

Darnley Bay Resources Limited

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MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE 2ND QUARTER AND HALF YEAR 2004

This MD&A for the 2nd quarter and half year of 2004 is a follow up of the MD&A for the year 2003, which provided background on the Company's objectives and operations since its commencement. Please refer to the MD&A for the year ended December 31, 2003. .

Schedule 1, "Financial Summary", provides balance sheet summaries as of June 30, 2004, June 30, 2003 and December 31, 2003 and the 2nd quarter and half year operation results and cash flow for 2004 and 2003. Schedule 2 provides a summary of quarterly results and cash flows for the 1st and 2nd quarters of 2004 and the eight quarters of 2002 and 2003. .

As stated in the MD&A for the year 2003, while there has been some recent recovery in the venture capital market, it has not been consistent and the Company has continued to rely on a small group of its shareholders for financing on a private placement basis, sufficient to cover day to day administrative expenses but not sufficient for continuation of ground exploration which has been deferred pending additional subscriptions for share capital. There are ongoing discussions with various potential investors for continuation of exploration. However prospecting for diamonds has continued through a joint venture with Diadem Resources Ltd., as disclosed in the MD&A for 2003.

Activation of the joint venture commence with the granting of prospecting permits by the Department of Energy & Mines in February 2004 followed by ground geophysics, till sampling and airborne EM surveying by Diadem. The ground magnetic survey covered 22 potential kimberlite targets. From the subsequent evaluation of these targets, eight have been classified as high priority drill targets. With completion of geophysical modeling on these high priority targets, Diadem plans to commence drilling for which purpose it is currently in discussions with various sources of financing, with some commitments already in hand.

As provided under the joint venture agreement the initial stage of the current diamond exploration is being financed by Diadem. The current financing of exploration for diamonds directly by Diadem accounts for the relatively small mineral property expenditures in the accounts of Darnley Bay; only about \$98 thousand for 2004 half year. The expenditures for the half year are for professional services and other items applicable to the Company's general exploration and not directly for current explorations. Diadem is committed to spend \$5 million on the joint venture, by December 2006, in order to earn a 50% participating interest in the joint venture.

As disclosed by Schedule 1, the financial position of the Company as at June 30, 2004 was

compatible with that at December 31, 2003. The substantial decline in net assets, and net equity, from \$7.8 million as at June 30, 2003 to \$3.8 million as at June 30, 2004 resulted from the write down in the 4th quarter of 2003 of mineral property expenditures by \$6.5 million, less applicable future income taxes of \$2.9 million. This write down was covered in the MD&A for the year 2003, under "Financial Review - Years 2001 to 2003".

The negative cash flows, disclosed in the quarterly summaries, Schedule 2, reflects the inconsistencies in the markets for venture capital, which is a major source of funding for junior exploration companies.

FINANCIAL SUMMARY

BALANCE SHEET

	June 30		December 31
	2004	2003	2003
	\$	\$	\$
Current assets and deposits	242,382	250,387	464,332
Less payables and advances	-1,944,794	-1,177,415	-1,958,691
Working capital deficit	-1,702,412	-927,028	-1,494,359
Mineral property and related expenditures	6,487,441	12,539,859	6,389,649
Less applicable income taxes	-953,701	-3,792,796	-953,701
Net assets	3,831,328	7,820,035	3,941,589
Share capital	17,787,280	17,625,837	17,670,837
Deficit	-13,955,952	-9,805,802	-13,729,248
Net equity	3,831,328	7,820,035	3,941,589

	2nd Quarter		Half Year	
	2004	2003	2004	2003
Administrative and general expenses	125,752	128,392	226,704	234,510
Future income tax (reduction) payable		96,297		213,454
Loss for period	125,752	224,689	226,704	447,964
Deficit at beginning of period	13,830,199	9,581,602	13,729,248	9,357,839
Deficit at end of period	13,955,951	9,806,291	13,955,952	9,805,803
<i>loss per share</i>	<i>0.003</i>	<i>0.003</i>	<i>0.006</i>	<i>0.014</i>
<i>diluted loss per share</i>	<i>0.003</i>	<i>0.003</i>	<i>0.006</i>	<i>0.014</i>

CASH FLOW

Funds received				
subscriptions for shares	nil	234,690	116,443	500,956
Less disbursements on				
exploration	52,404	75,310	97,791	186,153
administration	125,753	128,392	226,704	234,510
	178,157	203,702	324,495	420,663
Increase (decrease) in working capital	-178,157	30,988	-208,052	80,293
Working capital (deficit) at beginning of period	-1,524,255	-958,017	-1,494,360	-1,007,322
Working capital (deficit) at end of period	-1,702,412	-927,029	-1,702,412	-927,029

SUMMARY OF QUARTERLY RESULTS

	1st Quarter \$	2nd Quarter \$	3rd Quarter \$	4th Quarter \$	Year \$
LOSS & DEFICIT					
2002					
Revenue	nil	nil	nil	nil	nil
Administrative & general expenses	120,547	200,872	144,855	160,407	626,681
Future income tax (reduction) payable	52,966	100,753	13,223	64,096	231,038
Loss for period	173,513	301,625	158,078	224,503	857,719
Share issue expense	5,591	-20,687	900		-14,196
Deficit for period	179,104	280,938	158,978	224,503	843,523
<i>loss per share</i>	<i>0.006</i>	<i>0.010</i>	<i>0.005</i>	<i>0.007</i>	<i>0.029</i>
<i>diluted loss per share</i>	<i>0.006</i>	<i>0.010</i>	<i>0.005</i>	<i>0.007</i>	<i>0.028</i>
2003					
Revenue	nil	nil	nil	nil	nil
Administrative & general expenses	106,607	128,392	142,415	122,349	499,763
Write down of mineral property				6,500,000	6,500,000
Future income tax (reduction) payable	117,156	96,298	13,200	-2,852,295	-2,625,641
Loss for period	223,763	224,690	155,615	3,770,054	4,374,122
Share issue expense			-2,223		-2,223
Deficit for period	223,763	224,690	153,392	3,770,054	4,371,899
<i>loss per share</i>	<i>0.007</i>	<i>0.003</i>	<i>0.004</i>	<i>0.107</i>	<i>0.132</i>
<i>diluted loss per share</i>	<i>0.007</i>	<i>0.003</i>	<i>0.004</i>	<i>0.105</i>	<i>0.129</i>

SUMMARY OF QUARTERLY RESULTS

	1st Quarter \$	2nd Quarter \$	3rd Quarter \$	4th Quarter \$	Year \$
CASH FLOW					
2002					
Share subscriptions, less commissions	176,467	252,152	71,901	145,677	646,196
Expenditures					
Administrative & general expenses	120,547	200,872	144,855	160,408	626,681
Mineral property expenditures	81,221	89,710	141,198	178,012	490,141
	<u>201,768</u>	<u>290,582</u>	<u>286,053</u>	<u>338,420</u>	<u>1,116,822</u>
Change in working capital	<u>-25,301</u>	<u>-38,430</u>	<u>-214,152</u>	<u>-192,743</u>	<u>-470,626</u>
2003					
Share subscriptions, less commissions	266,266	234,690	47,224	nil	548,179
Expenditures					
Administrative & general expenses	106,117	128,392	142,414	122,350	499,273
Mineral property expenditures	110,843	75,310	132,361	217,429	535,943
	<u>216,960</u>	<u>203,702</u>	<u>274,775</u>	<u>339,779</u>	<u>1,035,216</u>
Change in working capital	<u>49,306</u>	<u>30,988</u>	<u>-227,551</u>	<u>-339,779</u>	<u>-487,037</u>