -             | -                  | -                   | 101,481      |
|                            | 4,600,857        | 26,076      | 226,766             | 212,982                         | 153,291                 | 1,401,091       | 25,134        | 32,256        | 330,741            | 27,589              | 7,036,783    |
| Less:                      |                  |             |                     |                                 |                         |                 |               |               |                    |                     |              |
| Recoveries                 | (1,703,007)      | -           | (281,408)           | (883,010)                       | (75,850)                | (210,770)       | -             | -             | (885,513)          | 49,485              | (3,990,073)  |
| Plan of arrng. (Note 1)    | -                | (553,126)   | -                   | -                               | -                       | -               | -             | -             | (202,242)          | (309,827)           | (1,065,195)  |
| Write downs                | -                | -           | -                   | -                               | -                       | -               | -             | -             | -                  | (385,841)           | (385,841)    |
|                            | (1,703,007)      | (553,126)   | (281,408)           | (883,010)                       | (75,850)                | (210,770)       | -             | -             | (1,087,755)        | (646,183)           | (5,441,109)  |
| Net additions              | 2,925,479        | (527,050)   | (54,642)            | (670,028)                       | 77,441                  | 1,190,321       | 25,134        | 32,256        | (757,014)          | (618,594)           | 1,623,303    |
| Balance at                 |                  |             |                     |                                 |                         |                 |               |               |                    |                     |              |
| December 31, 2006          | \$4,465,493      | \$ -        | \$ 260,658          | \$4,106,319                     | \$ 282,598              | \$ 3,905,253    | \$ 365,658    | \$ 447,426    | \$1,549,630        | \$ 640,747          | \$16,023,782 |

1. Disclosed as separate projects in 2005 but have been combined under Victoria Island (Note 5(d)).
2. Included under "Other Properties" in 2005.

## DIAMONDS NORTH RESOURCES LTD.

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### 5. Mineral Properties (continued)

|                              | Blue Ice,<br>Hadley Bay,<br>White Ice (1) | Amaruk JV,<br>NU | Washburn,<br>NU | Wellington,<br>NU | Tasiq,<br>NU (2) | Banks<br>Island,<br>NWT (3) | Hepburn,<br>NWT (3) | Kennap<br>NWT (3) | Kidme,<br>NWT | Manitoba<br>Highlands<br>(3) | Northern<br>Recon. | Other<br>Properties | Total        |
|------------------------------|---|------------------|-----------------|-------------------|------------------|-----------------------------|---------------------|-------------------|---------------|------------------------------|--------------------|---------------------|--------------|
| Balance at                   |   |                  |                 |                   |                  |                             |                     |                   |               |                              |                    |                     |              |
| December 31, 2004            | \$4,001,975                               | \$1,505,718      | \$ 681,421      | \$ -              | \$ 422,294       | \$ 109,714                  | \$ 869,383          | \$ 162,505        | \$ 337,889    | \$ 334,876                   | \$2,278,107        | \$ 1,770,512        | \$12,474,394 |
| Additions during the period: |   |                  |                 |                   |                  |                             |                     |                   |               |                              |                    |                     |              |
| Acquisition costs            | -   | -                | 10              | -                 | 8,613            | -                           | 912,271             | 227               | -             | 20,000                       | -                  | 130,016             | 1,071,137    |
| Exploration:                 |   |                  |                 |                   |                  |                             |                     |                   |               |                              |                    |                     |              |
| Project admin.               | -   | -                | -               | 32                | -                | 28                          | 125                 | 31                | 5,979         | -                            | -                  | -                   | 6,195        |
| Airborne geoph.              | 179,947                                   | 15,925           | 3,741           | 2,771             | -                | -                           | -                   | -                 | -             | 7,133                        | 656                | 9,398               | 219,571      |
| Environment                  | 4,719                                     | -                | -               | 15,315            | -                | -                           | -                   | -                 | -             | -                            | -                  | 5,161               | 25,195       |
| Geochemistry                 | 171,489                                   | 17,762           | 20,319          | -                 | 81,549           | 259,868                     | 919,690             | 171,383           | 8,755         | 733                          | 459,340            | 362,967             | 2,473,855    |
| Geology                      | 79,934                                    | 13,245           | 7,616           | 9,522             | 1,860            | 5,497                       | 8,670               | 6,368             | 4,752         | 7,411                        | 2,681              | 18,061              | 165,617      |
| Ground geoph.                | 1,200                                     | 3,961            | -               | 341               | -                | -                           | 1,335               | -                 | 57,795        | 3,500                        | -                  | 4,306               | 72,438       |
| Mobilization                 | -   | -                | -               | -                 | 12,518           | 1,500                       | -                   | -                 | -             | -                            | 21,948             | 6,745               | 42,711       |
| Permitting                   | 5,760                                     | -                | -               | -                 | -                | -                           | 2,874               | 10                | -             | -                            | -                  | -                   | 8,644        |
| Property                     | 870                                       | 1,790            | 23,088          | 15,829            | 216              | 12,073                      | 584                 | -                 | -             | 10                           | 200                | -                   | 54,660       |
| Trenching                    | 13,951                                    | -                | -               | -                 | -                | 297                         | -                   | -                 | -             | -                            | -                  | -                   | 14,248       |
|                              | 457,870                                   | 52,683           | 54,764          | 43,810            | 96,143           | 279,263                     | 933,278             | 177,792           | 77,281        | 18,787                       | 484,825            | 406,638             | 3,083,134    |
| Less:                        |   |                  |                 |                   |                  |                             |                     |                   |               |                              |                    |                     |              |
| Recoveries                   | (540,794)                                 | (18,387)         | -               | (15,829)          | -                | (183,820)                   | -                   | -                 | -             | (77,549)                     | (9,797)            | (660,001)           | (1,506,177)  |
| Write downs                  | -   | -                | -               | -                 | -                | -                           | -                   | -                 | -             | (296,114)                    | (425,895)          | -                   | (722,009)    |
|                              | (540,794)                                 | (18,387)         | -               | (15,829)          | -                | (183,820)                   | -                   | -                 | -             | (373,663)                    | (435,692)          | (660,001)           | (2,228,186)  |
| Net additions                | (82,924)                                  | 34,296           | 54,774          | 27,981            | 104,756          | 95,443                      | 1,845,549           | 178,019           | 77,281        | (334,876)                    | 49,133             | (123,347)           | 1,926,085    |
| Balance at                   |   |                  |                 |                   |                  |                             |                     |                   |               |                              |                    |                     |              |
| December 31, 2005            | \$3,919,051                               | \$1,540,014      | \$ 736,195      | \$ 27,981         | \$ 527,050       | \$ 205,157                  | \$ 2,714,932        | \$ 340,524        | \$ 415,170    | \$ -                         | \$2,327,240        | \$ 1,647,165        | \$14,400,479 |

## DIAMONDS NORTH RESOURCES LTD.

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### 5. Mineral Properties (continued)

#### Acquisitions

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 reasonable 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.

#### 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.

#### (a) Amaruk JV, 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. This project covered approximately 8 million acres (currently 3.6 million acres) around the town of Kugaaruk, Nunavut with each party holding a 50% interest in the project.

BHP Billiton initiated the first option, which would have allowed BHP Billiton to earn an additional 10% interest (for an aggregate 60% interest) by sole funding the project to feasibility before May 10, 2011. In early 2006, BHP Billiton elected to terminate the first option and, under the terms of the agreement, BHP Billiton's interest in the project was reduced to 49%. On January 26, 2006, BHP Billiton assigned its 49% interest to the Company in consideration for a 2% gross overriding royalty on diamonds and a 2% net smelter royalty on other minerals except gold. On September 1, 2006, the Company and BHP Billiton finalized an Assignment Agreement, which among other things, concluded the joint venture. The Company holds a 100% interest in the project, subject to the foregoing royalties reserved unto BHP Billiton.

On July 26, 2006, the Company and International Samuel Exploration Corp. ("International Samuel") entered into an agreement covering more than 1 million acres predominantly within the western portion of the Company's Amaruk project in Pelly Bay, Nunavut. International Samuel has an option to earn a 30% interest in the newly named Ualliq project by issuing 2,000,000 common shares to the Company (1,000,000 received) and incurring \$3,000,000 in expenditures on the property over the next four years. In addition, for each of the first four kimberlite bodies discovered on the property, International Samuel shall issue 250,000 common shares to the Company. The Company will operate the project. At December 31, 2006, the carrying value of the Ualliq project is \$15,393.

## DIAMONDS NORTH RESOURCES LTD.

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### 5. Mineral Properties (continued)

#### (a) Amaruk JV, Nunavut (continued)

On July 31, 2006, the Company and Shear Minerals Ltd. ("Shear") entered into an agreement covering approximately 42,000 acres of claims located within the southwest portion of the Company's Amaruk project in Pelly Bay, Nunavut. Shear has an option to earn a 50% interest in the newly named Sakari property by making a payment of \$97,000 in refundable deposits (completed) and incurring \$185,940 in expenditures on the property on or before June 30, 2007. The Company will operate the project. At December 31, 2006, the carrying value of the Sakari project is \$2,162.

On October 4, 2006, the Company and Arctic Star Diamond Corp. ("Arctic Star") entered into an agreement covering approximately 455,000 acres of claims located within the southwest portion of the Company's Amaruk project in Pelly Bay, Nunavut. Arctic Star has an option to earn a 50% interest in the newly named Siku project by issuing 1,500,000 shares to the Company (1,000,000 shares received), funding approximately \$956,000 in bonds on the claims and incurring \$2,500,000 in expenditures on the property over the next three years. In addition, for each of the first five kimberlite bodies discovered on the property, Arctic Star shall issue 100,000 common shares to the Company. The Company will serve as project operator. At December 31, 2006, the carrying value of the Siku project is \$31,931.

#### (b) Tasiq, Nunavut

As part of the Uranium North Plan of Arrangement described in Note 1, the Company transferred its 100% interest (except for diamonds which are reserved unto the Company) in the 449,000 acre Tasiq property to Uranium North. The Company retains a 2% net smelter return royalty with respect to metals (except for uranium) and a 5% uranium royalty.

#### (c) Thelon, Nunavut and Northwest Territories

As part of the Uranium North arrangement described in Note 1, the Company transferred substantially all of its interest in the property pursuant to a memorandum of understanding ("MOU") dated April 14, 2005, with Pathfinder Resources Ltd. ("Pathfinder"). In August 2006, Pathfinder amalgamated with Bayswater Uranium Corporation. The Company retains the right to receive future share issuances under the MOU, a 2% net smelter return royalty with respect to metals (except for uranium) and a 5% uranium royalty.

#### (d) Victoria Island, Nunavut and Northwest Territories

The Company holds a 100% interest in the Blue Ice, Hadley Bay, Holman, Washburn, Wellington and White Ice projects, which are now collectively referred to as "Victoria Island". At varying times, options had been granted on the individual projects and over the course of fiscal 2005 and 2006, the options were terminated. The projects consisted of various claims and permits, which either adjoined or are within close proximity of each other. The Company views the land position as a single package but may re-parcel portions of Victoria Island into individual projects, in the future. Portions of the Victoria Island properties are subject to a 1% gross overriding royalty and the Washburn property is subject to a 2% gross overriding royalty, both on diamonds.

On January 25, 2006, the Company and Teck Cominco Limited ("Teck Cominco") mutually agreed to terminate the Blue Ice Agreement prior to Teck Cominco earning any interest. To satisfy certain obligations under the agreement, Teck Cominco paid the Company \$650,000 in cash and assigned the future benefit of any bonds recovered to the Company.

## DIAMONDS NORTH RESOURCES LTD.

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### 5. Mineral Properties (continued)

#### (e) Banks Island, Northwest Territories

The Company holds a 50% interest in the 1.2 million acre Banks Island property. In 2003, the Company entered into an alliance with Majescor Resources Inc. to jointly explore for regional projects on a 50/50 cost sharing basis in three areas, one of which was Banks Island.

#### (f) Hepburn, Northwest Territories

The Company holds a 100% interest in the 3.6 million acre Hepburn property located approximately 300 kilometres north of Yellowknife. During 2006, the Company allowed approximately 2.1 million acres to lapse.

#### (g) Kennap, Northwest Territories

The Company holds a 100% interest in the 162,000 acre Kennap property. Kennap is located 235 kilometres northeast of Yellowknife.

#### (h) Kidme, Northwest Territories

The Company owns 40% of the 87,000 acre Kidme Project situated adjacent to the eastern border of the Misty Lake property (Note 5(j)(i)). SouthernEra Diamonds Inc., 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 additional land position is held on a 50/50 basis by the two companies.

#### (i) Northern Recon, Nunavut and Northwest Territories

The Northern Recon Initiative comprises numerous Canadian grassroots projects within the Company's property portfolio. In 2004, the Company acquired exploration permits for these projects and the Company continues to develop and evaluate these projects. As part of the Uranium North Plan of Arrangement described in Note 1, some projects were transferred to Uranium North whereby the Company retains varying royalties, which include a 2% gross overriding royalty with respect to diamonds, a 2% net smelter return royalty with respect to metals (except for uranium) and a 5% uranium royalty.

#### (j) Other Properties

The Company holds a 40% to 100% interest in various other properties located in Nunavut, the Northwest Territories and Saskatchewan.

#### (i) Misty Lake, Northwest Territories

The Company holds approximately a 40% interest in the Misty Lake properties. At December 31, 2006, the carrying value of the Misty Lake property is \$279,204.

## DIAMONDS NORTH RESOURCES LTD.

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### 5. Mineral Properties (continued)

#### (j) Other Properties (continued)

##### (ii) Arnaq, Nunavut

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 "Arnaq" is located immediately south of the Company's Amaruk project. The Arnaq property 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 Arnaq 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. During 2006, approximately 480,000 acres of permits were allowed to lapse. At December 31, 2006, the carrying value of the Arnaq project is \$69,149.

##### (iii) Uranium North, Nunavut and Saskatchewan

- a) On May 15, 2006, the Company entered into an option agreement with MPH Consulting Limited ("MPH") to acquire a 100% interest in four mineral permits near Amer Lake, Nunavut. On July 28, 2006, the Company assigned substantially all of the option agreement to Uranium North (see Note 5 (j)(iii)(c) below).

The permits are subject to a 3% royalty on uranium payable to MPH, of which the Company may purchase two-thirds of this royalty for total cash payments of \$2,000,000. In addition, the permits are also subject to a 2% net smelter return royalty, a 3% royalty on uranium and a 2% gross overriding royalty on diamonds, all payable to the Company.

- b) On May 15, 2006, the Company entered into a staking agreement with MPH to stake a minimum of 83,000 hectares of land in the Athabasca Basin of Saskatchewan. On July 28, 2006, the Company assigned substantially all of the staking agreement to Uranium North (see Note 5 (j)(iii)(c) below).

The mineral claims are subject to a 2% royalty on uranium payable to MPH, of which the Company may purchase one-half of this royalty for a cash payment of \$1,000,000. In addition, the property is also subject to a 2% net smelter return royalty, a 3% royalty on uranium and a 2% gross overriding royalty on diamonds, all payable to the Company.

- c) On July 28, 2006, the Company entered into an assignment agreement whereby it assigned substantially all of the interest in the option and staking agreements noted above together with certain mineral claims and permits held by the Company to Uranium North. In consideration for this assignment, Uranium North assumed all of the obligations of the Company under the option and staking agreements and issued 2,000,000 common shares to the Company and subsequently paid \$195,989 to the Company as a reimbursement of costs related to the option and staking agreements.

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**6. Property, Plant and Equipment**

|                        | Cost              | Accumulated<br>Amortization | 2006<br>Net Book<br>Value |
|------------------------|-------------------|-----------------------------|---------------------------|
| Furniture and fixtures | \$ 35,360         | \$ 15,352                   | \$ 20,008                 |
| Computer equipment     | 57,423            | 30,436                      | 26,987                    |
| Equipment              | 56,743            | 8,512                       | 48,231                    |
| Leasehold improvements | 35,882            | 13,700                      | 22,182                    |
|                        | <u>\$ 185,408</u> | <u>\$ 68,000</u>            | <u>\$ 117,408</u>         |

|                        | Cost              | Accumulated<br>Amortization | 2005<br>Net Book<br>Value |
|------------------------|-------------------|-----------------------------|---------------------------|
| Furniture and fixtures | \$ 32,960         | \$ 10,672                   | \$ 22,288                 |
| Computer equipment     | 45,795            | 21,362                      | 24,433                    |
| Leasehold improvements | 31,595            | 7,899                       | 23,696                    |
|                        | <u>\$ 110,350</u> | <u>\$ 39,933</u>            | <u>\$ 70,417</u>          |

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

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

Unlimited common shares without par value.

**(b) Issued:**

|   | Number of<br>Shares | Amount        |
|---|---------------------|---------------|
| Balance at December 31, 2004  | 28,453,321          | \$ 18,312,772 |
| Issued for cash   |                     |               |
| Private placements, net of issue costs (Note 7(c))                  | 10,045,927          | 8,043,814     |
| Exercise of options   | 159,850             | 105,630       |
| Exercise of warrants  | 870,000             | 696,000       |
| Issued for other consideration                                      |                     |               |
| Income tax effect on flow-through share renouncement<br>(Note 7(d)) | -                   | (1,310,816)   |
| Exercise of options, stock-based compensation                       | -                   | 47,221        |
| Balance at December 31, 2005  | 39,529,098          | 25,894,621    |
| Issued for cash   |                     |               |
| Private placements, net of issue costs (Note 7(c))                  | 10,633,422          | 9,451,626     |
| Exercise of options   | 77,300              | 27,375        |
| Exercise of warrants  | 1,339,500           | 1,232,107     |
| Issued for other consideration                                      |                     |               |
| Plan of arrangement (Note 1)  | -                   | (1,065,195)   |
| Income tax effect on flow-through share renouncement<br>(Note 7(d)) | -                   | (853,060)     |
| Exercise of options, stock-based compensation                       | -                   | 26,290        |
| Balance at December 31, 2006  | 51,579,320          | \$ 34,713,764 |

For share issuance after December 31, 2006, see Note 13(b).

**(c) Private placements**

- (i) On July 12, 2006, the Company completed a brokered private placement of 3,000,000 flow-through common shares at a purchase price of \$1.00 per share. Agent's commission of \$180,000 in cash and 210,000 in warrants to purchase up to 210,000 common shares at a price of \$0.858, expiring on July 12, 2007, were paid and issued to non-related third parties in connection with the financing. Concurrently, the Company completed a non-brokered private placement of 265,000 flow-through common shares at a purchase price of \$1.00 per share.
- (ii) On November 16, 2006, the Company completed a brokered private placement of 7,368,422 flow-through common shares at a purchase price of \$0.95 per share. Agent's commission of \$490,000 in cash and 515,789 in warrants to purchase up to 515,789 common shares at a price of \$0.858, expiring February 16, 2008, were paid and issued to non-related third parties in connection with the financing.

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### 7. Share Capital (continued)

#### (c) Private placements (continued)

- (iii) 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.
- (iv) 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.
- (v) On July 22, 2005, the Company completed a non-brokered private placement of 4,000,000 units at a price of \$0.75 per unit. Each unit consists of one common share and one non-transferable share purchase warrant. The warrant attached to the unit entitles the holder to purchase one additional common share, exercisable for two years, at a price of \$1.00 during the first year until July 19, 2006 and at \$1.50 during the second year until July 19, 2007. The units have a forced warrant conversion if the Company's stock price trades at \$1.30 or higher for 10 consecutive days in the first year. Finder's fees of \$124,125 in cash and 198,600 in warrants were paid to non-related third parties in connection with the financing.
- (vi) On December 14, 2005, the Company completed a brokered private placement consisting of 2,577,500 flow-through common shares at a purchase price of \$0.97 per share and 2,439,300 units at a purchase price of \$0.82 per unit for total gross proceeds of \$4.5 million dollars. Each unit consists of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to purchase one common share at a price of \$0.95 per common share until December 13, 2006. Finder's fees of \$270,024 in cash and 351,176 in warrants were paid to non-related third parties in connection with the financing.

#### (d) Income tax effect on flow-through share renouncements

In March 2006, the Company renounced \$2,500,175 of exploration expenditures under its flow-through share program, resulting in a future tax liability of \$853,060, which is deducted from share capital. The Company subsequently reduced the future income tax liability by recognizing previously unrecorded future income tax assets equal to the amount of the future tax liability, which resulted in a future income tax recovery of \$853,060 (Note 12).

In February 2005, the Company renounced \$3,680,000 of exploration expenditures under its flow-through share program, resulting in a future tax liability of \$1,310,816, which is deducted from share capital. The Company subsequently reduced the future income tax liability by recognizing previously unrecorded future income tax assets equal to the amount of the future tax liability, which resulted in a future income tax recovery of \$1,310,816 (Note 12).

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**7. Share Capital (continued)****(e) 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 7,909,429 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, 2006, the Company had stock options outstanding for the purchase of 5,582,500 common shares with an average remaining contractual life of 2.66 years, of which 5,125,000 stock options were exercisable at December 31, 2006.

|                                  | Shares    | Weighted Average<br>Exercise Price |
|----------------------------------|-----------|------------------------------------|
| Outstanding at December 31, 2004 | 3,424,650 | \$ 0.80                            |
| Granted                          | 852,500   | \$ 0.95                            |
| Exercised                        | (159,850) | \$ 0.66                            |
| Cancelled                        | (152,500) | \$ 1.16                            |
| Outstanding at December 31, 2005 | 3,964,800 | \$ 0.82                            |
| Granted                          | 1,795,000 | \$ 0.86                            |
| Exercised                        | (77,300)  | \$ 0.36                            |
| Cancelled                        | (100,000) | \$ 1.19                            |
| Outstanding at December 31, 2006 | 5,582,500 | \$ 0.76                            |

The following summarizes information about stock options outstanding at December 31, 2006:

| Number of Shares | Exercise Price | Expiry Date       |
|------------------|----------------|-------------------|
| 9,500            | \$ 0.215       | January 10, 2007  |
| 1,062,300        | \$ 0.429       | July 15, 2007     |
| 50,000           | \$ 0.686       | December 19, 2007 |
| 482,200          | \$ 0.686       | February 20, 2008 |
| 100,000          | \$ 0.686       | March 4, 2008     |
| 60,000           | \$ 0.686       | May 22, 2008      |
| 111,000          | \$ 0.600       | October 6, 2008   |
| 200,000          | \$ 1.021       | March 30, 2009    |
| 560,000          | \$ 0.944       | August 8, 2009    |
| 300,000          | \$ 0.858       | October 18, 2009  |
| 50,000           | \$ 0.858       | January 27, 2010  |
| 252,500          | \$ 0.987       | March 22, 2010    |
| 550,000          | \$ 0.729       | May 17, 2010      |
| 1,660,000        | \$ 0.848       | April 12, 2011    |
| 135,000          | \$ 1.021       | July 13, 2011     |
| 5,582,500        |                |                   |

For stock options exercised and granted after December 31, 2006, see Notes 13(a) and 13(b).

**DIAMONDS NORTH RESOURCES LTD.**

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**7. Share Capital** (continued)**(f) Stock-based and option compensation**

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, 2006:

|                                 | 2006  | 2005  |
|---------------------------------|-------|-------|
| Risk-free interest rate         | 2.87% | 2.88% |
| Expected dividend yield         | -     | -     |
| Expected stock price volatility | 77%   | 83%   |
| Expected option life in years   | 2.51  | 2.50  |

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 period.

The following summarizes information about option compensation:

|  | 2006         | 2005         |
|--|--------------|--------------|
| Option compensation, beginning of year | \$ 1,211,198 | \$ 863,837   |
| Stock-based compensation expense       | 555,286      | 452,373      |
| Reallocated to share capital           | (26,290)     | (47,222)     |
| Reallocated to contributed surplus     | (62,610)     | (57,790)     |
| Option compensation, end of year       | \$ 1,677,584 | \$ 1,211,198 |

The following summarizes information about stock-based compensation summarized by the statement of operations categories:

|                                   | 2006       | 2005       | 2004       |
|-----------------------------------|------------|------------|------------|
| Accounting and audit              | \$ 20,152  | \$ 2,890   | \$ 8,668   |
| Administration fees               | 17,561     | 47,927     | 21,669     |
| Consulting fees                   | 54,410     | 4,815      | 14,446     |
| Directors' fees                   | 122,267    | 227,271    | 28,890     |
| Investor relations and promotions | 49,804     | 77,114     | 28,891     |
| Wages and benefits                | 291,092    | 92,356     | 271,713    |
| Stock-based compensation expense  | \$ 555,286 | \$ 452,373 | \$ 374,277 |

## DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements  
December 31, 2005 and 2006  
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### 7. Share Capital (continued)

#### (g) Warrants

At December 31, 2006, the Company had outstanding warrants to purchase an aggregate of 4,165,389 common shares as follows:

| Exercise Price | Expiry Date       | Outstanding at December 31, 2005 | Issued  | Exercised   | Expired   | Outstanding at December 31, 2006 |
|----------------|-------------------|----------------------------------|---------|-------------|-----------|----------------------------------|
| \$ 0.815       | December 13, 2006 | 1,219,650                        | -       | (580,500)   | (639,150) | -                                |
| \$ 0.815       | December 13, 2006 | 351,176                          | -       | -           | (351,176) | -                                |
| \$ 0.858       | July 12, 2007     | -                                | 210,000 | -           | -         | 210,000                          |
| \$ 1.286       | July 19, 2007     | 4,000,000                        | -       | (750,000)   | -         | 3,250,000                        |
| \$ 1.286       | July 19, 2007     | 198,600                          | -       | (9,000)     | -         | 189,600                          |
| \$ 0.858       | February 16, 2008 | -                                | 515,789 | -           | -         | 515,789                          |
|                |                   | 5,769,426                        | 725,789 | (1,339,500) | (990,326) | 4,165,389                        |

### 8. Related Party Transactions

The Company had the following related party transactions and balances:

- (a) Included in accounts receivable is \$2,385 (2005 - \$8,758) owed by Commander Resources Ltd., a company related by virtue of a common director, for shared office costs and \$18,513 (2005 - \$Nil) owed by Uranium North, a company related by virtue of other common directors, for mineral property and office costs.
- (b) As at December 31, 2006, a director of the Company has been paid a total of \$18,900 (2005 - \$18,900) for consulting fees. Of this amount, \$18,375 (2005 - \$17,325) has been charged to deferred exploration expenditures and \$525 (2005 - \$1,575) has been expensed. In addition, the Company has accrued a retainer of \$40,000 (2005 - \$Nil) to be paid to the four independent directors of the Company.
- (c) Amounts due to related parties, totalling \$51,359 (2005 - \$9,946), consist of fees, retainer and reimbursement of expenses owed to directors and officers.

### 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 \$90,000.

### 10. Segmented Information

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

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

**DIAMONDS NORTH RESOURCES LTD.**

Notes to Consolidated Financial Statements  
 December 31, 2005 and 2006  
*(expressed in Canadian dollars)*

**11. Supplemental Cash Flow Information**

|  | 2006                  | 2005                  | 2004             |
|--|-----------------------|-----------------------|------------------|
| <b>Investing activities</b>  |                       |                       |                  |
| Marketable securities received in settlement for accounts receivable | \$ -                  | \$ -                  | \$ 51,475        |
| Mineral properties acquired with common shares                       | -                     | -                     | 20,800           |
| Marketable securities received for option payments                   | 525,000               | 105,000               | -                |
| Plan of arrangement (Note 1)   | 1,065,195             | -                     | -                |
|  | <u>\$ 1,590,195</u>   | <u>\$ 105,000</u>     | <u>\$ 72,275</u> |
| <b>Financing activities</b>  |                       |                       |                  |
| Income tax effect on flow-through share renouncement (Note 7(d))     | \$ (853,060)          | \$ (1,310,816)        | \$ -             |
| Plan of arrangement (Note 1)   | (1,065,195)           | -                     | -                |
| Stock-based compensation   | 26,290                | 47,221                | 73,112           |
|  | <u>\$ (1,891,965)</u> | <u>\$ (1,263,595)</u> | <u>\$ 73,112</u> |
| <b>Other cash flow information:</b>                                  |                       |                       |                  |
| Interest received  | \$ 138,150            | \$ 23,307             | \$ 86,506        |
| Interest paid  | \$ 15,934             | \$ -                  | \$ -             |
| Income taxes paid  | \$ -                  | \$ -                  | \$ -             |

**12. Income Taxes**

The Company has accumulated non-capital losses for Canadian income tax purposes of \$4,057,973. The losses may be carried forward to reduce taxable income in future years and, unless utilized, expire by 2026.

|      |                     |
|------|---------------------|
| 2009 | \$ 869,376          |
| 2010 | 986,744             |
| 2011 | 861,188             |
| 2015 | 1,302,410           |
| 2026 | 38,255              |
|      | <u>\$ 4,057,973</u> |

**DIAMONDS NORTH RESOURCES LTD.**

Notes to Consolidated Financial Statements  
 December 31, 2005 and 2006  
*(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:

|   | 2006        | 2005         | 2004         |
|---|-------------|--------------|--------------|
|   | 34.12%      | 34.12%       | 35.62%       |
| Income tax computed at Canadian statutory rates                             | \$ 496,710  | \$ 798,728   | \$ 739,652   |
| Temporary differences not recognized in period                              | 329,551     | (167,251)    | (187,444)    |
| Permanent difference not recognized   | 153,946     | (154,350)    | -            |
| Tax losses not recognized   | (1,343,911) | -            | -            |
| Change in tax rates   | -           | (29,757)     | (186,287)    |
|   | (363,704)   | 447,370      | (365,921)    |
| Future income tax arising from flow-through share renouncements (Note 7(d)) | 853,060     | 1,310,816    | -            |
| Future income tax recovery (expense)  | \$ 489,356  | \$ 1,758,186 | \$ (365,921) |

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:

|   | 2006         | 2005         |
|---|--------------|--------------|
| Future income tax assets (liabilities)      |              |              |
| Non-capital losses carried forward          | \$ 1,384,987 | \$ 1,371,775 |
| Temporary differences on mineral properties | (2,862,178)  | (1,790,680)  |
| Temporary differences on other assets       | 723,806      | 29,224       |
| Future income tax liabilities, net          | \$ (753,385) | \$ (389,681) |

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, 2006 and which are held by the Company for such expenditures. As at December 31, 2006, the amount of flow-through proceeds remaining to be expended is \$7,315,991.

## DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements  
December 31, 2005 and 2006  
*(expressed in Canadian dollars)*

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### 13. Subsequent Events

- (a) On February 28, 2007, the Company granted incentive stock options under the Company's stock option plan to directors, officers, employees and consultants to purchase an aggregate of 1,630,000 treasury shares. The options are exercisable for a period of five years at a price of \$0.77 per share and are subject to the policies of the Exchange.
- (b) Subsequent to December 31, 2006, the Company issued 49,500 common shares for proceeds of \$19,202 pursuant to the exercise of stock options.
- (c) On March 12, 2007, the Company reported the retention of Toronto-based Genoa Management Limited ("Genoa") to provide investor relations and independent capital market counsel. Under the terms of the agreement, Genoa will receive a fixed fee of \$6,500 per month for a term of six months beginning on February 15, 2007.





# **Management Discussion and Analysis**

**Year Ended December 31, 2006**

**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 trades on the TSX Venture Exchange under the symbol "DDN" and is listed as a Tier One reporting issuer in British Columbia and Alberta. 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, 2006.

*Forward-Looking Information*

This Management Discussion and Analysis ("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 4, 2007 (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, 2006**

- Exploration success on the Company's **100%** owned **Amaruk Project** included:
  - Drill tested five kimberlites.
  - Nearly three tonnes of kimberlite were collected for diamond analysis.
  - Drill results from Qavvik yielded 596 diamonds and Umingmak 33 diamonds.
- In February, the 2005 diamond results from four kimberlite float occurrences (WMC, WCA, WA1 & WA2) and the Umingmak kimberlite (U-SW & U-NE) confirmed the first diamond bearing kimberlite on the Amaruk project, named **Umingmak**.
- On July 16<sup>th</sup>, the Company completed a brokered private placement of 3,000,000 flow-through common shares at a purchase price of \$1.00 per share, see **Liquidity**.
- On July 28<sup>th</sup>, the Plan of Arrangement between the Company and Uranium North Resources Corp. ("Uranium North") was completed and shareholders were issued 7,264,164 common shares of Uranium North, see **Uranium North**.
- On August 2<sup>nd</sup>, the Company optioned approximately 1 million acres on the western portion of the Amaruk project to International Samuel Exploration Corp. ("International Samuel"), see **Ualliq Project**.
- On August 15<sup>th</sup>, the Company optioned approximately 42,000 acres of claims located within the southwest portion of the Amaruk project, to Shear Minerals Ltd. ("Shear"), see **Sakari Project**.
- On October 12<sup>th</sup>, the Company optioned approximately 455,000 acres of claims located within the southwest portion of the Amaruk project to Arctic Star Diamond Corp. ("Arctic Star"), **Siku Project**.
- On November 16<sup>th</sup>, the Company completed a brokered private placement of 7,368,422 flow-through common shares at a purchase price of \$0.95 per share, see **Liquidity**.
- On December 7<sup>th</sup>, Uranium North common shares were listed for trading on the Exchange under the symbol **UNR**.



### Events Subsequent to December 31, 2006

- On March 12<sup>th</sup>, the Company reported the retention of Toronto-based Genoa Management Limited ("Genoa") to provide investor relations and independent capital market counsel. Under the terms of the agreement, Genoa will receive a fixed fee of \$6,500 per month for a term of six months beginning on February 15, 2007.
- On February 15<sup>th</sup> and March 29<sup>th</sup>, the Company reported lab results from the 2006 RC drill program which yielded 596 diamonds from Qavvik and 33 diamonds from Umingmak.

### Uranium North

The Company recognized uranium potential and shareholders have benefited by receiving shares of Uranium North. Amongst junior exploration companies, Uranium North is in a unique position of having projects on all three of Canada's known uranium basins: Athabasca, Hornby Bay and Thelon.

- On March 14<sup>th</sup>, the Company provided the initial working capital to Uranium North through a \$300,000 loan from the Company, which, at the option of the Company may be repaid in cash or converted as noted below. The Company was issued 1,500,000 common shares of Uranium North as a bonus for the foregoing loan and to provide a measure of control over this new company.
  - prior to December 7, 2007, the loan and accrued interest or any portion thereof may be converted into units ("Unit") at a price of \$0.75 per Unit, with each Unit consisting of one common share of Uranium North and one share purchase warrant entitling the Company to purchase one additional common share of Uranium North at a price equal to \$0.90, up to December 6, 2007, whereupon any unexercised warrants will expire; and
  - on and after December 7, 2007, the loan and accrued interest or any portion thereof may be converted into common shares of Uranium North at a per share conversion price equal to \$0.75 per share.
- On July 28<sup>th</sup>, the Company entered into an Assignment Agreement with Uranium North and assigned substantially all of its interest in the MPH option and staking agreements together with certain mineral claims and permits held by the Company to Uranium North. In consideration, Uranium North assumed all of the obligations of the Company under the MPH option and staking agreements, issued 2,000,000 common shares to the Company and reimbursed \$195,898 in costs. The mineral claims and permits are subject to a 2% net smelter return royalty, a 3% royalty on uranium and a 2% gross overriding royalty on diamonds, all payable to the Company.
- On July 28<sup>th</sup>, the Plan of Arrangement between the Company and Uranium North was completed. As a result of the closing, shareholders of the Company were issued one common share of Uranium North for each six common shares of the Company held. A total of 7,264,164 common shares of Uranium North were issued. Upon the closing, Uranium North became a reporting issuer in British Columbia and Alberta.
- On December 6<sup>th</sup>, Uranium North completed a brokered private placement financing consisting of 9,492,900 units consisting of one common share and one-half of one transferable share purchase warrant (the "Units") at price of \$0.75 per Unit.
- On December 7<sup>th</sup>, Uranium North common shares were listed for trading on the Exchange under the symbol "UNR".

## Property Locations



The Company controls one of the largest diamond potential land packages in northern Canada. In early 2006, management focused on advancing the Company's key properties while at the same time reducing future land holding costs. Management continues to mitigate diamond exploration risk through a diversified portfolio of projects, both by location and exploration stage and through partnerships. The Company's focus for 2007 will be on Amaruk, Hepburn and Banks Island.

**Amaruk** is 100% owned by the Company. Over \$10 million in historical expenditures has moved the project into the drill testing stage. The Company has discovered a central diamondiferous kimberlite field and has identified three other separate regions with kimberlite indicator minerals that could potentially represent three additional kimberlite fields. Diamond results from the central kimberlite field are very encouraging.

**Hepburn** is a 100% owned project and was generated from the Company's Northern Recon Initiative. Regional work demonstrates the potential of two separate kimberlite fields. The project is located on a portion of the western margin of the Slave Craton which has never previously been block staked for diamonds. A combination of regional airborne magnetics and indicator mineral data has identified 204 anomalies.

**Banks Island** is a 50:50 joint venture with Majescor Resources Inc. ("Majescor") covering 1.2 million acres of permits in NWT. Airborne geophysics interpretation data has identified 65 targets with seven ranked as high to moderate priority. One high priority geophysical target has a size estimate of 12 to 14 hectares.

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, limited season, lack of surface infrastructure, and availability of skilled labour, fuel and supplies. Exploration is heavily dependent on air transportation (fixed wing and helicopter), which is both costly and susceptible to bad weather. The unpredictability of the weather can cause delays in carrying out a planned exploration program which can result in cost overruns. The Company manages these risks by utilizing experienced project geologists who are familiar with the north and the challenges associated with working there.



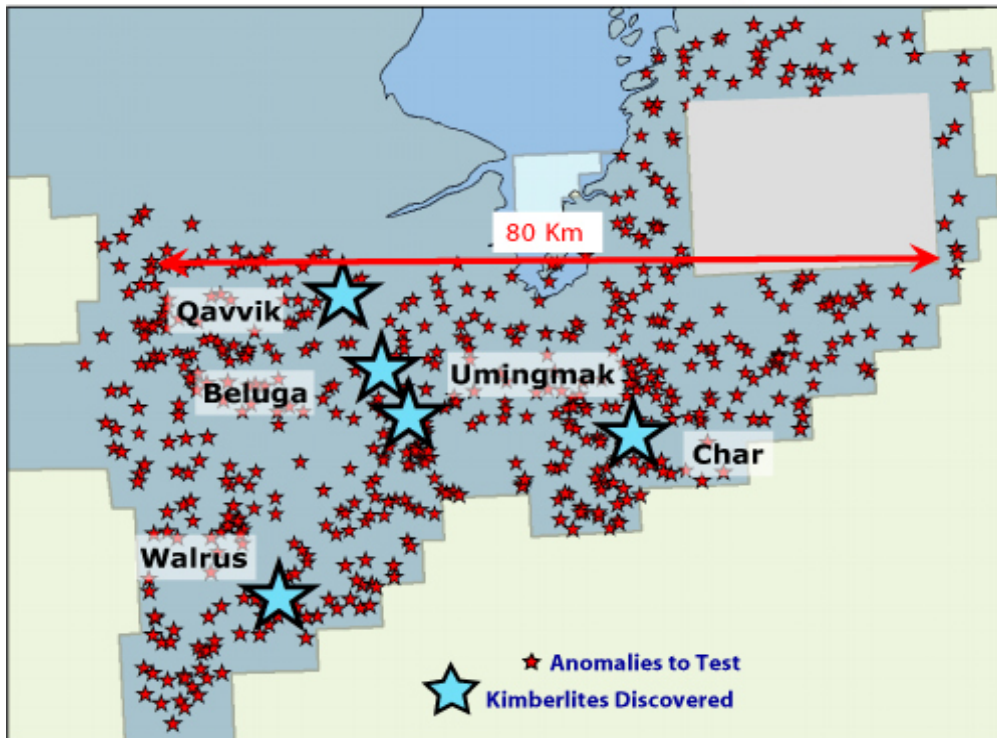
Management Discussion and Analysis  
For the Year Ended December 31, 2006

In 2006, net mineral property expenditures of \$1,623,303 includes \$27,629 in acquisition costs, \$7,036,783 in exploration expenditures less \$3,990,073 in recoveries, \$1,065,195 as part of the Arrangement with Uranium North and \$385,841 in write downs. Included under property expenditures of \$1,752,903 is the posting of work bonds. A breakdown by key projects as follows:

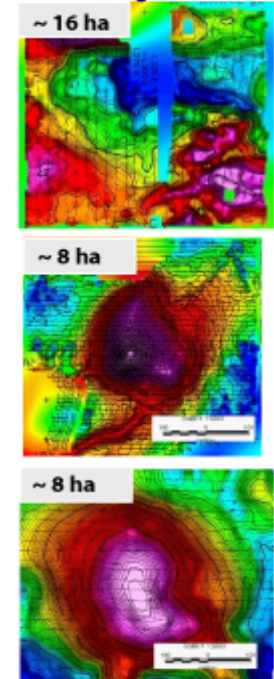
|                            | Amaruk JV,<br>NU | Tasiq<br>NU | Thelon<br>NU/NWT(2) | Victoria<br>Island<br>NU/NWT(1) | Banks<br>Island,<br>NWT | Hepburn,<br>NWT | Kennap<br>NWT | Kidme,<br>NWT | Northern<br>Recon. | Other<br>Properties | Total         |
|----------------------------|------------------|-------------|---------------------|---------------------------------|-------------------------|-----------------|---------------|---------------|--------------------|---------------------|---------------|
| Balance at                 |                  |             |                     |                                 |                         |                 |               |               |                    |                     |               |
| December 31, 2005          | \$ 1,540,014     | \$ 527,050  | \$ 315,300          | \$ 4,776,347                    | \$ 205,157              | \$ 2,714,932    | \$ 340,524    | \$ 415,170    | \$ 2,306,644       | \$ 1,259,341        | \$ 14,400,479 |
| Additions during the year: |                  |             |                     |                                 |                         |                 |               |               |                    |                     |               |
| Acquisition costs          | 27,629           | -           | -                   | -                               | -                       | -               | -             | -             | -                  | -                   | 27,629        |
| Exploration:               |                  |             |                     |                                 |                         |                 |               |               |                    |                     |               |
| Project admin.             | 16,041           | 174         | -                   | -                               | 1,684                   | 1,420           | -             | -             | -                  | -                   | 19,319        |
| Airborne geoph.            | 479,500          | -           | -                   | 5,902                           | 121,569                 | 515,532         | -             | -             | -                  | 163                 | 1,122,666     |
| Camp costs                 | 605,312          | -           | -                   | -                               | 27                      | 153,588         | -             | -             | 5,780              | -                   | 764,707       |
| Drilling                   | 453,494          | -           | -                   | 118,299                         | -                       | -               | -             | 31,197        | -                  | -                   | 602,990       |
| Geochemistry               | 1,097,222        | 25,852      | 1,022               | 19,622                          | 23,929                  | 478,100         | 24,110        | -             | 159,761            | 6,197               | 1,835,815     |
| Geology                    | 420,740          | -           | 3,846               | 40,064                          | 6,022                   | 108,462         | 1,024         | 1,059         | 5,319              | 1,452               | 587,988       |
| Ground geoph.              | 70,663           | -           | -                   | 366                             | -                       | 63,029          | -             | -             | -                  | 1,743               | 135,801       |
| Mobilization               | 66,122           | -           | -                   | -                               | -                       | 24,281          | -             | -             | -                  | -                   | 90,403        |
| Permitting                 | 17,464           | -           | -                   | 2,186                           | -                       | 1,396           | -             | -             | 100                | 1,564               | 22,710        |
| Property                   | 1,278,862        | 50          | 221,898             | 20,499                          | 60                      | 55,283          | -             | -             | 159,781            | 16,470              | 1,752,903     |
| Trenching                  | 95,437           | -           | -                   | 6,044                           | -                       | -               | -             | -             | -                  | -                   | 101,481       |
|                            | 4,600,857        | 26,076      | 226,766             | 212,982                         | 153,291                 | 1,401,091       | 25,134        | 32,256        | 330,741            | 27,589              | 7,036,783     |
| Less:                      |                  |             |                     |                                 |                         |                 |               |               |                    |                     |               |
| Recoveries                 | (1,703,007)      | -           | (281,408)           | (883,010)                       | (75,850)                | (210,770)       | -             | -             | (885,513)          | 49,485              | (3,990,073)   |
| Plan of arrng. (Note 1)    | -                | (553,126)   | -                   | -                               | -                       | -               | -             | -             | (202,242)          | (309,827)           | (1,065,195)   |
| Write downs                | -                | -           | -                   | -                               | -                       | -               | -             | -             | -                  | (385,841)           | (385,841)     |
|                            | (1,703,007)      | (553,126)   | (281,408)           | (883,010)                       | (75,850)                | (210,770)       | -             | -             | (1,087,755)        | (646,183)           | (5,441,109)   |
| Net additions              | 2,925,479        | (527,050)   | (54,642)            | (670,028)                       | 77,441                  | 1,190,321       | 25,134        | 32,256        | (757,014)          | (618,594)           | 1,623,303     |
| Balance at                 |                  |             |                     |                                 |                         |                 |               |               |                    |                     |               |
| December 31, 2006          | \$ 4,465,493     | \$ -        | \$ 260,658          | \$ 4,106,319                    | \$ 282,598              | \$ 3,905,253    | \$ 365,658    | \$ 447,426    | \$ 1,549,630       | \$ 640,747          | \$ 16,023,782 |

1. Disclosed as separate projects in 2005 but have been combined under Victoria Island.
2. Included under "Other Properties" in 2005.

## Amaruk Property



### Sizeable Geophysical Targets



### Amaruk Project, NU

Amaruk and the surrounding projects cover approximately 3.6 million acres of land around the community of Kugaaruk in Pelly Bay, Nunavut. Part of the property was originally acquired by the Company and part through a joint venture with BHP Billiton Diamonds Inc. ("BHP Billiton"). On January 26, 2006, BHP Billiton assigned its 49% interest to the Company in consideration for a 2% gross overriding royalty on diamonds and a 2% net smelter royalty on other minerals except gold. On September 1, 2006, the Company and BHP Billiton finalized an Assignment Agreement which, among other things, concluded the joint venture. The Company holds a 100% interest in the project, subject to the foregoing royalties reserved unto BHP Billiton.

### Amaruk Exploration Program for 2006

The 2006 exploration program was originally budgeted at \$2.0 million (not including posting of work bonds) and subsequently increased to expand the drill program. Actual costs to date approximate \$3.0 million (not including posting of work bonds) and it is anticipated that \$200,000 in lab assay costs will be incurred in Q1 of 2007. Some of the program highlights:

#### - Airborne survey

During the 2006 exploration program, over 25,000 line kilometres of detailed magnetic surveying was completed over parts of the property not previously flown. The Company doubled the amount of airborne that was flown in the past two years under the joint venture. Preliminary interpretation has identified 400 geophysical anomalies.

Management Discussion and Analysis  
For the Year Ended December 31, 2006

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**- Till Sampling and Geochemistry**

In 2006, more than 1,300 till samples were collected from the property of which 1,000 have been processed. From this new data, several new areas have been identified with anomalous kimberlite indicator minerals which led to the discovery of four new kimberlite float occurrences. Two till samples from one of the areas yielded more than 58,000 and 10,000 kimberlite indicator minerals respectively (lab estimates, more than 800 grains in the 1 to 2 mm size fraction) indicating proximity to source.

**- Drilling**

The 2006 drill program was designed to test a variety of geophysical targets on different parts of the property and to identify separate clusters of kimberlite (more than one pipe). More than 30 separate areas with kimberlite indicator minerals have been identified over an 80 kilometre wide area within the central part of the property. Five of these areas (each separated by up to 40 km) were tested with a lightweight, portable reverse circulation ("RC") drill equipped to penetrate a maximum depth of 65 metres.

A total of 26 targets were tested by RC drilling. The targets covered a full range of magnetic signatures ranked from low to high priority. Some of the drill holes did not reach bedrock due to difficult drilling conditions for the small drill rig. All drill holes were vertical, with the exception of Umingmak and Char which were drilled at -60°, and all drill holes were drilled to a maximum depth of 65 metres unless the hole was abandoned.

RC drilling has proven to be a cost-effective kimberlite discovery tool that verifies whether geophysical targets are kimberlite and if they contain diamonds. However, the lack of stones remaining on screens above the 0.300 mm sieve is likely the result of the RC drill pulverizing the material. Overall, the RC drill program was successful by testing numerous targets quickly and at low cost. This benefit will be utilized in 2007 given that there are more than 400 targets on the property, 25 of which are within a 10-kilometre area around Qavvik.

***Amaruk Exploration Results for Qavvik 2006 RC Drilling***

On February 15, 2007, the Company reported the first Qavvik RC drill hole results which confirmed the discovery of a second diamond bearing kimberlite, named '**Qavvik**'. Ninety one diamonds or 1.5 stones per kilogram were collected from a 60.28 kilogram sample, table below.

| Weight (kg) | Sieve Size (mm) |       |       |       |       | Total |
|-------------|-----------------|-------|-------|-------|-------|-------|
|             | 0.075           | 0.106 | 0.150 | 0.212 | 0.300 |       |
| 60.28       | 36              | 27    | 15    | 8     | 5     | 91    |

Approximately 70% of the recovered diamonds from Qavvik are octahedrons and 95% of the diamonds are white in color. The three largest stones measure 0.51mm x 0.43mm x 0.36mm, 0.51mm x 0.46mm x 0.42mm, and 0.51mm x 0.43mm x 0.32 mm.

The Qavvik kimberlite is represented by a large 4.3 hectare magnetic anomaly and the area immediately surrounding Qavvik also exhibits highly prospective mineral chemistry. This area will be a high priority for the 2007 exploration program as more than 25 targets have been identified to test.



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For the Year Ended December 31, 2006

On March 29, 2007, the Company reported the second Qavvik RC drill hole results of 515 diamonds have been recovered from a 397.05 kilogram sample, table below. A total of 15 macrodiamonds (0.5mm in one dimension) have been recovered from this sample and the dimensions for the three largest diamonds are: 0.97mm x 0.86mm x 0.71mm; 0.94mm x 0.63mm x 0.52mm and 0.71mm x 0.66mm x 0.53mm. In addition, a high proportion of the diamonds are white, octahedral and exhibit high clarity, consistent with the first sample from Qavvik.

|              | Weight<br>(kg) | Sieve Size (mm) |            |           |           |           |          |          | Total      |
|--------------|----------------|-----------------|------------|-----------|-----------|-----------|----------|----------|------------|
|              |                | 0.075           | 0.106      | 0.150     | 0.212     | 0.300     | 0.425    | 0.600    |            |
| Q1a          | 60.10          | 21              | 21         | 16        | 7         | 2         | 0        | 0        | 67         |
| Q2a          | 70.40          | 16              | 34         | 14        | 5         | 6         | 0        | 0        | 75         |
| Q3a          | 61.70          | 3               | 39         | 13        | 8         | 4         | 0        | 0        | 67         |
| Q1b*         | 73.53          | 11              | 27         | 19        | 9         | 3         | 2        | 0        | 71         |
| Q2b          | 68.71          | 52              | 39         | 16        | 12        | 6         | 2        | 0        | 127        |
| Q3b          | 62.61          | 34              | 29         | 16        | 12        | 6         | 0        | 1        | 98         |
| <b>Total</b> | <b>397.05</b>  | <b>137</b>      | <b>189</b> | <b>94</b> | <b>53</b> | <b>27</b> | <b>4</b> | <b>1</b> | <b>505</b> |

\*Results are preliminary

The Company views these results as very significant because it is generally considered positive to recover one diamond per kilogram from drill core. Recovering up to 1.8 diamonds per kilogram from RC drill cuttings (where significant diamond loss is anticipated) confirms Qavvik is highly diamondiferous. The vertical drill hole intersected kimberlite after penetrating 31.4 metres of overburden. The drill hole was terminated in kimberlite at 64 metres depth.

**Amaruk Exploration Results for Umingmak 2006 RC Drilling**

On February 15, 2007, the Company reported Umingmak lab results from a 246.84 kilogram RC drill cutting sample which yielded 33 diamonds or approximately 0.1 stones per kg, table below. The RC drill hole intersected almost 30 metres horizontal distance across Umingmak. The Umingmak kimberlite is estimated to be three hectares in size.

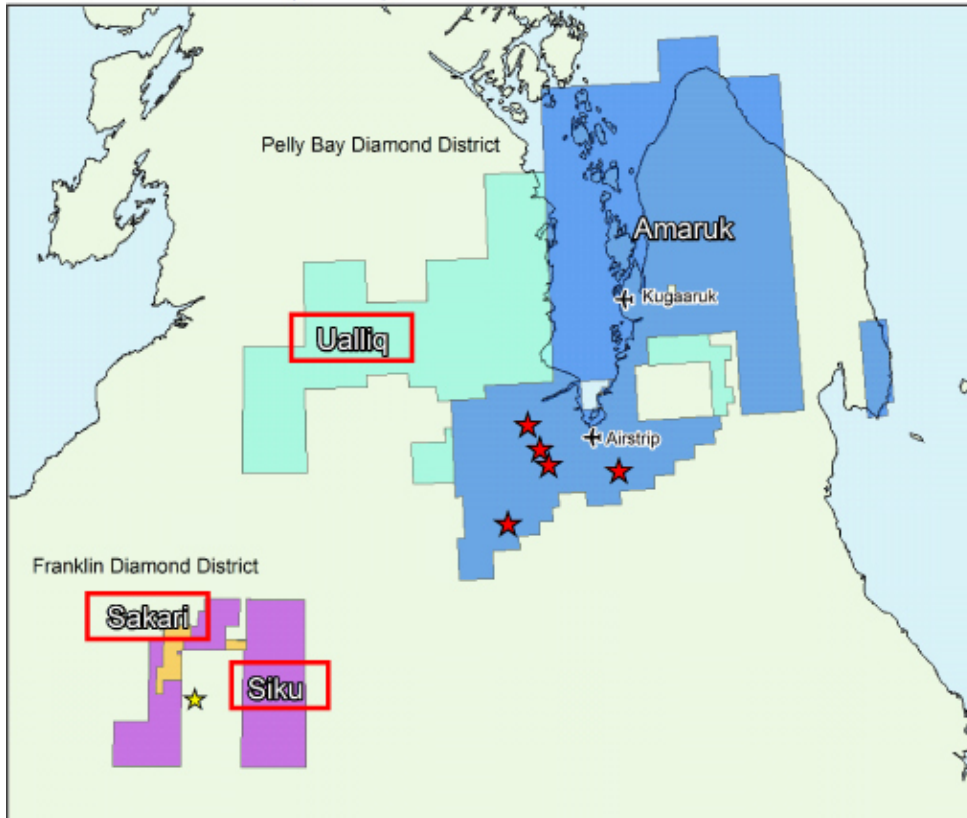
| Weight (kg) | Sieve Size (mm) |       |       |       |       | Total |
|-------------|-----------------|-------|-------|-------|-------|-------|
|             | 0.075           | 0.106 | 0.150 | 0.212 | 0.300 |       |
| 246.84      | 6               | 13    | 12    | 2     | 0     | 33    |

The Umingmak sample is comprised of four down-hole intervals for a total of 60 metres. Approximately 85% of the diamonds in the sample were recovered from the uppermost interval. The single drill hole was located about 136 metres from the center of the outcrop occurrence. Visual inspection of the kimberlite recovered by the drill indicates it appears to be of similar character to the kimberlite observed at surface.

**Future Developments for Amaruk Project**

For 2007, the Company has proposed a \$3.7 million budget which will include a \$300,000 airborne survey, \$360,000 to evaluate up to 200 targets with detailed geophysics, \$500,000 for till sampling, \$1.5 million for drill testing up to 60 targets and \$1.0 million for core drilling. The Qavvik kimberlite will be the target of a mini-bulk sample in 2007.

## Pelly Bay Diamond District



### Ualliq

30% option agreement with International Samuel Exploration Corp.

### Sakari

50% option agreement with Shear Minerals Ltd.

### Siku

50% option agreement with Arctic Star Diamond Corp.

### Ualliq - Amaruk Project, NU

On July 26<sup>th</sup>, the Company and International Samuel entered into an agreement covering more than 1 million acres predominantly within the western portion of the Company's Amaruk project. International Samuel has an option to earn a 30 % interest in the newly named Ualliq project by issuing 2,000,000 shares to the Company (1,000,000 received) and incurring \$3,000,000 in expenditures on the property over the next four years. In addition, for each of the first four kimberlite bodies discovered on the property, International Samuel shall issue 250,000 common shares to the Company. The Company will operate the project.

### Ualliq Exploration Program for 2006

During the summer 2006 program, 380 till samples were collected from the project and have been submitted for processing and picking. These samples were collected on a detailed grid to follow-up existing kimberlite indicator mineral anomalies for \$248,467. More than 3,520 line kilometres of magnetic airborne surveying have been completed on the property at a cost of \$114,259.

### Future Developments for Ualliq Project

The proposed 2007 Ualliq budget includes a \$400,000 airborne survey over the western portion of the project, \$110,000 in detailed geophysics for up to 60 targets and \$300,000 for drill testing for up to 10 targets.



Management Discussion and Analysis  
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### **Sakari – Amaruk Project, NU**

On July 31<sup>st</sup>, the Company and Shear entered into an agreement covering approximately 42,000 acres of claims located within the southwest portion of the Company's Amaruk project. Shear has an option to earn a 50% interest in the newly named Sakari project by making a payment of \$97,000 in refundable deposits (completed) and incurring \$185,940 in exploration expenditures on or before June 30, 2007. The Company will operate the project.

#### ***Sakari Exploration Program for 2006***

Due to bad weather in September, the Company was unable to fly all of the planned airborne survey. However, 477 line kilometres of magnetic airborne surveying were flown at a cost of \$14,630. The survey is anticipated to re-commence in April 2007.

#### ***Future Developments for Sakari Project***

The proposed 2007 Sakari budget includes a \$100,000 airborne survey, \$70,000 in detailed geophysics and drill testing.

### **Siku - Amaruk Project, NU**

On October 4<sup>th</sup>, the Company and Arctic Star entered into an agreement covering approximately 455,000 acres of claims located within the southwest portion of the Company's Amaruk project. Arctic Star has an option to earn a 50% interest in the newly named Siku project by issuing 1,500,000 shares to the Company, funding approximately \$1,000,000 in bonds on claims and incurring \$2,500,000 in expenditures on the property over the next three years. In addition, for each of the first five kimberlite bodies discovered on the property, Arctic Star shall issue 100,000 common shares to the Company. The Company will serve as project operator.

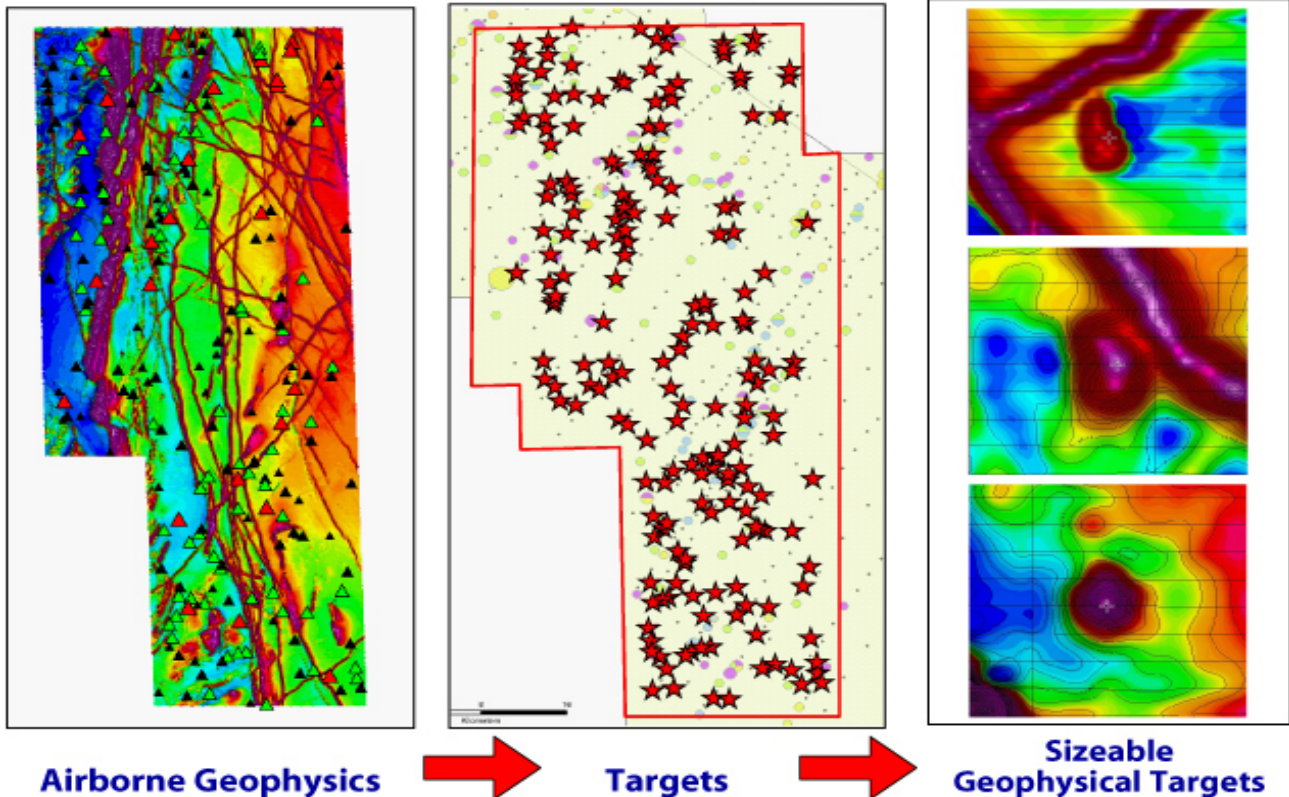
#### ***Siku Exploration Program for 2006***

Due to bad weather in September, the Company was unable to fly all of the planned airborne survey. However, 1910 line kilometres of magnetic airborne surveying were flown at a cost of \$58,519. The survey is anticipated to re-commence in April 2007.

#### ***Future Developments for Siku Project***

The proposed 2007 Siku budget includes a \$965,000 airborne survey and \$560,000 in drill testing.

## Hepburn Property



### Hepburn, NWT

The Company holds a 100% interest in the over 1.5 million acre Hepburn property located approximately 400 kilometres north of Yellowknife. Based on indicator mineral data, the Company has outlined two potential kimberlite fields on the property. A portion of the properties' uranium rights have been transferred to Uranium North. The Company will continue to hold 100% interest in all diamonds and other metals, except uranium for which the Company retains a royalty.

#### ***Hepburn Exploration Program for 2006***

In 2006, a fixed wing airborne magnetic survey was completed over the central part of the property representing only 30% of the property.

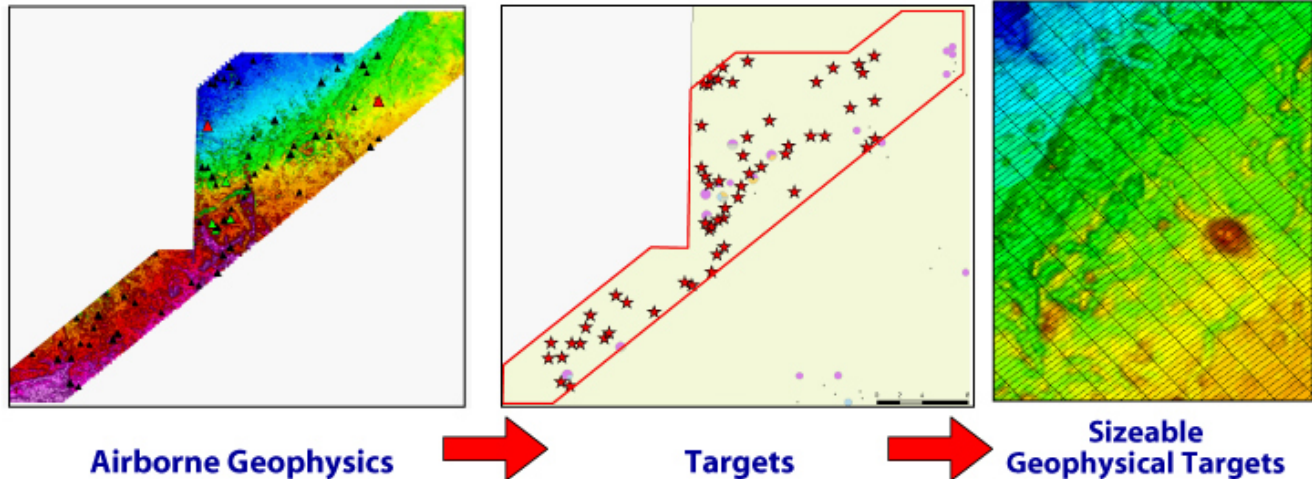
#### ***Hepburn Exploration Results for 2006***

The survey identified 204 anomalies with 25 ranked as high priority and 65 as moderate priority. The targets range in size from about one to eight hectares and are associated with kimberlite indicator minerals recovered from the property including G10 and eclogitic garnets often found in highly diamondiferous kimberlite.

#### ***Future Developments for Hepburn***

For 2007, the Company has proposed a \$3.0 million budget which will include an airborne surveying on the remaining 70% of the property, evaluating over 100 of the 200 targets with detailed geophysics, and drill testing up to 20 targets.

## Banks Island Property



### **Banks Island, NWT**

The Banks Island Project consists of 1.2 million acres of permits in NWT which was jointly acquired with Majescor on a 50:50 basis.

#### ***Banks Island Exploration Program for 2006***

For 2006, the Company and Majescor completed 4,855 line kilometres airborne survey flown from a camp at the Johnson airstrip located 70 kilometres from the project area. The cost of the program was approximately \$153,000. Only 10% of the 1.2 million acre property has been surveyed.

#### ***Banks Island Exploration Results for 2006***

Airborne geophysics interpretation data has identified 65 targets with seven ranked as high to moderate priority. One high priority geophysical target has a size estimate of 12 to 14 hectares.

#### ***Future Developments for Banks Island***

The proposed 2007 Banks Island budget includes a \$710,000 airborne survey, \$220,000 in till sampling and \$170,000 in ground geophysics.

### **Victoria Island, NWT**

The Company holds a 100% interest in the Blue Ice, Hadley Bay, Holman, Washburn, Wellington and White Ice projects which are now collectively referred to as "Victoria Island". At varying times, options had been granted on the individual projects and over the course of fiscal 2005 and 2006, the options were terminated. The projects consisted of various claims and permits, which either adjoined or are within close proximity of each other. The Company views the land position as a single package but may re-parcel portions of Victoria Island into individual projects, in the future. Portions of the Victoria Island properties are subject to 1% gross overriding royalty and the Washburn property subject to a 2% gross overriding royalty, both on diamonds.



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On January 25<sup>th</sup>, the Company and Teck Cominco Limited (“Teck Cominco”) mutually agreed to terminate the Blue Ice Agreement prior to Teck Cominco earning any interest. To satisfy certain obligations under the agreement, Teck Cominco paid the Company \$650,000 in cash and assigned the future benefit of any bonds recovered, to the Company.

**Victoria Island Project Exploration Results for 2005**

On June 22<sup>nd</sup>, the Company released the complete 2005 diamond results for the King Eider kimberlite based on 1,697.5 kilograms of drill core, submitted by the previous operator, Teck Cominco Limited plus 576.9 kilograms of drill core and a 1,053.6 kilogram trench sample submitted by the Company. The square mesh diamond results are shown in the table below:

| Sample              | Sample Weight (kg) | Sieve Size (mm) |       |      |       |       |      |        |      |        |       |         | TOTAL |
|---------------------|--------------------|-----------------|-------|------|-------|-------|------|--------|------|--------|-------|---------|-------|
|                     |                    | +3.35           | +2.36 | +1.7 | +1.18 | +0.85 | +0.6 | +0.425 | +0.3 | +0.212 | +0.15 | +0.100* |       |
| 2004 Core           | 679                | 1               | 0     | 2    | 4     | 3     | 4    | 23     | 35   | 50     | 116   | 196     | 434   |
| 2005 Trench         | 1053.6             | 0               | 1     | 2    | 1     | 5     | 12   | 15     | 23   | 53     | 85    | 72      | 269   |
| 2005 3/4 Split Core | 1697.5             | 0               | 0     | 0    | 1     | 6     | 19   | 32     | 50   | 113    | 250   | 239     | 710   |
| 2005 1/4 Split Core | 576.9              | 0               | 0     | 1    | 1     | 0     | 2    | 5      | 18   | 31     | 59    | 81      | 198   |

\* Sieve sizes vary from +0.106mm to +0.105mm due to two different laboratories used for analysis.

**Conclusions**

The 2005 trench sample and the ¼ split core sample are consistent with the 2004 sample demonstrating the propensity of the King Eider kimberlite to have large diamonds. The diamond results from the ¾ split sample are inconsistent with all other samples collected to date from King Eider. The company has concluded that either the kimberlite is extremely variable with regards to diamond content or there is unexplained diamond loss. The sample volume collected to date is too small to properly evaluate the kimberlite. The collection of a large sample should reduce the effects of erratic diamond distribution within the kimberlite body. The Company’s original recommendation of collecting a 5 to 10 tonne drill sample from the King Eider kimberlite remains valid and the Company plans to do so in the future.

**Future Developments for Victoria Island**

A collection of a mini-bulk sample on King Eider and Snowy Owl has been proposed. Due to commitments on other projects, future exploration on Victoria Island may not resume until 2008.



Management Discussion and Analysis  
For the Year Ended December 31, 2006

**Selected Annual Information**

Selected annual information from the Company's audited consolidated financial statements for the years ended December 31, 2006, 2005, and 2004:

|                                    | 2006           | 2005           | 2004           |
|------------------------------------|----------------|----------------|----------------|
| General and administrative expense | \$ (1,852,232) | \$ (1,567,338) | \$ (1,320,509) |
| Loss for the year                  | \$ (966,417)   | \$ (582,735)   | \$ (2,442,428) |
| Basic and diluted loss per share   | \$ (0.02)      | \$ (0.02)      | \$ (0.09)      |
| Cash dividends per share           | \$ Nil         | \$ Nil         | \$ Nil         |
| Assets                             | \$ 30,376,942  | \$ 21,464,318  | \$ 14,709,482  |
| Long-term liabilities              | \$ Nil         | \$ Nil         | \$ Nil         |

**Results of Operations**

**-Current Quarter Results**

At December 31, 2006, the Company had \$4,340,398 in cash, which represents a \$1,426,497 increase from the previous quarter. Sources of cash included the collection of \$1,177,931 in receivables from Uranium North for mineral property and office costs, \$488,107 from the exercise warrants and options, and \$77,221 from the sale of marketable securities. Receivables include a \$523,507 in mineral properties bonds (all collected in 2007) and \$596,989 in accruals from project partners (\$457,983 collected in 2007).

During the quarter, the Company completed a \$7,000,000 flow-through financing, increasing cash exploration funds to \$7,315,991. These funds will be used for the upcoming 2007 exploration programs on Amaruik and Hepburn.

**-Year ended December 31, 2006 compared with the Year Ended December 31, 2005**

General and administrative expenses of \$1,852,232 (2005 - \$1,567,338) represents a \$284,894 increase compared to the comparative fiscal period. Notable changes include:

- Directors' fees of \$40,000 were accrued and paid subsequent to the year end, to the four independent directors of the Company.
- Investor relations and promotion of \$303,496 saw decreases in conference and trade shows and stock-based compensation expense which was offset by an increase in consulting, wages and benefits. A breakdown is below:

|                                  | 2006       | 2005       |
|----------------------------------|------------|------------|
| Administration                   | \$ 4,255   | \$ 4,594   |
| Conferences and trade shows      | 78,143     | 102,353    |
| Consulting, wages and benefits   | 100,051    | 84,542     |
| Media                            | 31,289     | 28,542     |
| Promotion and advertising        | 39,954     | 52,251     |
| Stock-based compensation expense | 49,804     | 77,114     |
|                                  | \$ 303,496 | \$ 349,396 |



Management Discussion and Analysis  
For the Year Ended December 31, 2006

- Stock-based compensation expense of \$555,286 (2005 - \$452,373) was allocated to the statement of operations categories as follows:

|                      | 2006              | 2005              |
|----------------------|-------------------|-------------------|
| Accounting and audit | \$ 20,152         | \$ 2,890          |
| Administration       | 17,561            | 47,927            |
| Consulting           | 54,410            | 4,815             |
| Directors fees       | 122,267           | 227,271           |
| Investor relations   | 49,804            | 77,114            |
| Wages and benefits   | 291,092           | 92,356            |
|                      | <b>\$ 555,286</b> | <b>\$ 452,373</b> |

- Write down of mineral properties expense of \$385,841 (2005 - \$722,009) reflects the write down of the Red Ice and Melville Northern Recon projects, as results did not warrant maintaining the projects.
- Future income tax recovery of \$489,356 resulted from the renouncement of exploration expenditures under its flow-through share program. The renouncement resulted in \$853,060 income a result of the application of accounting pronouncement EIC-146. This is a non-cash transaction.

The Company's loss for the year was \$966,417 (2005 – \$582,753) or \$0.02 per share (2005 – \$0.02). The Company did not pay any dividends in 2006 and does not anticipate paying dividends in 2007.

**Summary of Quarterly Results**

|  | Mar. 31<br>2005<br>Q1 | Jun. 30<br>2005<br>Q2 | Sept. 30<br>2005<br>Q3 | Dec. 31<br>2005<br>Q4 | Mar. 31<br>2006<br>Q1 | Jun. 30<br>2006<br>Q2 | Sept. 30<br>2006<br>Q3 | Dec. 31<br>2006<br>Q4 |
|--|-----------------------|-----------------------|------------------------|-----------------------|-----------------------|-----------------------|------------------------|-----------------------|
| Mineral expenditures,<br>net of recoveries                       | \$ 756,109            | \$ 51,419             | \$ 1,839,462           | \$ 106,104            | \$ (112,034)          | \$ 1,880,861          | \$ 2,374,715           | \$ (544,203)          |
| G&A Expense  | \$ 391,794            | \$ 415,056            | \$ 340,612             | \$ 419,876            | \$ 321,698            | \$ 627,407            | \$ 341,588             | \$ 561,539            |
| Stock-based comp. exp.   | \$ 115,536            | \$ 127,391            | \$ 102,347             | \$ 107,099            | \$ 41,766             | \$ 159,298            | \$ 177,111             | \$ 177,111            |
| Income (loss)  | \$ (657,281)          | \$ (399,244)          | \$ (317,194)           | \$ 790,966            | \$ 431,128            | \$ (679,779)          | \$ 1,127,390           | \$ (1,845,156)        |
| Income (loss) per share<br>-basic and diluted                    | \$ (0.02)             | \$ (0.01)             | \$ (0.01)              | \$ 0.02               | \$ 0.01               | \$ (0.02)             | \$ 0.03                | \$ (0.04)             |
| Weighted avg. common<br>shares outstanding<br>-basic and diluted | 29,571,618            | 30,512,298            | 33,686,211             | 32,349,717            | 39,542,134            | 39,544,655            | 43,042,730             | 42,451,985            |

The Company conducts diamond exploration in Canada's far north, and mineral expenditures are subject to seasonal conditions with the majority of expenditures during Q2 and Q3. In Q1 2006, the Company's mineral recoveries exceeded expenditure due to cash received under the Blue Ice option agreement and refund of exploration bonds and in Q4, the Company recovered exploration costs from the Amaruk optionees.

G&A expense has increased commensurate with the growth of the Company, in mineral projects and staff. It is anticipated that G&A expenses will continue to rise as the cost to comply with regulatory requirements and to retain professional staff in a highly competitive market.



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For the Year Ended December 31, 2006

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The Company is still in the exploration stage and does not have an operating mine. The earnings per share in Q4-2005, Q1-2006 and Q3-2006 are anomalous and reflect the application of accounting pronouncement EIC-146 to future income tax.

### Liquidity

At December 31, 2006, the Company had \$13,287,063 in working capital, which is sufficient to achieve the Company's business objectives for fiscal 2007. The Company's primary focus has been on the Amaruk, Hepburn and Banks Island exploration projects. During 2006, the Company has completed the financings noted below and received \$27,375 from the exercise of stock options and \$1,232,107 from the exercise of warrants.

- On July 12<sup>th</sup>, the Company completed a brokered private placement of 3,000,000 flow-through common shares at a purchase price of \$1.00 per share. Agent's commission of \$180,000 in cash and 210,000 in warrants to purchase up to 210,000 common shares at a price of \$0.858, expiring on July 12, 2007, were paid and issued to non-related third parties in connection with the financing. Concurrently, the Company completed a non-brokered private placement of 265,000 flow-through common shares at a purchase price of \$1.00 per share.
- On November 16<sup>th</sup>, the Company completed a brokered private placement of 7,368,422 flow-through common shares at a purchase price of \$0.95 per share. Agent's commission of \$490,000 in cash and 515,789 in warrants to purchase up to 515,789 common shares at a price of \$0.858, expiring February 16, 2008, were paid and issued to non-related third parties in connection with the financing.

As of the report date, the Company has received an additional \$19,202 from the exercise of stock options.

### 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.

### Off-Balance Sheet Arrangements

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

### Related Party Transaction

The Company has engaged a business owned by Bernard Kahlert, a director of the Company, to provide project management and geological consulting. During the period, the Company paid fees to this related party in the aggregate of \$18,900.

The Company accrued and paid \$40,000 in directors' fees to the four independent directors of the Company.

Mark Kolebaba and Maynard Brown are directors of the Company and Uranium North and the transactions described throughout this MD&A between the Company and Uranium North are deemed to be related party transactions.

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. In addition, management adopted a set of Corporate Governance policies which incorporated language from these provisions into the Company's Code of Business Conduct and Ethics.



Management Discussion and Analysis  
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### **Proposed Transactions**

None.

### **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**

None.

### **Recent Changes in Accounting Standards**

#### **(a) Comprehensive Income**

The CICA issued CICA Section 1530 "Comprehensive Income," which became effective for fiscal years beginning on or after October 1, 2006. Comprehensive income is the change in shareholders' equity during a period from transactions and other events from non-owner sources. This standard requires certain gains and losses that would otherwise be recorded as part of net income to be presented in "other comprehensive income" until it is considered appropriate to recognize into net income. This standard requires the presentation of comprehensive income, and its components in a separate financial statement that is displayed with the same prominence as the other financial statements. The adoption of this standard will have a material impact the Company's 2007 -Q1 consolidated financial statements.

#### **(b) Financial Instruments**

The CICA issued CICA Section 3855 "Financial Instruments - Recognition and Measurement" and Section 3860 "Financial Instruments - Disclosure and Presentation," which both became effective for fiscal years beginning on or after October 1, 2006. These standards require all financial instruments within its scope, including derivatives, to be included on a Company's balance sheet and measured either at fair value or, in certain circumstances when fair value may not be considered most relevant, at cost or amortized cost. Changes in fair value are to be recognized in the statements of operations and comprehensive income. The adoption of this standard will have a material impact the Company's 2007 -Q1 consolidated financial statements.



Management Discussion and Analysis  
For the Year Ended December 31, 2006

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### **(c) Hedges**

The CICA issued CICA Section 3865 "Hedges," which became effective for fiscal years beginning on or after October 1, 2006. This standard specifies the circumstances which hedge accounting is permissible and how hedge accounting may be performed. The adoption of this standard in 2007 will not have a material impact on the Company's consolidated financial statements.

### **(d) International Financial Reporting Standards**

The CICA replaced CICA Section 1506 "Accounting Changes" with a new section based on International Financial Reporting Standard IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. The main features of the new Section are as follows:

- Voluntary changes in accounting policy are made only if they result in the financial statements providing reliable and more relevant information.
- Changes in accounting policy are applied retrospectively unless doing so is impracticable (as defined in the Section).
- Prior period errors are corrected retrospectively.
- New disclosures are required in respect of changes in accounting policies, changes in accounting estimates and correction of errors.

The final standard was released in July 2006 and is effective for fiscal years beginning on or after January 1, 2007.

### **Financial Instruments**

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

### **Certification of Annual Filing**

Based on their knowledge, the President and Chief Financial Officer of the Company have reviewed the annual filing and certified that the annual consolidated financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows. The President and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the Company, and they believe:

- the disclosure controls and procedures provide reasonable assurance that material information relating to the Company, including its consolidated subsidiary, are made known to them, particularly during the period in which the annual filings are being prepared; and
- the internal control over financial reporting provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the Canadian generally accepted accounting principles.

Due to the small size of the Company, there is a lack of segregation of duties which is an internal control weakness. Management mitigates this risk through direct involvement of senior management in day to day operations. It is unlikely that this weakness can be properly addressed until the Company grows to a significant size. During the year ended December 31, 2006, there were no changes in the Company's internal control over



Management Discussion and Analysis  
For the Year Ended December 31, 2006

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financial reporting that occurred that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

**Other MD&A Requirements**

Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).

As of the Report Date, the Company had 51,628,820 issued common shares outstanding and the following unexercised stock options and warrants:

-Stock Options

| Expiry Date       | Exercise Price | Number of Shares |
|-------------------|----------------|------------------|
| July 15, 2007     | \$0.429        | 1,022,300        |
| December 19, 2007 | \$0.686        | 50,000           |
| February 20, 2008 | \$0.686        | 482,200          |
| March 4, 2008     | \$0.686        | 100,000          |
| May 22, 2008      | \$0.686        | 60,000           |
| October 6, 2008   | \$0.600        | 111,000          |
| March 30, 2009    | \$1.021        | 200,000          |
| August 8, 2009    | \$0.944        | 560,000          |
| October 18, 2009  | \$0.858        | 300,000          |
| January 27, 2010  | \$0.858        | 50,000           |
| March 22, 2010    | \$0.987        | 252,500          |
| May 17, 2010      | \$0.729        | 550,000          |
| April 12, 2011    | \$0.848        | 1,660,000        |
| July 13, 2011     | \$1.021        | 135,000          |
| February 27, 2012 | \$0.770        | 1,630,000        |
|                   |                | 7,163,000        |

-Warrants

| Expiry Date       | Exercise Price | Number of Shares |
|-------------------|----------------|------------------|
| July 12, 2007     | \$0.858        | 210,000          |
| July 19, 2007     | \$1.286        | 3,250,000        |
| July 19, 2007     | \$1.286        | 189,600          |
| February 16, 2008 | \$0.850        | 515,789          |
|                   |                | 4,165,389        |



## HEAD OFFICE

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## OFFICERS & DIRECTORS

Mark Kolebaba  
*President and Director*

Bernard H. Kahlert, B.Sc., P.Eng.  
*Director*

Maynard E. Brown, LL.B.  
*Director*

Yale R. Simpson, B.Sc.  
*Director*

Terry A. Lyons, B.Sc., M.B.A.  
*Director*

Bill Zimmerman, B.Sc., M.B.A.  
*Director*

Bruce Kienlen, P.GEOL  
*VP, Exploration*

Graham Gill, P.GEO  
*VP, Operations*

Nancy Curry  
*VP, Corporate Communications*

Michael Lee, C.G.A  
*Chief Financial Officer*

Janice Davies  
*Corporate Secretary*

## LISTINGS

TSX Venture Exchange: **DDN**  
Tier One

## CAPITALIZATION

(as of December 31, 2006)

Shares Authorized: Unlimited

Shares Issued: 51,579,320

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