



ANNUAL REPORT 2009

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DIAMONDS NORTH RESOURCES LTD.

**Consolidated Financial Statements
December 31, 2009
(expressed in Canadian dollars)**

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AUDITORS' REPORT

To the Shareholders of
Diamonds North Resources Ltd.

We have audited the consolidated balance sheets of Diamonds North Resources Ltd. as at December 31, 2009 and 2008 and the consolidated statements of operations and comprehensive loss, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

The audited financial statements for the year ended December 31, 2007 were examined by other auditors who expressed an opinion without reservation on those statements in their report dated March 26, 2008.

“DAVIDSON & COMPANY LLP”

Vancouver, Canada

Chartered Accountants

April 1, 2010



DIAMONDS NORTH RESOURCES LTD.

Consolidated Balance Sheets
December 31
(expressed in Canadian dollars)

| | 2009 | 2008 |
|---|---------------|---------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 3,260,817 | \$ 3,602,896 |
| Cash, exploration funds (Note 13) | - | 2,507,033 |
| Marketable securities (Notes 4, 5 & 9(e)) | 622,560 | 498,635 |
| Receivables (Notes 9(a) & 9(e)) | 339,884 | 954,898 |
| Prepaid expenses | 39,453 | 38,450 |
| Field supplies | - | 533,962 |
| | 4,262,714 | 8,135,874 |
| Deposits | 55,000 | 180,000 |
| Mineral properties (Note 6) | 40,985,953 | 41,181,730 |
| Property, plant and equipment (Note 7) | 153,930 | 225,692 |
| | \$ 45,457,597 | \$ 49,723,296 |
| LIABILITIES | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | \$ 98,163 | \$ 1,209,526 |
| Due to related parties (Note 9(d)) | 98,987 | 39,005 |
| | 197,150 | 1,248,531 |
| Future income taxes (Note 13) | 4,177,000 | 2,814,000 |
| | 4,374,150 | 4,062,531 |
| SHAREHOLDERS' EQUITY | | |
| Share capital (Note 8) | 50,644,677 | 52,734,458 |
| Contributed surplus | 3,525,134 | 468,519 |
| Option compensation | 435,112 | 3,331,206 |
| Accumulated other comprehensive loss | (626,457) | (1,013,652) |
| Deficit | (12,895,019) | (9,859,766) |
| | 41,083,447 | 45,660,765 |
| | \$ 45,457,597 | \$ 49,723,296 |

Nature of Operations and Going Concern (Note 1)
Commitment (Note 10)
Subsequent Event (Note 14)

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 Comprehensive Loss
For the Years Ended December 31
(expressed in Canadian dollars)

| | 2009 | 2008 | 2007 |
|---|----------------|----------------|----------------|
| General and administrative expenses | | | |
| Accounting and audit | \$ 94,468 | \$ 100,975 | \$ 97,080 |
| Administration fees | 38,400 | 38,400 | 38,400 |
| Amortization | 73,248 | 73,075 | 47,736 |
| Annual report and meeting | 11,382 | 14,568 | 11,433 |
| Bad debts expense | 28,531 | - | 24,728 |
| Consulting fees | 15,935 | 8,700 | 6,090 |
| Directors' fees | 40,000 | 40,000 | 40,000 |
| Filing fees | 10,030 | 17,963 | 22,017 |
| Insurance | 51,679 | 50,157 | 51,404 |
| Interest | 26,875 | 22,698 | 191,423 |
| Investor relations and promotion | 204,785 | 391,484 | 519,358 |
| Legal fees | 24,928 | 15,409 | 21,698 |
| Office and miscellaneous | 52,059 | 87,594 | 82,751 |
| Rent and storage | 123,232 | 100,332 | 86,670 |
| Stock-based compensation (Note 8(e)) | 160,521 | 873,034 | 1,250,531 |
| Transfer agent fees | 13,724 | 20,571 | 17,921 |
| Wages and benefits | 581,017 | 655,763 | 518,354 |
| | (1,550,814) | (2,510,723) | (3,027,594) |
| Other income (expenses) | | | |
| Interest income | 91,388 | 253,663 | 394,233 |
| Mineral property transactions | - | - | 676,995 |
| Property investigation recoveries | 31,337 | 126,484 | 18,933 |
| Realized gain (loss) on marketable securities | (224,005) | - | 953,362 |
| Unrealized loss on convertible loan | - | - | (47,778) |
| Write down of mineral properties (Note 6) | (2,568,159) | (256,797) | (2,410,578) |
| Loss before income taxes | (4,220,253) | (2,387,373) | (3,442,427) |
| Future income tax recovery (Note 13) | 1,185,000 | 1,330,056 | 2,123,217 |
| Net loss for the year | (3,035,253) | (1,057,317) | (1,319,210) |
| Other comprehensive gain (loss) | | | |
| Unrealized gain (loss) on marketable securities | 143,810 | (1,532,226) | 25,421 |
| Reversal of previously recognized unrealized losses | 243,385 | - | - |
| Future income tax recovery | - | - | (4,337) |
| Other comprehensive income (loss) | 387,195 | (1,532,226) | 21,084 |
| Comprehensive loss | \$ (2,648,058) | \$ (2,589,543) | \$ (1,298,126) |
| Basic and diluted loss per share | \$ (0.04) | \$ (0.02) | \$ (0.02) |
| Weighted average number of common shares outstanding | 75,348,534 | 67,814,839 | 54,701,763 |

See Accompanying Notes to the Consolidated Financial Statements

DIAMONDS NORTH RESOURCES LTD.

Consolidated Statements of Shareholders' Equity
For the Years Ended December 31
(expressed in Canadian dollars)

| | 2009 | | 2008 | |
|--|------------------|---------------|------------------|---------------|
| | Number of Shares | | Number of Shares | |
| Share capital | | | | |
| Balance at the beginning of the year | 75,159,308 | \$ 52,734,458 | 59,746,820 | \$ 38,263,819 |
| Common shares issued for cash | | | | |
| Private placements, net of issue costs | 2,888,000 | 455,220 | 14,048,799 | 14,800,811 |
| Exercise of options | - | - | 708,700 | 504,479 |
| Exercise of warrants | 10,000 | 3,000 | 654,989 | 577,621 |
| Issued for other consideration | | | | |
| Income tax effect on flow-through share renouncement (Note 8(c)) | - | (2,548,001) | - | (1,734,200) |
| Exercise of options, stock-based compensation | - | - | - | 321,928 |
| Balance at the end of the year | 78,057,308 | 50,644,677 | 75,159,308 | 52,734,458 |
| Contributed surplus | | | | |
| Balance at the beginning of the year | | 468,519 | | 141,184 |
| Fair value of broker warrants issued during the year | | - | | 262,604 |
| Fair value of options cancelled during the year | | 3,056,615 | | 64,731 |
| Balance at the end of the year | | 3,525,134 | | 468,519 |
| Option compensation | | | | |
| Balance at the beginning of the year | | 3,331,206 | | 2,844,831 |
| Stock-based compensation expense | | 160,521 | | 873,034 |
| Reallocated to share capital | | - | | (321,928) |
| Reallocated to contributed surplus | | (3,056,615) | | (64,731) |
| Balance at the end of the year | | 435,112 | | 3,331,206 |
| Deficit | | | | |
| Balance at the beginning of the year | | (9,859,766) | | (8,802,449) |
| Net loss for the year | | (3,035,253) | | (1,057,317) |
| Balance at the end of the year | | (12,895,019) | | (9,859,766) |
| Accumulated other comprehensive loss | | | | |
| Balance at the beginning of the year | | (1,013,652) | | 518,574 |
| Other comprehensive income (loss) | | 387,195 | | (1,532,226) |
| Balance at the end of the year | | (626,457) | | (1,013,652) |
| TOTAL SHAREHOLDERS' EQUITY | 78,057,308 | \$ 41,083,447 | 75,159,308 | \$ 45,660,765 |

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)

| | 2009 | 2008 | 2007 |
|--|----------------|----------------|----------------|
| Cash flows from (applied to) operating activities | | | |
| Net loss for the year | \$ (3,035,253) | \$ (1,057,317) | \$ (1,319,210) |
| Items not involving cash: | | | |
| Amortization | 73,248 | 73,075 | 47,736 |
| Stock-based compensation | 160,521 | 873,034 | 1,250,531 |
| Future income taxes | (1,185,000) | (1,330,056) | (2,123,217) |
| Marketable securities received under mineral property transactions | - | - | (341,040) |
| Realized (gain)/loss on sale of marketable securities | 224,005 | - | (953,362) |
| Unrealized loss on convertible loan | - | - | 47,778 |
| Write down of mineral properties | 2,568,159 | 256,797 | 2,410,578 |
| | (1,194,320) | (1,184,467) | (980,206) |
| Net change in non-cash working capital items: | | | |
| Receivables | 450,465 | 893,301 | (83,709) |
| Prepaid expenses | (1,003) | 1,369 | 137,512 |
| Field supplies | - | (290,861) | (149,900) |
| Accounts payable and accrued liabilities | 24,702 | (289,284) | 1,436,401 |
| Due to related parties | 59,982 | 34,899 | (47,253) |
| | (660,174) | (835,043) | 312,845 |
| Cash flows from (applied to) investing activities | | | |
| Cash, exploration funds | 2,507,033 | 1,417,726 | 3,391,232 |
| Proceeds from sale of marketable securities, net | 39,265 | - | 1,042,842 |
| Mineral property acquisition and exploration costs, net of recoveries | (1,594,575) | (16,378,000) | (12,567,105) |
| Accounts payable and accrued liabilities related to mineral properties | (1,136,065) | (523,325) | 1,381,326 |
| Loan and interest receivable | - | (11,263) | (14,997) |
| Deposits | 45,703 | (125,000) | - |
| Purchase of equipment | (1,486) | (127,567) | (101,528) |
| | (140,125) | (15,747,429) | (6,868,230) |
| Cash flows from financing activity | | | |
| Shares issued for cash, net of issue costs | 458,220 | 16,145,515 | 6,254,840 |
| Decrease in cash and cash equivalents | (342,079) | (436,957) | (300,545) |
| Cash and cash equivalents, beginning of year | 3,602,896 | 4,039,853 | 4,340,398 |
| Cash and cash equivalents, end of year | \$ 3,260,817 | \$ 3,602,896 | \$ 4,039,853 |

Supplemental Cash Flow Information (Note 12)

See Accompanying Notes to the Consolidated Financial Statements

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

1. Nature of Operations and Going Concern

The Company was incorporated on February 13, 2002 pursuant to the *Company Act* (British Columbia) and on July 15, 2002 the common shares of the Company were listed for trading on the TSX Venture Exchange ("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 and does not have operating cash flow.

The recoverability of amounts shown for mineral property interests in Note 6 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.

For the year ended December 31, 2009, the Company reported net loss of \$3,035,253 (2008 – \$1,057,317), largely due to a future income tax adjustment. The Company has a history of losses and an accumulated deficit of \$12,895,019 (2008 - \$9,859,766). Management believes its \$4,065,564 (2008 - \$6,887,343) working capital is sufficient to meet administrative, exploration and property obligations for the 2010 year.

In 2008, the Company implemented a cash preservation measure whereby, senior employees and a consultant mutually agreed to defer 10% of their salaries or fees and the independent directors agreed to defer their retainer. These amounts accrued as a debt owing by the Company and did not bear interest. At the Company's election, this debt can be satisfied in cash and/or common shares. During 2009, the consultant and independent directors' debt was repaid in cash. Subsequent to December 31, 2009, the senior employee's debt was repaid in cash. In 2010, 10% of the senior employees' salaries will continue to be deferred under the terms above with repayment to be reviewed later in the year.

These consolidated financial statements have been prepared on a going concern basis in accordance with Canadian generally accepted accounting principles, 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 reflect adjustments in the carrying value of the assets and liabilities, the reported expenses, and the balance sheet classifications used, that would be necessary if the Company was unable to realize its assets and settle its liabilities as a going concern in the normal course of operations, and that such adjustment could be material.

2. Significant Accounting Policies

(a) Basis of presentation

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles and the functional currency is the Canadian dollar. These consolidated financial statements include the accounts of the Company and its wholly-owned integrated subsidiary, which has been inactive since its incorporation on December 17, 2003. All material intercompany transactions and balances have been eliminated.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

2. Significant Accounting Policies (continued)

(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 determining the fair value of marketable securities, collectability of receivables, the impairment of assets and rates for amortization, accrued liabilities, future income tax balances and the inputs used in calculating stock-based compensation. While management believes the estimates are reasonable, actual results may differ from those estimates and may impact future results of operations and cash flows.

(c) Cash and cash equivalents

The Company considers cash and cash equivalents to be cash and short-term investments with original maturities of three months or less or redeemable features from the date of acquisition, and readily convertible to known amounts of cash without a significant risk of change in value.

(d) Financial instruments - Recognition and measurement

The Company classifies all financial instruments as either held-for-trading, held-to-maturity, loans and receivables, available-for-sale or other financial liabilities. Available-for-sale instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss). Instruments classified as held-for-trading are measured at fair value with unrealized gains and losses recognized in the Statements of Operations.

The Company has classified its financial instruments as follows:

| | |
|--|-----------------------------|
| Cash and cash equivalents | Held-for-trading |
| Cash, exploration funds | Held-for-trading |
| Marketable securities | Available-for-sale |
| Receivables | Loans and receivables |
| Deposits | Loans and receivables |
| Accounts payable and accrued liabilities | Other financial liabilities |
| Due to related parties | Other financial liabilities |

The Company is entitled to varying royalties on various exploration projects and properties which may be characterized as a financial instrument in the future. No value has been assigned to such instruments as there is no reliable measurement basis to determine value until properties are in production, the mining feasibility stage or proven economically recoverable reserves have been determined.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

2. Significant Accounting Policies (continued)

(e) Financial instruments - Disclosures and presentation

The Canadian Institute of Chartered Accountants ("CICA") Section 3862 and 3863 require entities to provide disclosure of quantitative and qualitative information in their financial statements that enable the user to evaluate:

- a) the significance of financial instruments for the entity's financial position and performance; and
- b) the nature and extent of risks arising from the financial instruments to which the entity is exposed during the period and at the balance sheet date, and management's objectives, policies and procedures for managing such risks.

Entities are required to disclose the measurement basis or bases used and the criteria used to determine classification for different types of instruments. The required disclosures of this section are in Note 5.

(f) Capital disclosures

CICA Section 1535 established standards for disclosing information about an entity's capital and how it is managed. Under this standard the Company is required to disclose the following, based on the information provided internally to the entity's key management personnel:

- qualitative information about its objectives, policies and process for managing capital;
- summary quantitative data about what it manages as capital;
- whether during the period it complied with any externally imposed capital requirements to which it is subject; and
- when the company has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

The required disclosures of this section are in Note 5.

(g) 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 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 a property is abandoned, all related costs are written off to operations. If, after management review, it is determined that the carrying value amounts of a mineral property is impaired, that property is written down to its estimated net realizable value. A mineral property is reviewed for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

2. Significant Accounting Policies (continued)

(g) Mineral properties (continued)

Mineral property acquisition costs include the cash consideration and the fair market value of common shares issued for mineral property interests pursuant to the terms of the relevant agreement. The amounts shown for acquisition costs and deferred exploration expenditures represent costs incurred to date, less write-downs, and do not necessarily reflect present or future values. These costs will be 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.

(h) 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, 30% on computer and equipment and 100% on computer software, from the date of acquisition. Leasehold improvements are amortized on a straight-line basis over the remaining term of the lease.

(i) 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. When determinable, a liability for future site reclamation costs, or other obligations, would be recorded at fair value and the corresponding increase in the assets carrying value would then be amortized over the remaining useful life of the asset.

Management has reviewed the Company's likely retirement costs of its property, plant and equipment, and mineral properties for known obligations under contract, common practices or laws and regulations in effect or anticipated. The Company has determined that there are no known or quantifiable significant assets retirement obligations and accordingly, these financial statements do not include any provision related to future asset retirement.

(j) Share capital

Share capital is comprised of proceeds from share issuances, net of issue costs. Shares issued for consideration other than cash are valued at the quoted market price on the date of issue.

Canadian tax legislation permits a Company to issue flow-through common shares whereby the deduction for tax purposes relating to qualified resource expenditures is claimed by the investor(s) rather than the Company. The Company records a future income tax liability and a reduction in share capital for the estimated tax benefit transferred to the investor(s) when the related expenditures are renounced.

When flow-through expenditures are renounced, a portion of future income tax assets not recognized in previous years, due to the recording of valuation allowance, will be offset against related future income tax liabilities and recognized as a recovery of future income taxes in the Statement of Operations.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

2. Significant Accounting Policies (continued)

(k) Stock-based compensation

The Company accounts for stock-based compensation 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.

(l) 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.

(m) Comprehensive income (loss)

This standard requires certain gains and losses that would otherwise be recorded as part of net income (loss) to be presented in "other comprehensive income" until it is considered appropriate to recognize into net income (loss). This standard requires the presentation of comprehensive income and its components in a separate statement that is displayed with the same prominence as the other financial statements. Accumulated other comprehensive income is presented as a separate category in shareholders' equity.

(n) 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 (loss) per share. However, diluted loss per share has not been presented separately as the effects of outstanding options and warrants is anti-dilutive.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

3. Changes in Accounting Policies

The Company adopted the following new accounting standards issued by the CICA. As provided by the transitional provisions of these new standards, these new standards have been adopted on a prospective basis with no restatement to the prior period financial statements.

(a) Goodwill and Intangible Assets

Effective January 1, 2009, CICA Section 3064 replaced Section 3062 "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The adoption of this section did not impact the Company's financial statements.

(b) Fair Value Hierarchy Disclosures

Effective October 1, 2009, CICA Section 3862 "Financial Instruments - Disclosures" was amended to require disclosures about the relative inputs to fair value measurements, including their classification within a hierarchy that prioritizes the inputs to fair value measurements. The three levels of fair value are:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for assets or liabilities either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data.

The effects of the adoption of this section have been disclosed in Note 5.

New Accounting Pronouncements Not Yet Adopted:

A summary of new Canadian GAAP pronouncements which may affect the financial disclosure and results of operations of the Company for future interim and annual periods.

(c) Business Combinations, Non-controlling Interest and Consolidated Financial Statements

In January 2009, the CICA issued Section 1582 "Business Combinations", Section 1601, "Consolidated Financial Statements" and Section 1602 "Non-controlling Interests" which replace Section 1581 "Business Combinations" and Section 1600 "Consolidated Financial Statements". Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combinations accounting standard under IFRS (defined below). Section 1582 is applicable for the Company's business combinations with acquisitions dates on or after January 1, 2011. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. Section 1601 is applicable for the Company's interim and annual consolidated financial statements for its fiscal year beginning January 1, 2011. Early adoption of these Sections is permitted and all three Sections must be adopted concurrently. The Company is evaluating these new standards.

(d) International Financial Reporting Standards ("IFRS")

In February 2008, the Canadian Accounting Standards Board announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

4. Marketable Securities

| | Cost | Unrealized Loss | Fair Value |
|---|--------------|--------------------|---------------|
| Available-for-sale securities at December 31, 2009 | \$ 1,192,231 | \$ (569,671) | \$ 622,560 |

| | Cost | Unrealized Loss | Fair Value |
|---|--------------|--------------------|---------------|
| Available-for-sale securities at December 31, 2008 | \$ 1,406,117 | \$ (907,482) | \$ 498,635 |

Marketable securities are common shares in other junior exploration companies received via property or option agreements and from the conversion of the Uranium North Resources Corp. ("Uranium North") loan in 2008.

5. Financial Instruments, Risk Management and Capital Disclosures

(a) Fair value of financial instruments

The Company's cash and cash equivalents and marketable securities are recognized on the balance sheet at their fair value. The carrying value of receivables, deposits, accounts payable and accrued liabilities, and due to related parties approximates their fair value due to their short-term nature. Marketable securities are carried at their fair value based on quoted market prices on the TSX Venture Exchange, as disclosed in Note 4.

The following table illustrates the classification of the Company's financial instruments carried at fair value within the fair value hierarchy as at December 31, 2009:

| | Level 1 | Level 2 | Level 3 | Total |
|---------------------------|--------------|------------|---------|--------------|
| Cash and cash equivalents | \$ 3,260,817 | \$ - | \$ - | \$ 3,260,817 |
| Marketable securities | - | 622,560 | - | 622,560 |
| | \$ 3,260,817 | \$ 622,560 | \$ - | \$ 3,883,377 |

As it may be difficult to sell the Company's marketable securities position without impacting the quoted market price and the market may not be considered active, the marketable securities have been classified as Level 2.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

5. Financial Instruments, Risk Management and Capital Disclosures (continued)

(b) Risk management

Credit Risk

The Company is exposed to credit risk with respect to its cash and cash equivalents, cash exploration funds and receivables. To minimize this risk, cash and cash equivalents, and cash exploration funds have been placed with major Canadian financial institutions. Receivables include GST which has low risk of default.

Over the last eighteen months, credit risk increases, as service providers may not always be able to perform in accordance with the terms of a contract. To help mitigate this risk with contracts that require large advances, the Company may place funds in-trust with a lawyer.

Equity Market Risk

The Company is exposed to equity price risk arising from its marketable securities, which are classified as available for sale and carried at quoted market prices.

Interest Rate Risk

The Company is not exposed to significant interest rate risk due to the short-term maturity of its monetary assets and liabilities.

Liquidity Risk

The Company ensures that there is sufficient capital in order to meet annual business requirements, after taking into account administrative, property holding and exploration budgets, against cash and cash equivalent holdings. As the Company does not have operating cash flow, the Company has relied primarily on equity financings to meet its capital requirements.

Over the last eighteen months, liquidity risk increases, as other things being equal, the price of an asset will be reduced if the holder cannot sell the asset immediately. Included in marketable securities are large share positions in junior resource companies, which could be difficult to sell in depressed markets.

Foreign Exchange Risk

The Company is not exposed to significant foreign exchange risk as it operates in Canada and makes few US dollar purchases.

(c) Capital management

The Company considers its capital structure to consist of the components of shareholders' equity. Management's objective is to ensure that there is sufficient capital to minimize liquidity risk and to continue as a going concern (see Note 1). As an exploration stage company, the Company is currently unable to self-finance its operations.

The Company's share capital is not subject to any external restriction and the Company did not change its approach to capital management during the year.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
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6. Mineral Properties

As at December 31, 2009 and 2008, the Company's mineral properties are comprised of properties located in Canada. Expenditures incurred on mineral properties are as follows:

| | Amaruk, NU | Ualliq, NU | Sakari, NU | Siku, NU | Tunerq, NU | Victoria Island NU/NWT | Banks Island, NWT | Hepburn, NWT | Kidme, NWT | Other Properties (1) | Total |
|----------------------------|---------------|---------------|---------------|-------------|---------------|------------------------------|-------------------------|-----------------|---------------|-------------------------|---------------|
| Balance at | | | | | | | | | | | |
| December 31, 2008 | \$ 22,266,482 | \$ 370,686 | \$ 163,246 | \$ 397,141 | \$ 1,276,569 | \$ 4,441,629 | \$ 2,513,877 | \$ 9,003,735 | \$ 526,110 | \$ 222,255 | \$ 41,181,730 |
| Additions during the year: | | | | | | | | | | | |
| Acquisition costs | - | - | - | - | - | - | - | - | - | 87,780 | 87,780 |
| Exploration: | | | | | | | | | | | |
| Airborne geophysics | 30,883 | 8,142 | - | 380 | 1,392 | - | - | 4,993 | 1,501 | 125,413 | 172,704 |
| Camp costs | 222,630 | 9,044 | 4,271 | 50,768 | 43,937 | 1,033 | 3,663 | 14,846 | - | 243 | 350,435 |
| Camp heli. (incl. fuel) | 222,730 | 8,680 | 1,652 | 21,945 | 10,763 | - | - | 543 | - | - | 266,313 |
| Drilling - Core | 217,823 | - | - | - | - | - | - | - | - | - | 217,823 |
| Drilling - Percussion | 487,551 | - | - | - | - | - | - | (650) | - | - | 486,901 |
| Geochemistry | 47,664 | 2,638 | - | 15,333 | - | - | 2,531 | 3,686 | - | - | 71,852 |
| Geology | 552,203 | 22,934 | 3,270 | 6,538 | 19,395 | 1,551 | 8,608 | 40,736 | 1,511 | 47,718 | 704,464 |
| Ground geophysics | 101,444 | 3,102 | - | - | 2,135 | - | - | 3,300 | - | 31 | 110,012 |
| Permitting | 8,601 | 535 | 535 | 7,505 | - | 2,034 | 1,017 | 3,226 | - | 3,051 | 26,504 |
| Property | 77,588 | 11,935 | 3,579 | 15,402 | 2,613 | - | - | 70,667 | 10,847 | 76,989 | 269,620 |
| Prospecting | 150,187 | 6,960 | - | - | - | - | - | 80,303 | - | 29,309 | 266,759 |
| | 2,119,304 | 73,970 | 13,307 | 117,871 | 80,235 | 4,618 | 15,819 | 221,650 | 13,859 | 282,754 | 2,943,387 |
| Less: | | | | | | | | | | | |
| Recoveries | (398,825) | (79,498) | (4,895) | (64,450) | - | (5,716) | (32,479) | - | - | (72,922) | (658,785) |
| Write downs | - | - | - | - | - | - | (2,497,217) | - | - | (70,942) | (2,568,159) |
| | (398,825) | (79,498) | (4,895) | (64,450) | - | (5,716) | (2,529,696) | - | - | (143,864) | (3,226,944) |
| Net additions | 1,720,479 | (5,528) | 8,412 | 53,421 | 80,235 | (1,098) | (2,513,877) | 221,650 | 13,859 | 226,670 | (195,777) |
| Balance at | | | | | | | | | | | |
| December 31, 2009 | \$ 23,986,961 | \$ 365,158 | \$ 171,658 | \$ 450,562 | \$ 1,356,804 | \$ 4,440,531 | \$ - | \$ 9,225,385 | \$ 539,969 | \$ 448,925 | \$ 40,985,953 |

1. In 2008, 'Northern Recon was disclosed as a separate project and is now combined under 'Other Properties'.

DIAMONDS NORTH RESOURCES LTD.

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6. Mineral Properties (continued)

| | Amaruk, NU | Ualliq, NU | Sakari, NU | Siku, NU | Tunerq, NU(1) | Victoria Island NU/NWT | Banks Island, NWT | Hepburn, NWT | Kidme, NWT | Northern Recon. | Other Properties | Total |
|------------------------------|---------------|---------------|---------------|-------------|------------------|------------------------------|-------------------------|-----------------|---------------|--------------------|---------------------|---------------|
| Balance at | | | | | | | | | | | | |
| December 31, 2007 | \$ 11,319,082 | \$ - | \$ 19,084 | \$ - | \$ 26,064 | \$ 4,145,442 | \$ 1,831,525 | \$ 7,157,418 | \$ 447,426 | \$ 270,709 | \$ 272,233 | \$ 25,488,983 |
| Additions during the period: | | | | | | | | | | | | |
| Acquisition costs | - | - | - | - | - | - | - | - | 20,000 | - | - | 20,000 |
| Exploration: | | | | | | | | | | | | |
| Airborne geophysics | 762,979 | 192,987 | 2,995 | 102,374 | 274 | - | 6,330 | 38,799 | - | - | - | 1,106,738 |
| Camp costs | 1,855,890 | 75,959 | 72,466 | 171,480 | 272,429 | 5,852 | 226,109 | 193,583 | - | - | - | 2,873,768 |
| Camp heli. (incl. fuel) | 906,034 | 422,417 | 27,440 | 109,922 | 205,948 | - | 125,692 | 393,357 | - | 2,106 | - | 2,192,916 |
| Drilling - Core | 4,105,215 | - | - | - | - | - | - | - | - | - | - | 4,105,215 |
| Drilling - Percussion | 1,812,559 | 328,005 | 88,622 | 309,369 | 187,188 | - | - | - | - | - | - | 2,725,743 |
| Geochemistry | 216,170 | 569 | - | 1,270 | 2,813 | 4,096 | 8,889 | 255,052 | - | - | - | 488,859 |
| Geology | 163,106 | 6,520 | 4,412 | 15,230 | 90,027 | 3,485 | 1,729 | 26,307 | - | 2,583 | 68 | 313,467 |
| Ground geophysics | 669,889 | 180,264 | 79,478 | 290,291 | 395,436 | 1,667 | 173,155 | 482,634 | - | 358 | - | 2,273,172 |
| Permitting | 6,420 | 20,202 | 3,385 | 3,385 | 17,310 | 260,509 | 14,613 | 2,625 | 30,419 | 525 | - | 359,393 |
| Prospecting | 59,085 | 24,132 | 2,958 | 9,853 | 72,401 | - | 38,732 | 52,936 | - | 8,416 | - | 268,513 |
| Property | 417,727 | 172,797 | 4,231 | 26,676 | 6,679 | 20,578 | 87,103 | 455,806 | 36,878 | 16,649 | - | 1,245,124 |
| | 10,975,074 | 1,423,852 | 285,987 | 1,039,850 | 1,250,505 | 296,187 | 682,352 | 1,901,099 | 67,297 | 30,637 | 68 | 17,952,908 |
| Less: | | | | | | | | | | | | |
| Recoveries | (27,674) | (1,013,166) | (141,825) | (642,709) | - | - | - | (54,782) | (8,613) | (94,595) | - | (1,983,364) |
| Option payments | - | (40,000) | - | - | - | - | - | - | - | - | - | (40,000) |
| Write downs | - | - | - | - | - | - | - | - | - | (81,285) | (175,512) | (256,797) |
| | (27,674) | (1,053,166) | (141,825) | (642,709) | - | - | - | (54,782) | (8,613) | (175,880) | (175,512) | (2,280,161) |
| Net additions | 10,947,400 | 370,686 | 144,162 | 397,141 | 1,250,505 | 296,187 | 682,352 | 1,846,317 | 78,684 | (145,243) | (175,444) | 15,692,747 |
| Balance at | | | | | | | | | | | | |
| December 31, 2008 | \$ 22,266,482 | \$ 370,686 | \$ 163,246 | \$ 397,141 | \$ 1,276,569 | \$ 4,441,629 | \$ 2,513,877 | \$ 9,003,735 | \$ 526,110 | \$ 125,466 | \$ 96,789 | \$ 41,181,730 |

1. Included under "Northern Recon." in 2007.

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6. Mineral Properties (continued)

Acquisitions

The Company has taken steps, in accordance with industry standards, to verify title to mineral properties in which it has an interest. However, 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 asset, net of expected recoveries.

(a) Amaruk Project, Nunavut

The Amaruk property is near the community of Kugaaruk, Nunavut. Portions of the property have been optioned to other diamond exploration companies as described below. The property is subject to a 2% gross overriding royalty ("GOR") on diamonds and a 2% net smelter royalty ("NSR") on other minerals except gold, payable to BHP Billiton Diamonds Inc.

(b) Ualliq - Amaruk Project, Nunavut

On July 26, 2006, the Company and International Samuel Exploration Corp. ("International Samuel") entered into an agreement covering an area predominantly within the western portion of the Company's Amaruk Project. International Samuel has an option to earn a 30% interest in the Ualliq project by issuing 100,000 common shares (post consolidation of 20 to 1) to the Company (received) and incurring \$3,000,000 in expenditures on the property on or before December 31, 2010 (one year extension granted, previously December 31, 2009). 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.

In 2007, the Company and International Samuel entered into an agreement to form a 50/50 partnership on claims that were staked called the Ualliq West property and contiguous with the Amaruk and Ualliq properties. The Company is the project operator.

(c) Sakari - Amaruk Project, Nunavut

On July 31, 2006, the Company and Shear Minerals Ltd. ("Shear") entered into an agreement covering an area within the southwest portion of the Company's Amaruk Project. Shear earned a 50% interest in the Sakari project by making a payment of \$97,000 in refundable deposits and incurring \$185,940 in expenditures on the property before June 30, 2007. The Company is the project operator.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
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6. Mineral Properties (continued)

(d) Siku - Amaruk Project, Nunavut

On October 4, 2006, the Company and Arctic Star Diamond Corp. ("Arctic Star") entered into an agreement covering an area within the southwest portion of the Company's Amaruk Project. Arctic Star earned a 50% interest in the Siku project by issuing 1,500,000 shares to the Company, funding approximately \$956,000 in bonds on the claims and incurring \$2,500,000 in expenditures on the property before September 30, 2009. 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 is the project operator.

(e) Tunerq – Amaruk Project, Nunavut

The Company holds a 100% interest in the Tunerq nickel prospect located on the Amaruk property.

(f) Victoria Island, Nunavut and Northwest Territories

The Company holds a 100% interest in the Blue Ice, Hadley Bay, Holman, Mariner, Washburn, Wellington and White Ice projects, which are collectively referred to as "Victoria Island". The projects consist of various claims and permits, which are 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% GOR and Washburn is subject to a 2% GOR, both on diamonds.

(g) Banks Island, Northwest Territories

The Company held a 100% interest in the Banks Island property. The Company allowed the permits to lapse subsequent to the year end and accordingly, the carrying value has been written down to \$Nil.

(h) Hepburn, Northwest Territories

The Company holds a 100% interest in the Hepburn property located approximately 300 kilometres north of Yellowknife.

(i) Kidme, Northwest Territories

The Company holds a 100% interest in the Kidme project. In 2008, the Company purchased SouthernEra Diamonds Inc. (the previous co-owner of the property), 60% interest for \$20,000.

(j) Other properties

The Company holds interests in various other properties located in Nunavut and the Northwest Territories.

(i) Arnaq, Nunavut

The Arnaq property is located immediately south of the Company's Amaruk Project. Under an agreement dated July 8, 2004, with Kennecott Canada Exploration Inc. ("Kennecott"), Kennecott holds a 74% interest and the Company holds the remaining 26% interest. At December 31, 2009, the carrying value of the Arnaq project is \$Nil (2008 - \$70,942).

DIAMONDS NORTH RESOURCES LTD.

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6. Mineral Properties (continued)

(j) Other properties (continued)

(ii) Thelon, Nunavut and Northwest Territories

As part of the Uranium North arrangement completed in 2006, the Company transferred substantially all of its interest in the property pursuant to a memorandum of understanding dated April 14, 2005, with Pathfinder Resources Ltd. ("Pathfinder"). In August 2006, Pathfinder amalgamated with Bayswater Uranium Corporation. The Company retains the right to a 2% NSR with respect to metals (except for uranium) and a 5% uranium royalty.

(iii) Northern Recon, Nunavut and Northwest Territories

The Company has acquired various exploration permits for grass-roots projects and continues to develop and evaluate these projects. In 2006, some projects were transferred to Uranium North whereby the Company retains varying royalties, which include a 2% GOR with respect to diamonds, a 2% NSR with respect to metals (except for uranium) and a 5% uranium royalty.

7. Property, Plant and Equipment

| | 2009 | | |
|------------------------|-------------------|--------------------------|-------------------|
| | Cost | Accumulated Amortization | Net Book Value |
| Furniture and fixtures | \$ 36,167 | \$ 25,458 | \$ 10,709 |
| Computer equipment | 113,376 | 78,426 | 34,950 |
| Computer software | 10,439 | 9,784 | 655 |
| Equipment | 220,126 | 116,751 | 103,375 |
| Leasehold improvements | 35,882 | 31,641 | 4,241 |
| | <u>\$ 415,990</u> | <u>\$ 262,060</u> | <u>\$ 153,930</u> |

| | 2008 | | |
|------------------------|-------------------|--------------------------|-------------------|
| | Cost | Accumulated Amortization | Net Book Value |
| Furniture and fixtures | \$ 36,167 | \$ 22,780 | \$ 13,387 |
| Computer equipment | 113,376 | 63,447 | 49,929 |
| Computer software | 8,953 | 4,477 | 4,476 |
| Equipment | 220,126 | 72,447 | 147,679 |
| Leasehold improvements | 35,882 | 25,661 | 10,221 |
| | <u>\$ 414,504</u> | <u>\$ 188,812</u> | <u>\$ 225,692</u> |

Leasehold improvements costs are in connection with the office premises (Note 10).

DIAMONDS NORTH RESOURCES LTD.

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8. Share Capital

(a) Authorized

Unlimited common shares without par value.

(b) Private placements

- i) On August 4, 2009, the Company completed a non-brokered private placement of \$462,080 from the issuance of 2,888,000 flow-through shares at \$0.16 per share. Finders' fees of \$3,800 and other share issue costs of \$3,060 were paid in cash.
- ii) On July 7, 2008, the Company completed a \$12.5 million bought deal financing, led by Canaccord Capital Corporation and including Dundee Securities Corporation, GMP Securities L.P. and Haywood Securities Inc. (collectively, the "Underwriters") consisted of 3,833,600 units (the "Units") at a price of \$1.05 per Unit and 7,083,700 flow-through common shares ("Flow-Through Shares") at a price of \$1.20 per Flow-Through Share for aggregate proceeds of \$12,525,720 (the "Offering"). A Unit consists of one common share and one-half of one transferable common share purchase warrant (a "Warrant"). Each whole warrant entitled the holder to purchase one additional common share at a price of \$1.30 per share by July 7, 2009 (see Note 8(f)).

In consideration for their efforts, the Underwriters were paid a cash commission of \$751,543 and received 655,038 non-transferable Underwriters' warrants ("Underwriters' Warrants"). Each Underwriters' Warrant entitled the holder to purchase one common share at a price of \$1.30 per share by July 7, 2009. A fair value of \$243,912 was assigned to these warrants issued and added to contributed surplus. In addition, the Company incurred additional costs of \$114,313 in relation to the financings.

Concurrently, the Company closed the first tranche of the non-brokered private placement for gross proceeds of \$2,946,799 from the issuance of 1,391,666 Flow-Through Shares and 1,216,000 Units. Finders' fees were paid consisting of \$65,745 cash and the issuance of share purchase warrants entitling finders to purchase up to 24,000 common shares at a price of \$1.30 per share by July 7, 2009. A fair value of \$8,936 was assigned to these warrants issued and added to contributed surplus.

The fair value of the above compensatory warrants were estimated using the Black-Scholes option pricing model with a risk-free interest rate of 2.13%, an expected life of 1 year, expected volatility of 100% and an expected dividend yield of Nil%.

- iii) On July 10, 2008, the Company closed the second tranche of the non-brokered private placement for gross proceeds of \$552,500 from the issuance of 16,833 Flow-Through Shares and 507,000 Units. A Unit consists of one common share and one-half of one transferable common share purchase warrant (a "Warrant"). Each whole warrant entitled the holder to purchase one additional common share at a price of \$1.30 per share by July 9, 2009 (see Note 8(f)).

Finders' fees were paid consisting of \$30,051 cash and the issuance of share purchase warrants entitling finders to purchase up to 28,620 common shares at a price of \$1.30 per share by July 9, 2009. A fair value of \$9,756 was assigned to these warrants issued and added to contributed surplus.

The fair value of the compensatory warrants was estimated using the Black-Scholes option pricing model with a risk-free interest rate of 2.13%, an expected life of 1 year, expected volatility of 100% and an expected dividend yield of Nil%.

DIAMONDS NORTH RESOURCES LTD.

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8. Share Capital (continued)

(c) Income tax effect on flow-through share renouncements

In February 2009, the Company renounced \$10,190,639 of exploration expenditures under its flow-through share program, resulting in a future tax liability of \$2,548,001, which is deducted from share capital.

In January 2008, the Company renounced \$5,336,000 of exploration expenditures under its flow-through share program, resulting in a future tax liability of \$1,734,200, which is deducted from share capital.

(d) Stock options

Options to purchase common shares have been granted to directors, officers, 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 15,000,000 (2008 - 12,189,700) common shares. Vesting of stock options is made at the discretion of the board of directors at the time the options are granted. At December 31, 2009, the Company had stock options outstanding for the purchase of 9,065,500 (2008 - 7,649,000) common shares which 1,730,500 (2008 - 7,614,000) stock options were exercisable, with a weighted average exercise price of \$0.44 (2008 - \$0.87) per option.

| | Shares | Weighted Average Exercise Price |
|----------------------------------|-------------|------------------------------------|
| Outstanding at December 31, 2007 | 7,027,700 | \$ 0.85 |
| Granted | 1,500,000 | \$ 0.88 |
| Exercised | (708,700) | \$ 0.71 |
| Expired | (170,000) | \$ 0.67 |
| Outstanding at December 31, 2008 | 7,649,000 | \$ 0.87 |
| Granted | 8,410,000 | \$ 0.27 |
| Cancelled | (5,686,500) | \$ 0.87 |
| Expired | (1,307,000) | \$ 0.94 |
| Outstanding at December 31, 2009 | 9,065,500 | \$ 0.31 |

The following summarizes information about stock options outstanding at December 31, 2009:

| Number of Shares | Exercise Price | Expiry Date |
|------------------|----------------|-------------------|
| 220,000 | \$ 0.848 | April 12, 2011 |
| 113,500 | \$ 1.021 | July 13, 2011 |
| 177,000 | \$ 0.770 | February 27, 2012 |
| 135,000 | \$ 0.880 | February 14, 2013 |
| 10,000 | \$ 0.820 | September 2, 2013 |
| 2,150,000 | \$ 0.175 | May 28, 2014 |
| 6,260,000 | \$ 0.300 | December 23, 2014 |
| 9,065,500 | | |

Subsequent to December 31, 2009, 25,000 stock options with an exercise price \$0.175 were exercised.

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8. Share Capital (continued)

(e) Stock-based and option compensation

Stock-based compensation recognized for options vested during the year was \$160,521 (2008 - \$873,034; 2007 - \$ 1,250,531). For stock options granted during the year, the fair value of \$0.17 (2008 - \$0.51) per option is estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

| | 2009 | 2008 | 2007 |
|---------------------------------|-------|-------|-------|
| Risk-free interest rate | 2.03% | 3.22% | 2.93% |
| Expected dividend yield | - | - | - |
| Expected stock price volatility | 92% | 67% | 72% |
| Expected option life in years | 5.00 | 5.00 | 3.20 |

(f) Warrants

At December 31, 2009, the Company had outstanding warrants to purchase an aggregate of 2,768,300 (2008 - 3,485,958) common shares as follows:

| Exercise Price | Expiry Date | Outstanding at December 31, 2008 | Issued | Exercised | Expired | Outstanding at December 31, 2009 |
|----------------|------------------|----------------------------------|--------|-----------|-----------|----------------------------------|
| \$0.30 | January 9, 2010* | 1,916,800 | - | (10,000) | - | 1,906,800 |
| \$0.30 | January 9, 2010* | 608,000 | - | - | - | 608,000 |
| \$1.30 | July 7, 2009 | 24,000 | - | - | (24,000) | - |
| \$1.30 | July 7, 2009 | 655,038 | - | - | (655,038) | - |
| \$0.30 | January 9, 2010* | 253,500 | - | - | - | 253,500 |
| \$1.30 | July 9, 2009 | 28,620 | - | - | (28,620) | - |
| | | 3,485,958 | - | (10,000) | (707,658) | 2,768,300 |

*The Company extended the expiry date of these warrants from July 7, 2009 to January 9, 2010 and repriced them from \$1.30 to \$0.30. The warrants were subject to a 30 day exercise period had the closing price of the Company's shares exceed \$0.40 for ten consecutive trading days.

Subsequent to December 31, 2009, 52,500 warrants with an exercise price of \$0.30 were exercised for gross proceeds of \$15,750 and 2,715,800 warrants with an exercise price of \$0.30 expired, unexercised.

9. Related Party Transactions

Related party transactions are in the normal course of business, recorded at the exchange amount and bear no interest or stated terms of repayment. In addition to items disclosed elsewhere in these statements, the Company had the following related party transactions and balances:

- (a) Included in receivables is \$22,025 (2008 - \$2,510) owed by Commander Resources Ltd., a company related by virtue of a common director, for shared office costs.
- (b) For the year ended December 31, 2009, an officer of the Company has been paid \$38,400 (2008 - \$38,400; 2007 - \$38,400) for corporate secretarial services, which has been expensed as administration fees.

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
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9. Related Party Transactions (continued)

- (c) For the year ended December 31, 2009, a director of the Company has been paid \$19,330 (2008 - \$18,900; 2007 - \$18,900) for geological consulting, which has been charged to mineral properties.
- (d) Amounts due to related parties, totalling \$98,987 (2008 - \$39,005), consist of deferred salaries and retainer, fees and reimbursement of expenses owed to directors and officers of the Company.
- (e) As at December 31, 2009, the Company held 11.3% (2008 – 12.1%) of the issued common shares of Uranium North. Included in receivables is \$108,170 (2008 - \$12,542) owed by Uranium North, a company related by virtue of other common directors, for mineral property, administrative and office costs.

10. 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 will expire on June 30, 2010. The cost of the entire premises is shared amongst several companies in proportion to the area occupied. Two of the companies are related by virtue of common directors. The Company's proportionate share of minimum remaining rental payments under this arrangement is approximately \$49,000.

11. Segmented Information

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

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

12. Supplemental Cash Flow Information

| | 2009 | 2008 | 2007 |
|---|------------|------------|--------------|
| Investing activities | | | |
| Mineral properties acquired with common shares | \$ - | \$ - | \$ (900,000) |
| Marketable securities received for option payments | \$ - | \$ 40,000 | \$ 551,040 |
| Field supplies charged to mineral properties | \$ 533,962 | \$ - | \$ - |
| Repayment of loan and interest receivable in common shares of Uranium North | \$ - | \$ 337,856 | \$ - |
| Deposits charged to mineral properties | \$ 79,297 | \$ - | \$ - |

DIAMONDS NORTH RESOURCES LTD.

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12. Supplemental Cash Flow Information (continued)

| | 2009 | 2008 | 2007 |
|---|--------------|--------------|--------------|
| Financing activities | | | |
| Income tax effect on flow-through share renouncement | \$ 2,548,001 | \$ 1,734,200 | \$ 3,673,018 |
| Receivables included in mineral properties recoveries | \$ 223,907 | \$ 388,456 | \$ - |
| Accounts payable included in mineral properties | \$ 17,845 | \$ 1,153,910 | \$ 1,677,236 |
| Fair value of broker warrants issued | \$ - | \$ 262,604 | \$ 15,039 |
| Stock-based compensation reallocation | \$ - | \$ (321,928) | \$ (83,272) |
| Cash and cash equivalents | | | |
| Cash | \$ 1,252,422 | \$ 3,594,579 | \$ 3,217,984 |
| Cash equivalents | 2,008,395 | 8,317 | 821,869 |
| | \$ 3,260,817 | \$ 3,602,896 | \$ 4,039,853 |
| Other cash flow information: | | | |
| Interest received | \$ 148,287 | \$ 234,819 | \$ 417,375 |
| Interest paid | \$ - | \$ 18,375 | \$ 185,051 |
| Income taxes paid | \$ - | \$ - | \$ - |

13. Income Taxes

The Company has accumulated non-capital losses for Canadian income tax purposes of \$8,700,000. The losses may be carried forward to reduce taxable income in future years and, unless utilized, will expire beginning 2010 through to 2029.

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

| | 2009 | 2008 | 2007 |
|--|--------------|--------------|--------------|
| | 30.00% | 31.00% | 34.12% |
| Income tax recovery computed at Canadian statutory rates | \$ 1,266,076 | \$ 739,980 | \$ 1,174,556 |
| Temporary differences not recognized in year | (859,624) | (102,260) | (561,471) |
| Permanent difference not recognized | 75,075 | (80,076) | (266,178) |
| Net tax effect of flow through share renunciation | - | - | 3,251,017 |
| Tax benefits not recognized and other | 731,613 | 796,511 | - |
| Change in tax rates | (28,140) | (24,099) | (1,474,707) |
| Future income tax recovery | \$ 1,185,000 | \$ 1,330,056 | \$ 2,123,217 |

DIAMONDS NORTH RESOURCES LTD.

Notes to Consolidated Financial Statements
December 31, 2009 and 2008
(expressed in Canadian dollars)

13. Income Taxes (continued)

Significant components of the Company's future tax assets and liabilities, after applying enacted corporate income tax rates, are as follows:

| | 2009 | 2008 |
|--|-----------------------|-----------------------|
| Future income tax assets (liabilities) | | |
| Non-capital losses carried forward | \$ 2,166,000 | \$ 1,835,000 |
| Mineral properties | (7,287,000) | (5,460,000) |
| Other assets | 944,000 | 811,000 |
| Future income tax liabilities, net | <u>\$ (4,177,000)</u> | <u>\$ (2,814,000)</u> |

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 share 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, 2009 and are held by the Company for such expenditures. As at December 31, 2009, the amount of flow-through proceeds remaining to be expended is \$Nil (2008 - \$2,507,033).

14. Subsequent Event

On March 8th, 2010, the Company announced that it has signed a Letter of Intent with Minerals and Metals Group ("MMG") whereby MMG may earn 75% of the nickel and other base metals on the Amaruk Property in Nunavut, by spending \$6,000,000 and completing a pre-feasibility study on any nickel or base metal deposit that might be identified on Amaruk.



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“Amaruk 2010 will be a busy year for Diamonds North, a bulk sample from the Beluga 3, reverse circulation drilling on the PB gold prospects and advancement of our nickel project with partner, MMG.” says Mark Kolebaba, President & CEO.

1.1 Description of Business and Report Date

Diamonds North Resources Ltd. (“Diamonds North” or “the Company”) is an exploration stage company engaged in the acquisition and exploration of diamond and precious metal properties in Canada. The principal properties are located in northern Canada throughout Nunavut (“NU”) and the Northwest Territories (“NWT”). The Company trades as a Tier One company on the TSX Venture Exchange (“Exchange”) under the symbol “DDN” and is a 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, 2009.

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 12th, 2010 (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. Factors that could cause actual results to differ materially from those in forward-looking statements include market prices, exploration success, continued availability of capital, and general economic, market or business conditions.

Bruce Kienlen (P.Geol) and Graham Gill (P. Geo) are the Company's qualified persons reviewing the exploration projects described throughout the MD&A. They are responsible for the design and conduct of the exploration programs and the verification and quality assurance of analytical results.

1.2 Company Overview and Projects

Amaruk 2009, Diamonds North collected a 6.7 tonne kimberlite sample from Beluga-3 and the recovery of a diamond on the 1.70mm screen warrants the collection of a larger sample see [1.2\(c\)\(i\) Amaruk – Diamonds](#). The Amaruk project still remains one of Canada's top opportunities for a significant diamond discovery, as mineral chemistry across the property suggests high diamond potential. Microdiamond data shows an anomalously high amount of carbon in the system and kimberlites with size potential have been discovered.

Canada's under-explored north provides our shareholders with a unique opportunity. In addition to our diamond discoveries, shareholders now own 100% of several new gold prospects. At the Amaruk ‘PB1 Gold prospect’, a continuous rock chip sample across an oxidized sulfide zone yielded 9.4 g/T gold over 3 metres, see [1.2\(c\)\(ii\) Amaruk – Gold Prospects \(100% owned\)](#). Our 2009 program has demonstrated grade and size potential of the PB1 Gold prospect and will be a significant drill target to kick-off our gold exploration campaign in 2010.

We have listened to our stakeholders and diamond exploration will continue as our primary focus. However, with gold prices near historic highs, a diversified approach to exploration is a prudent approach in these current market conditions.

(a) Highlights for the Year Ended December 31, 2009

- On July 14th, Diamonds North announced 17 new gold anomalies have been identified on its 100% owned Amaruk project. The majority of the anomalies are defined by multiple samples containing 25 to 250 gold grains per 15 kilograms of till sampled. Surface textures on the recovered grains suggest minimal transport, estimated by Diamonds North to be in the range of 500 to 1,000 metres from source in most cases.
- On August 4th, Diamonds North completed a non-brokered private placement of \$462,080 from the issuance of 2,888,000 flow-through shares at \$0.16 per share. Finders' fees were paid consisting of \$3,800 in cash. All securities are subject to a hold period which expires on December 5, 2009.
- On October 19th, Diamonds North announced gold assay results from its PB1 Gold prospect on its 100% owned Amaruk property in Nunavut. A continuous rock chip sample across an oxidized sulfide zone yielded 9.4 g/T gold over 3 metres. A nearby grab sample of un-oxidized altered Quartz Feldspar Porphyry (QFP) devoid of sulfides contained 24 g/T gold, see [1.2\(c\)\(ii\) Amaruk – Gold Prospects \(100% owned\)](#).
- On October 29th, Diamonds North announced the discovery of 21 additional gold targets on its 100% owned Amaruk property, see [1.2\(c\)\(ii\) Amaruk – Gold Prospects \(100% owned\)](#). First pass regional prospecting of an 80 x 80 kilometre area on Amaruk identified 21 additional gold occurrences predominantly in the central part of the property including:
 - 3 regions with assays greater than 1.0 g/T gold;
 - 7 regions with samples yielding 100 ppb to 1.0 g/T gold; and
 - 11 regions with elevated gold between 20 and 100 ppb.

Each of these gold target areas are discrete and represent an exploration target area in the order of about 5 x 5 kilometres. All regions are within 50 kilometres of the coast.

- On December 1st, Diamonds North announced the recovery of larger stones from the Beluga-3 kimberlite on its 100% owned Amaruk project. A 6.7 tonne sample collected by reverse circulation drilling and processed by dense media separation ("DMS") yielded a total of 126 diamonds above the 0.5 mm mesh including 9 stones on the 1.18 mm mesh and 1 stone on the 1.70 mm mesh see [1.2\(c\)\(i\) Amaruk – Diamonds](#).

(b) Events Subsequent to December 31, 2009

- On March 4th, Diamonds North announced high grade copper, silver, and bismuth assays from recently discovered showings on its Hepburn copper-silver project located in the Northwest Territories. Grab samples have returned up to 19.8 % copper, 123.0 grams per tonne silver, 0.20% uranium and 0.17% bismuth, see [1.2\(d\) Hepburn Project – Northwest Territories, Canada](#).
- On March 8th, Diamonds North announced that it has signed a Letter of Intent with Minerals and Metals Group ("MMG") whereby MMG may earn 75% of the nickel and other base metals on the Amaruk Property, by spending \$6 million and completing a pre-feasibility study on any nickel or base metal deposit that might be identified on Amaruk, see [1.2\(iii\) Tunerq – Amaruk Nickel Project \(100%\) owned](#).

Management Discussion and Analysis
For the Year Ended December 31, 2009

(c) Amaruk Project – Nunavut, Canada

The Amaruk property along with the Ualliq, Sakari, Siku and Tunerq projects cover approximately 3.4 million acres around the community of Kugaaruk, Nunavut. The projects are subject to a 2% gross overriding royalty (“GOR”) on diamonds and a 2% net smelter royalty (“NSR”) on other minerals except gold, payable to BHP Billiton Diamonds Inc. Portions of the property have been optioned or in joint ventures with other exploration companies.

(i) Amaruk – Diamonds

-Amaruk Exploration Program for 2009

A 6.7 tonne sample collected from the Beluga-3 and was designed to test for the presence of larger stones. No diamond recovery was performed below the 0.50mm sieve size. Collecting the sample by reverse circulation drill was approximately \$800,000 less than by core drill. The sample was processed by DMS and the sieve size results:

| Kimberlite | Weight(t) | Total | 0.50mm | 0.60mm | 0.85mm | 1.18mm | 1.70mm |
|------------|-----------|-------|--------|--------|--------|--------|--------|
| Beluga 3 | 6.7 | 126 | 12 | 67 | 37 | 9 | 1 |

The diamond recovered from the 1.70 mm mesh measures 2.6 mm x 2.0 mm x 1.0 mm and is a fragment with an estimated 60% loss. In addition, 5 of the 9 diamonds on the 1.18 mm screen are fragments with varying characteristics (4 of the stones show an estimated 60% loss). A high proportion of the diamonds recovered are white, clear octahedrons (see photos at www.diamondsnorth.com).

In addition, eight geophysical targets were drilled tested resulting in the discovery of the Kanguq kimberlite. The Kanguq kimberlite is located approximately 10 kilometres north of Beluga-3 and appears to represent a new kimberlite cluster. An 868 kilograms sample of Kanguq kimberlite was collected from one vertical drill hole and was processed by DMS. No diamonds above the 0.5 mm mesh were recovered. It is important to note that while Kanguq kimberlite does not warrant further work, it does represent a new kimberlite cluster on the property.

Under [1.2\(e\) Mineral Property Expenditure Table](#) Amaruk exploration expenditures for:

- Drilling – core expenditures of \$217,823 relate to the demobilization of the two core rigs used in 2008;
- Drilling – percussion expenditures of \$487,551 relate to the collections of the Beluga-3 and Kanguq kimberlite samples and DMS processing;
- Property expenditures of \$77,588 relate to filing and grouping fees for the 2008 assessment report filed with the Mining Recorder; and
- Prospecting expenditures of \$150,187 includes prospecting for gold samples.

-Future Developments for Amaruk

Diamonds North jointly funded the development of a low cost, light weight bulk sampling drill that utilizes reverse circulation without percussion, in an effort to reduce and or eliminate diamond breakage. Plans to mobilize this drill for the Amaruk 2010 bulk sample of 25 to 50 tonnes are underway. Estimated collection cost with this drill rig is \$10 per kilogram in contrast with core drilling which is approximately \$150 per kilogram.

(ii) Amaruk – Gold Prospects (100% owned)

PB1 is located along a 40 kilometre long structure and is less than 10 kilometres from the coast. The oxidized sulfide zone, which was the target for gold exploration has been observed over a length exceeding 100 metres and 3 to 8 metres wide, increasing up to 20 metres wide locally. The gold bearing QFP, which was not the original target, extends laterally tens of metres beyond the oxide zone. The full extent of the QFP is not yet known. The discovery of gold in both the surrounding QFP and the oxide zone significantly increases the potential strike, width and grade of the prospect.

Two additional chip samples within the oxidized zones collected 15 metres east and 30 metres west of the 9.4 g/T sample returned 2.7 g/T over 3 metres and 1.3 g/T over 6 metres respectively. All assays have been rechecked by a second laboratory and all variances fall within acceptable levels. Coarse gold is suspected as gravimetric assay methods on the grab sample returned 24.3 g/T against 18.1 g/T using normal fire assay techniques.

As part of the prospecting program, previous holes drilled on Amaruk that intersected sulfide bearing rocks rather than kimberlite have been analyzed. Drill hole GA-5 (now named PB2) contained gold and is described below. Fifteen additional drill holes with sulfides will be reviewed for gold potential. Geological site descriptions for regions with samples yielding greater than 1.0 g/T gold are provided below:

- **PB2** - rock samples with sulfides from a reverse circulation drill hole targeting kimberlite yielded 1.4 g/T and 1.0 g/T gold over 2 separate 1.5 metre intervals. Ten additional 1.5 metre samples from the drill hole have been submitted for assay. All samples contain sulfide minerals.
- **PB3** - four grab samples were collected from rusty gossan zones in probable metasedimentary rocks. Sulfides including pyrite and chalcopyrite were observed. The best assays contain 1.2 g/T and 0.6 g/T gold and up to 49.5 g/T silver. Base metal values are elevated (0.14% Cu, 0.57% Pb and 0.29% Zn). Similar gossan zones were observed over an area spanning about 1 kilometre.
- **PB4** - abundant sulfide bearing angular boulders were identified over an area spanning approximately 1 kilometre. The source of the boulders appears to be the contact of a quartz diorite pluton intruding metasedimentary rocks. A total of five samples were collected for assay. Sample 24236 which is the closest sample to the quartz diorite contact yielded 1.0 g/T gold.

-Future Developments for Amaruk Gold Prospects

Planning is underway for an extensive gold exploration program to begin in the first quarter of 2010. The PB1 Gold prospect is considered high priority for reverse circulation drilling and plans for the other gold prospects include detailed mapping and prospecting in preparation for drilling.

(iii) Tunerq - Amaruk Nickel Project (100% owned)

The Tunerq prospect is an oxidized sulphide bearing outcrop, approximately 20 to 30 metres wide and slopes gently into an extensive low lying area with no outcrop exposure. In 2008, percussion drill hole 2 intersected 2.49% Ni, 0.56 % Cu and 0.05% Co over 9.1 metres within a 34.8 metre zone containing 1.05% Ni and 0.26% Cu.



Management Discussion and Analysis
For the Year Ended December 31, 2009

In March 2010, MMG, an Australian headquartered major producer of zinc, copper, lead, gold and silver with operations in Australia and South-East Asia signed a Letter of Intent with Diamonds North, whereby MMG may earn a 75% interest in the nickel and base metals on the Amaruk property by:

- Incur \$6 million in expenditures on the project within 4 years of signing the formal agreement;
- Complete and deliver to Diamonds North, a Scoping Study and a Pre-Feasibility Study on one project area within ten (10) years of signing the formal agreement; and
- Until the earn-in conditions are satisfied, MMG shall have exploration expense obligations of at least \$750,000 per year up to year 8 and \$1 million through years 9 and 10.

At any time during years 5 through 8, MMG shall have the option, at its sole discretion, to suspend, on a one time basis only, exploration expenditures for the elected year as long as the minimum expenditures are met to maintain claims in good standing. In the event that Diamonds North dilutes to 10% or less, such interest shall convert to a 2% NSR where one-half the NSR may be purchased for \$500,000.

-Tunerq Exploration Program for 2009

Diamonds North completed prospecting to follow-up on numerous other mafic and ultra-mafic intrusions on the property. Diamonds North is waiting for assay results.

-Future Developments for Tunerq

For 2010, MMG is estimated an exploration program between \$2 to \$2.5 million consisting of:

- A +40 kilometre Crone pulse EM survey over the Tunerq prospect;
- Up to 1500 metres of NQ core drilling;
- Regional prospecting to identify additional mafic and ultra-mafic bodies; and
- Detailed mapping of other mafic and ultra-mafic bodies across the property.

(d) Hepburn Project – Northwest Territories, Canada

Diamonds North holds a 100% interest in the Hepburn property located approximately 400 kilometres north of Yellowknife. A portion of the property's uranium rights were transferred to Uranium North Resources Corp. ("Uranium North") and the Company continues to hold 100% interest in all diamonds and other metals, except uranium for which the Company retains a royalty.

Regional exploration has identified additional copper-silver mineralization along strike for 1 kilometre and in stratigraphically similar rocks 1.5 kilometres south of the historic drill holes, noted below. In addition, 5 separate geophysical magnetic anomalies with copper-silver potential have been identified over a 12.5 kilometre long area, potentially defining a new large scale copper-silver district.

Two historic angle drill holes from a single site intersected 13-15 metres of sulfide mineralization with high grade copper and copper-silver zones including 4.71 metres of 2.4% copper and 99 g/T silver.

In 2008, trench sampling on the north flank of this geophysical anomaly returned values of up to 2.9% copper and 218.5 grams per tonne silver over three metres.



Management Discussion and Analysis
For the Year Ended December 31, 2009

-Hepburn Exploration Program for 2009

During 2009, a sampling program along the southern margin of a geophysical anomaly defined by a 3.5 kilometre by 1.5 kilometre magnetic high and semi-coincident radiometric anomaly (uranium, potassium and thorium) detected by airborne surveying. Grab samples from the area are shown in the table below. Anomalous gold values ranging from 72 ppb to 258 ppb suggest the system is gold bearing.

| Sample | Copper (%) | Silver (g/T) | Bismuth (%) | U (%) | Au (ppb) |
|--------|------------|--------------|-------------|-------|----------|
| 1 | 19.80 | 72.0 | 0.170 | 0.003 | 72 |
| 2 | 7.60 | 32.5 | 0.124 | n/a | 216 |
| 3 | 5.80 | 31.1 | 0.040 | 0.009 | 150 |
| 4 | 4.12 | 123.0 | 0.030 | 0.030 | 258 |
| 5 | 0.14 | 4.2 | n/a | 0.200 | 2 |

The mineralization occurs in breccias, vein stockworks and faults. Alteration minerals include potassium feldspar, hematite, magnetite, carbonate, actinolite, chlorite, epidote, quartz, sericite and albite. Important pathfinder elements for iron-oxide deposits such as cerium, lanthanum, fluorite and barium are elevated in many rock samples collected by Diamonds North.

Under [1.2\(e\) Mineral Property Expenditure Table](#) Hepburn exploration expenditures for:

- Geology of \$40,736 relate to research and review of historical data;
- Property expenditures of \$70,667 relate to filing and grouping fees for the 2008 assessment report filed with the Mining Recorder; and
- Prospecting expenditures of \$80,303 includes prospecting for copper and silver samples.

-Future Developments for Hepburn

The next exploration program for the Hepburn copper-silver project will entail ground geophysics, soil sampling and detailed mapping designed to delineate areas of mineralization for drilling.



Management Discussion and Analysis
For the Year Ended December 31, 2009

(e) Mineral Property Expenditures Table

| | Amaruk, NU | Ualliq, NU | Sakari, NU | Siku, NU | Tunerq, NU | Victoria Island NU/NWT | Banks Island, NWT | Hepburn, NWT | Kidme, NWT | Other Properties (1) | Total |
|---------------------------------|---------------|---------------|---------------|-------------|---------------|------------------------------|-------------------------|-----------------|---------------|-------------------------|---------------|
| Balance at December 31, 2008 | \$ 22,266,482 | \$ 370,686 | \$ 163,246 | \$ 397,141 | \$ 1,276,569 | \$ 4,441,629 | \$ 2,513,877 | \$ 9,003,735 | \$ 526,110 | \$ 222,255 | \$ 41,181,730 |
| Additions during the year: | | | | | | | | | | | |
| Acquisition costs | - | - | - | - | - | - | - | - | - | 87,780 | 87,780 |
| Exploration: | | | | | | | | | | | |
| Airborne geophysics | 30,883 | 8,142 | - | 380 | 1,392 | - | - | 4,993 | 1,501 | 125,413 | 172,704 |
| Camp costs | 222,630 | 9,044 | 4,271 | 50,768 | 43,937 | 1,033 | 3,663 | 14,846 | - | 243 | 350,435 |
| Camp heli. (incl. fuel) | 222,730 | 8,680 | 1,652 | 21,945 | 10,763 | - | - | 543 | - | - | 266,313 |
| Drilling - Core | 217,823 | - | - | - | - | - | - | - | - | - | 217,823 |
| Drilling - Percussion | 487,551 | - | - | - | - | - | - | (650) | - | - | 486,901 |
| Geochemistry | 47,664 | 2,638 | - | 15,333 | - | - | 2,531 | 3,686 | - | - | 71,852 |
| Geology | 552,203 | 22,934 | 3,270 | 6,538 | 19,395 | 1,551 | 8,608 | 40,736 | 1,511 | 47,718 | 704,464 |
| Ground geophysics | 101,444 | 3,102 | - | - | 2,135 | - | - | 3,300 | - | 31 | 110,012 |
| Permitting | 8,601 | 535 | 535 | 7,505 | - | 2,034 | 1,017 | 3,226 | - | 3,051 | 26,504 |
| Property | 77,588 | 11,935 | 3,579 | 15,402 | 2,613 | - | - | 70,667 | 10,847 | 76,989 | 269,620 |
| Prospecting | 150,187 | 6,960 | - | - | - | - | - | 80,303 | - | 29,309 | 266,759 |
| | 2,119,304 | 73,970 | 13,307 | 117,871 | 80,235 | 4,618 | 15,819 | 221,650 | 13,859 | 282,754 | 2,943,387 |
| Less: | | | | | | | | | | | |
| Recoveries | (398,825) | (79,498) | (4,895) | (64,450) | - | (5,716) | (32,479) | - | - | (72,922) | (658,785) |
| Write downs | - | - | - | - | - | - | (2,497,217) | - | - | (70,942) | (2,568,159) |
| | (398,825) | (79,498) | (4,895) | (64,450) | - | (5,716) | (2,529,696) | - | - | (143,864) | (3,226,944) |
| Net additions | 1,720,479 | (5,528) | 8,412 | 53,421 | 80,235 | (1,098) | (2,513,877) | 221,650 | 13,859 | 226,670 | (195,777) |
| Balance at December 31, 2009 | \$ 23,986,961 | \$ 365,158 | \$ 171,658 | \$ 450,562 | \$ 1,356,804 | \$ 4,440,531 | \$ - | \$ 9,225,385 | \$ 539,969 | \$ 448,925 | \$ 40,985,953 |

1. In 2008, 'Northern Recon was disclosed as a separate project and is now combined under 'Other Properties'.



Management Discussion and Analysis
For the Year Ended December 31, 2009

1.3 Selected Annual Information

Selected annual information from Diamonds North's audited consolidated financial statements for the years ended December 31, 2009, 2008, and 2007:

| | 2009 | 2008 | 2007 |
|------------------------------------|----------------|----------------|----------------|
| General and administrative expense | \$ (1,550,814) | \$ (2,510,723) | \$ (3,027,594) |
| Net loss for the year | \$ (3,035,253) | \$ (1,057,317) | \$ (1,319,210) |
| Basic and diluted loss per share | \$ (0.04) | \$ (0.02) | \$ (0.02) |
| Cash dividends per share | \$ Nil | \$ Nil | \$ Nil |
| Other comprehensive income (loss) | \$ 387,195 | \$ (1,532,226) | \$ 21,084 |
| Assets | \$ 45,457,597 | \$ 49,723,296 | \$ 37,402,056 |
| Long-term liabilities | \$ Nil | \$ Nil | \$ Nil |

1.4 Results of Operations

(a) Current Quarter

Diamonds North's cash position decreased \$1,082,934 to \$3,260,817 consisting of \$1,252,422 in cash and \$2,008,395 in guaranteed investments certificates and a money market fund. The largest use of cash was a \$500,004 reduction in accounts payable and accrued liabilities related to mineral properties.

Diamonds North received \$3,000 from the exercise of 10,000 warrants and subsequent to the year end, \$15,750 from the exercise of 52,500 warrants, \$8,750 from the exercise of 50,000 stock options and \$24,990 from the sale of marketable securities.

Diamonds North's \$93,749 in mineral property acquisition and exploration costs was funded by \$100,192 in cash exploration funds. At December 31, 2009, Diamonds North had expended the remaining flow-through from the non-brokered private placement completed in August 2009.

(b) Year Ended December 31, 2009

Results of operations for the year ended December 31, 2009 are discussed in comparison with the year ended December 31, 2008. General and administrative expenses of \$1,550,814 (2008 - \$2,510,723) represents a \$959,909 decrease compared to the comparative fiscal year. Notable changes include:

- Bad debts expense of \$28,531 (2008 - \$Nil) for an allowance of doubtful accounts relating to a 2008 project costs recovery.
- Interest of \$26,875 (2008 - \$22,698) includes \$25,446 (2008 - \$18,375) in flow-through related interest paid to the Canada Revenue Agency.



Management Discussion and Analysis
For the Year Ended December 31, 2009

- Investor relations and promotion of \$204,785 reflects a reduced presence at conferences and trade shows. A breakdown is below:

| | 2009 | 2008 |
|--------------------------------|-------------------|-------------------|
| Administration | \$ 729 | \$ 4,240 |
| Conferences and trade shows | 46,642 | 125,727 |
| Consulting, wages and benefits | 121,921 | 179,448 |
| Media | 25,473 | 39,642 |
| Promotion and advertising | 10,020 | 42,427 |
| | \$ 204,785 | \$ 391,484 |

- Office and miscellaneous expense of \$52,059 (2008 - \$87,594) reflects reduced operations and staffing.
- Rent and storage expense of \$123,232 (2008 - \$100,332) increased as Diamonds North absorbed a portion of the shared office space, as another company in the office reduced its operations.
- Stock-based compensation expense of \$160,521 (2008 - \$873,034) decreased as the fair value estimated using the Black-Scholes option pricing model decreased to \$0.17 (2008 - \$0.51) per option.
- Realized loss on marketable securities of \$224,005 resulted from the sale of Bayswater Uranium Corporation common shares. The shares were received under an option agreement and Diamonds North is not an insider of the company.
- Write down of mineral properties expense of \$2,568,159 reflects the write down of the Banks Island, NWT project for \$2,497,217, acquired for its prospective till data and the Arnaq, Nunavut project for \$70,942, acquired for its proximity to other diamond projects in the area, notably the Amaruk project.
- Future income tax recovery of \$1,185,000 (2008 - \$1,330,056) largely reflects renouncement of exploration expenditures to investors who purchased flow-through shares. Diamonds North renounced \$10,190,639 in flow-through financings compared to \$5,336,000 in 2008. This is a non-cash transaction.

Diamonds North's net loss for the year was \$3,035,253 (2008 - \$1,057,317) or \$0.04 per share (2008 - \$0.02) which is not reflective of the operating deficit, due to the future income tax recovery noted above.

Other comprehensive income (loss) of \$387,195 (2008 - \$(1,532,226)) includes \$143,810 in unrealized gain on marketable securities due to the fair value increase of Diamonds North's marketable securities portfolio since the beginning of the year and the reversal of previously recognized unrealized losses of \$243,385 in connection with the loss on marketable securities noted above.



Management Discussion and Analysis
For the Year Ended December 31, 2009

1.5 Summary of Quarterly Results

| | Q1 Mar. 31 2008 | Q2 Jun. 30 2008 | Q3 Sept. 30 2008 | Q4 Dec. 31 2008 | Q1 Mar. 31 2009 | Q2 Jun. 30 2009 | Q3 Sep. 30 2009 | Q4 Dec. 31 2009 |
|--|-----------------------|-----------------------|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Mineral expenditures, net of recoveries | \$ 1,020,663 | \$ 7,505,249 | \$ 7,157,026 | \$ 695,062 | \$ (101,208) | \$ 125,359 | \$ 1,476,675 | \$ 93,749 |
| G&A expense | \$ 700,851 | \$ 564,388 | \$ 572,262 | \$ 673,222 | \$ 416,595 | \$ 314,701 | \$ 344,347 | \$ 475,171 |
| Stock-based comp. exp. | \$ 311,594 | \$ 182,083 | \$ 190,319 | \$ 189,038 | \$ 8,236 | \$ 8,235 | \$ 72,025 | \$ 72,025 |
| Net income (loss) | \$ 1,097,719 | \$ (492,272) | \$ (662,604) | \$ (1,000,160) | \$ 2,676,138 | \$ (286,446) | \$ (336,631) | \$ (5,088,314) |
| Other comprehensive income (loss) | \$ (174,987) | \$ (176,802) | \$ (463,456) | \$ (716,981) | \$ (18,366) | \$ 199,357 | \$ 1,900 | \$ 204,304 |
| Income (loss) per share -basic | \$ 0.02 | \$ (0.01) | \$ (0.01) | \$ (0.02) | \$ 0.04 | \$ (0.01) | \$ - | \$ (0.07) |
| Weighted avg. common shares outstanding -basic | 60,602,852 | 61,078,366 | 74,231,694 | 67,814,839 | 75,159,308 | 75,159,308 | 76,948,623 | 75,348,534 |

The summaries of quarterly results are from Diamonds North's financial statements, prepared in accordance with Canadian generally accepted accounting principles and denoted in the currency of Canada.

Due to seasonal conditions in Canada's north, Diamonds North conducts exploration in Q2 and Q3. The 2009 exploration programs were smaller than the previous year. Q1-2009 includes refunded bonds incurred as mineral property expenditures posted in lieu of exploration work.

G&A expense for 2009 decreased, largely to lower stock-based compensation expense. The decline in stock price has computed into a lower call value under the Black-Scholes option pricing model. Stock-based compensation is a method used by junior exploration companies to compensate staff and directors. For 2010, Diamonds North is moving to graded vesting whereby a greater portion of expense is recorded in the first and second vesting periods compared to distributing the expense equally over all vesting period.

Diamonds North is in the exploration stage and does not have operating cash-flow. Earnings per share are anomalous and reflect adjustments to future income tax. The Company renounced exploration expenditures under its flow-through share program, resulting in future income tax recovery of \$1,734,200 in Q1-2008 and \$3,057,192 in Q1-2009. In Q4-2009, Diamonds North increased its future income tax payable estimate by \$1,363,000 and reduced the future income tax recovery to \$1,185,000.

Other comprehensive income (loss) represents unrealized gains or losses on marketable securities. The positive trend in the last three quarters reflects a small recovery in the junior resource sector. Q4-2009 includes a \$243,385 reversal of previously recognized unrealized losses for marketable securities sold during the years.



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1.6 Liquidity

To minimize liquidity risk, the Company ensures that there is sufficient capital in order to meet annual business requirements, after taking into account administrative, property holding and exploration budgets, against cash and cash equivalent holdings.

Management believes its \$4,065,564 in working capital is sufficient to meet administrative and tenure costs for 2010. Diamonds North is planning the 2010 exploration program and funding requirements have yet to be determined. The preliminary estimates is \$2 million which may be funded with a combination of existing capital and/or a future equity offering. As previously noted, nickel exploration will be funded by MMG.

Fluctuations in commodity prices may influence financial markets and commodity price risk may indirectly affect the Company. As the Company is in the exploration stage, commodity prices are not reflected in operating results. Unlike other commodities, diamonds are typically sold in private transactions and rough diamond prices are generally not publicly disclosed. Any valuation based on gold prices would likely be premature until the Company has a proven and probable reserve.

Over the last eighteen months:

- liquidity risk increased, as other things being equal, the price of an asset will be reduced if the holder cannot sell the asset immediately. Included in marketable securities are large share positions in junior resources companies, which may be difficult to sell without impacting quoted market prices.
- credit risk increased, as service providers may not always be able to perform in accordance with the terms of a contract. To help mitigate this risk the Company has long-term relations with key vendors and if contracts require large advances, the Company may place funds in-trust.

In 2008, the Company implemented a cash preservation measure whereby, senior employees and a consultant mutually agreed to defer 10% of their salaries or fees and the independent directors agreed to defer their retainer. These amounts accrued as a debt owing by the Company and did not bear interest. At the Company's election, this debt can be satisfied in cash and/or common shares. During 2009, the consultant and independent directors' debt was repaid in cash. Subsequent to December 31, 2009, the senior employee's debt was repaid in cash. In 2010, 10% of the senior employees' salaries will continue to be deferred under the terms above with repayment to be reviewed later in the year.

1.7 Capital Management

The Company considers its capital structure to consist of the components of shareholders' equity. Management's objective is to ensure that there is sufficient capital to minimize liquidity risk and to continue as a going concern. As an exploration stage company, the Company is currently unable to self-finance its operations and has relied primarily on equity financings to meet its capital requirements.

The Company's share capital is not subject to any external restriction and the Company did not change its approach to capital management during the year.

1.8 Off-Balance Sheet Arrangements

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



Management Discussion and Analysis
For the Year Ended December 31, 2009

1.9 Related Party Transactions

The Company has engaged a business owned by Janice Davies, an officer of the Company, to provide corporate secretarial services. During the year, the Company paid fees to this related party in the aggregate of \$38,400 (2008 - \$38,400).

The Company paid an aggregate of \$40,000 (2008 - \$40,000) in directors' fees to the four independent directors.

The Company has engaged a business owned by Bernard H. Kahlert, a director of the Company, to provide project management and geological consulting. During the year, the Company paid fees to this related party in the aggregate of \$19,330 (2008 - \$18,900).

At December 31, 2009, the Company held 11.3% of the issued common shares of Uranium North, a company related by virtue of other common directors. Included in accounts receivable is \$108,170 (2008 - \$12,542) owed by Uranium North, for mineral property, administrative and office costs.

1.10 Proposed Transactions

None.

1.11 Changes in Accounting Policies

The Company adopted the following new accounting standard issued by the CICA.

-Goodwill and Intangible Assets

Effective January 1, 2009, CICA Section 3064 replaced Section 3062 "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The adoption of this section did not impact the Company's financial statements.

-Fair Value Hierarchy Disclosures

Effective October 1, 2009, CICA Section 3862 "Financial Instruments - Disclosures" was amended to require disclosures about the relative inputs to fair value measurements, including their classification within a hierarchy that prioritizes the inputs to fair value measurements. The three levels of fair value are:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for assets or liabilities either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data

The effects of the adoption of this standard have been disclosed, see [1.13 Financial Instruments](#).



Management Discussion and Analysis
For the Year Ended December 31, 2009

1.12 New Accounting Pronouncements

A summary of new Canadian GAAP pronouncements which may affect the financial disclosure and results of operations of the Company for future interim and annual periods.

-Business Combinations, Non-controlling Interest and Consolidated Financial Statements

In January 2009, the CICA issued Section 1582 "Business Combinations", Section 1601, "Consolidated Financial Statements" and Section 1602 "Non-controlling Interests" which replace Section 1581 "Business Combinations" and Section 1600 "Consolidated Financial Statements". Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combinations accounting standard under IFRS (defined below). Section 1582 is applicable for the Company's business combinations with acquisitions dates on or after January 1, 2011. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. Section 1601 is applicable for the Company's interim and annual consolidated financial statements for its fiscal year beginning January 1, 2011. Early adoption of these Sections is permitted and all three Sections must be adopted concurrently. The Company is evaluating these new standards.

-International Financial Reporting Standards ("IFRS")

In February 2008, the Canadian Accounting Standards Board announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. The Company has adopted a three phase approach to IFRS, consisting of:

- Phase 1 'Preliminary Planning and Scoping';
- Phase 2 'Detailed Impact and Assessment'; and
- Phase 3 'Implementation'.

Phase 1 has been completed and work on Phase 2 will carry on through-out 2010. The majority of adjustments required on transitions to IFRS will be made, retrospectively, against the opening deficit as of January 1, 2011 of the first comparative balance sheet presented based on standards applicable at that time.

The Canadian Accounting Standards Board ("AcSB") has ongoing projects and intends to issue new accounting standards during the conversion period. As a result, the final impact of IFRS on the Company's consolidated financial statements can only be measured along with the required disclosure, once all the IFRS accounting standards at the conversion date are known.

Generally, disclosure requirements under IFRS contain more breadth and depth than those required under Canadian GAAP and will result in more extensive financial statement notes.

Set out below are the most significant areas, management has identified to date, where changes in accounting policies may have the potential impact on the Company's consolidated financial statements.

-Share Based Payments

IFRS and Canadian GAAP largely converge on the accounting treatment for share based transaction with only a few differences. Starting Q1 2010, the Company is moving from 'straight line' to 'graded' vesting for the recognition of stock-based compensation expense. A greater portion of expense is recorded in the first and second vesting periods compared to distributing the expense equally over all vesting period.



Management Discussion and Analysis
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-Mineral Property Expenditures

Under IFRS 6, a mining entity has to determine an accounting policy specifying which expenditures on exploration and evaluation activities will be recorded as assets then apply that policy consistently. It is anticipated the Company will elect under the provisions in IFRS to continue the accounting practice of capitalizing all costs related to investments in mineral property interests on a property-by-property basis.

1.13 Financial Instruments

The Company is exposed to credit risk with respect to its cash and cash equivalents and marketable securities. To minimize this risk, cash has been placed with major financial institutions. The total amount of cash is available on short notice and is not invested in commercial paper or asset backed security programs.

Marketable securities are common shares in other junior exploration companies received via property or option agreements and from the conversion of the Uranium North loan in 2008. Marketable securities are carried at their fair value based on quoted market prices on the TSX Venture Exchange.

| Marketable securities | Cost | Unrealized Loss | Fair Value |
|---|--------------|----------------------------|-----------------------|
| Available-for-sale at December 31,2009 | \$ 1,192,231 | \$ (569,671) | \$ 622,560 |

The follow table illustrates the classification of the Company's financial instruments carried at fair value within the fair value hierarchy at December 31, 2009:

| | Level 1 | Level 2 | Level 3 | Total |
|---------------------------|----------------|----------------|----------------|--------------|
| Cash and cash equivalents | \$ 3,260,817 | \$ - | \$ - | \$ 3,260,817 |
| Marketable securities | - | 622,560 | - | 622,560 |
| | \$ 3,260,817 | \$ 622,560 | \$ - | \$ 3,883,377 |

As it may be difficult to sell the Company's marketable securities position without impacting the quoted market price and the market may not be considered active, the marketable securities have been classified as Level 2.

1.14 Certification of Annual Filing

The Company follows BC Securities Commission 52-511 'Relief for Venture Issuers from Certification Requirements' that helps small size companies like ours, where there is a lack of segregation of duties which is an ongoing internal control weakness. The Company mitigates this risk through direct involvement of senior management in day to day operations.



Management Discussion and Analysis
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1.15 Other MD&A Requirements

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

As of the Report Date, the Company had 78,159,808 issued common shares outstanding and the following unexercised stock options:

-Stock Options

| Expiry Date | Exercise Price | Number of Shares |
|--------------------|-----------------------|-------------------------|
| April 12, 2011 | \$0.848 | 220,000 |
| July 13, 2011 | \$1.021 | 113,500 |
| February 27, 2012 | \$0.770 | 177,000 |
| February 14, 2013 | \$0.880 | 135,000 |
| September 2, 2013 | \$0.820 | 10,000 |
| May 28, 2014 | \$0.175 | 2,100,000 |
| December 23, 2014 | \$0.300 | 6,260,000 |
| | | 9,015,500 |

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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, 2009)

Shares Authorized: Unlimited

Shares Issued: 78,057,308

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