Darnley Bay Resources Limited
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MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEAR ENDED DECEMBER 31, 2004

This Management Discussion and Analysis should be read along with the audited financial statements of the Company for the year ended December 31, 2004.

INTRODUCTION

Darnley Bay Resources (the Company) was incorporated in 1993 for the purpose of acquiring exploration rights to and to explore what is known as the Darnley Bay Anomaly in the area of, and surrounding, the Hamlet of Paulatuk in the Northwest Territories of Canada. The initial target of the exploration was base metals but subsequently with the discovery of kimberlite, the host rock for diamonds, exploration has been extended to cover diamonds also.

The area hosts the strongest isolated gravity anomaly in North America. Furthermore, the anomaly has not been systematically explored and there is the potential for a mafic-ultramafic complex such as exists in the Sudbury Basin anomaly in Ontario or at Norilsk in Russia. The area is within the Inuvialuit Settlement Region. The governing body of this area is the Inuvialuit Land Corporation (ILC), the consent of which must be obtained to operate within the area. Please refer to Note 3 to the Financial Statements as at December 31, 2004 for a summary of the Company's operating agreement with the ILC. Also in the NWT of Canada is the Lac de Gras corridor which is the location of Canada's two operating diamond mines.

An investment in the Company's shares is highly speculative and subject to significant risks. The Company is a mineral exploration company. Its mineral property does not contain a known body of commercial ore. There is no assurance that a commercial ore body will be discovered and, even if discovered, will be feasible to develop. Certain permits are required to carry out the exploration and there is no guarantee that the required permits will be obtained.

Ongoing funding is required for the purpose of continuation of exploration. While further funding is anticipated through equity sales from time to time, there is no assurance that such funds will be raised. In addition, not being an established mining company, the Company has no history of revenues, cash flow or earnings from operations. Preliminary success in the Company's exploratory operations depends upon its cash resources.

SUMMARY OF OPERATIONS TO DATE

The source of funding for the Company's mining exploration is the venture capital market. From inception of the Company in 1993 up to mid 2001, the Company obtained some $16.7 million, net of share issue costs, through combination of sources; initially from founding investors, followed by two public offerings and subscriptions through rights and private placements.

With these funds, the Company commenced its exploration program in 1997 with an aeromagnetic survey undertaken to determine targets for exploration for base metals. From the aeromagnetic survey, seven ground targets were selected and test drilling was undertaken in the Thrasher Zone, one of the seven selected targets. The first drill hole, after reaching about 6,000 feet, was suspended for technical reasons before reaching the target. However, the drill hole did clarify much of the geological picture of the gravity/magnetic anomaly and the plan is to resume the drilling for base metals in the other six targets. The aeromagnetic survey also detected possible kimberlite pipes, the host rock for diamonds and subsequently diamonds were discovered in till sampling and consequently the Company has extended its exploration to cover diamonds in addition to base metals.

In its exploration, De Beers Exploration and Falconbridge Limited assisted the Company financially and technically.

For continuation of exploration, in 2001 the Company sought additional funds through a rights issue to shareholders The rights offering raised only a modest $185,000, which was an indication of the depressed state of market for securities in the post September 11th (9/11) period.

While subsequently there has been some recovery in the venture capital market, the recovery has not been consistent and the Company has relied 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.

As disclosed by Note 3 to the December 31, 2004 financial statements and in this MD&A under "Financial Review", some of the Company's rights under an agreement with the Inuvialuit ended and certain of the lands in the area of mutual interest have been abandoned.

In conjunction with a joint venture diamond exploration program with Diadem Resources, outlined below, in February 2004 a new agreement with the ILC was made covering diamond exploration in the Area of Mutual Interest. This agreement is summarized in the Note 3 to the financial statements.

The Company continues to seek the requisite funding to resume exploration for base metals and in conjunction therewith is renegotiating its earlier agreements with the ILC covering exploration for base metals.

DIAMOND EXPLORATION & JOINT VENTURE AGREEMENT

As disclosed above, the aeromagnetic survey undertaken to determine targets for base metals also detected possible kimberlite pipes, the host rock for diamonds and subsequently diamonds were discovered in till samples. In recent years there has been very strong interest in Canada with respect to the mining of diamonds, in particular with diamond discoveries and establishment of mines in the Lac de Gras corridor in the NWT of Canada. Consequently the Company has extended its exploration to cover diamonds in addition to base metals.

With the discovery of diamonds, on June 24, 2003 the Company entered into a joint venture agreement with Carnarvon Capital Corporation for diamond exploration and subsequently, on November 26, 2003, the Company agreed to the transfer of the agreement with Carnarvon to Diadem Resources Ltd. Subsequently, on March 16, 2005, revisions to the agreement with Diadem were made. For an outline of the agreement with Diadem as revised, and an associated agreement with the ILC (the governing body of the area under exploration), please refer to Note 3 "Agreements & Mineral Property and Related Expenditures" to the Company's December 31, 2004 financial statements or www.sedar.com.

In summary, the joint venture with Diadem covers an area of approximately 8 million acres near Paulatuk in the Northwest Territories To obtain a 50% participation in exploration for diamonds with the Company, Diadem was committed to spend $5 million by June 30, 2006, subsequently extended to December 31, 2006. To mid 2005, Diadem has expended approximately $900,000. The revised agreement of March 16, 2005 reduces the financial commitment to an additional $2.1 million, from the estimated $900,000 spent to date and extends the expiry date to December 31, 2007. Also previously explorations north of the 68th parallel was covered financially 100% by Diadem up to the initial obligation for $5 million and south of the 68th parallel jointly (50/50) by both companies. Under the restructure, the joint venture is applicable only north of the 68th parallel. In addition to the joint venture agreement, the two partners have a commitment with the ILC for minimum project expenditures. On March 1, 2005 the minimum of $2 million was extended from June 30, 2005 to September 30, 2005.

The current expenditures for diamonds, although undertaken by Diadem, ***are for the joint benefit of both companies*** and with respect to Darnley Bay are classified as "off-balance sheet financing". Although the current diamond exploration program is being undertaken by Diadem, any resulting benefits accrue to both companies. The joint venture commenced with the granting of prospecting permits by the Department of Energy & Mines in February 2004 followed by staking and ground magnetic surveys covering 22 potential kimberlite targets. Diadem, in its November 30, 2005 MD&A distributed to its shareholders, reports its exploration in 2004 under the joint venture, (described as the Franklin project) as follows:

> "During March and April 2004, Diadem staked 459 claims comprising an area of approximately 1,120,071 acres. During May and June 2004, the Company completed a ground magnetic survey over 22 potential kimberlite targets, as well as one known kimberlite.
> Survey data continues to be further processed and evaluated. Geophysical modelling of selected

> priority targets will be completed as a prelude to drill testing targets."

And subsequently on March 17, 2005, with the revisions to the joint venture agreement as outlined above, Diadem outlined exploration for 2005 as follows:

> "exploration on the Franklin diamond exploration project has commenced with the mobilization of a Fugro Airborne Surveys Ltd. airborne geophysical survey aircraft and crew to the community of Paulatuk, NT. Fugro has been retained to complete an airborne magnetic gradiometer survey of the property. The survey, consisting of some 50,000 line km, will initially focus on the Parry Peninsula Kimberlite Field and complete a 100 meter in-fill survey over the known kimberlite field with 200 meter coverage over selected areas of interest north of the 68th parallel. The geology of the project area is such that it facilitates direct targeting by airborne geophysics. Priority targets will be the subject of detailed ground investigation during the 2005 summer months with the objective of delineating priority targets for subsequent drill testing.".

FINANCIAL REVIEW - YEARS 2002 TO 2004

The annual and quarterly financial statements are available electronically on SEDAR (http://www.sedar.com) or upon request to the Company. The financial statements provide a quarterly, year to date and cumulative (from inception of the company) accounting for all expenditures and cash flows. In addition to the Balance Sheet, the statements consist of "Statement of Mineral Properties and Related Expenditures" covering exploration expenditures, "Statement of Loss and Deficit" covering administrative expenses and costs applicable to the issue of shares and "Statement of Cash Flows".

The Company has no operating revenues and relies solely on investors' subscriptions to shares with which to finance its exploration and administrative functions. The Company's financial statements are prepared in accordance with Canadian generally accepted accounting principles (Canadian "GAAP"). Administrative expenses are charged to operations as incurred and mineral property and related exploration expenditures are capitalized and deferred until the start of commercial mining operations when they will be amortized on the unit of production basis.

Attached as Schedule 1 is "SELECTED FINANCIAL INFORMATION" which summarizes the Company's "Loss & Deficit", "Balance Sheet" and "Cash Flow" for the past three years, 2002 to 2004. This financial presentation illustrates the reliance of the Company on investors' subscriptions to shares for financing its exploration program A "SUMMARY OF QUARTERLY RESULTS", is also attached as Schedule 2 which provides a quarterly analysis supporting the "Loss & Deficit" for the past eight quarters.

As disclosed in the "Introduction" to this MD&A, the area covered by the Company's exploration for base metals is governed by the ILC. In 2003 some of the Company's rights under its agreements with the ILC ended and consequently certain of the lands have been abandoned for exploration. Therefor the Company in 2003 wrote down its deferred mineral property expenditures by $6.5 million. Under the revised joint venture agreement with Diadem covering exploration for diamonds, the Company will retain its interest in diamond exploration north of the 68th parallel and abandon exploration south of the 68th parallel. This has resulted in a write down in 2004 of exploration costs attributable to the abandoned area of $197,000.

The Company provides for future income taxes applicable to mineral property expenditures renounced to shareholders on the issue of flow-through shares from time to time. The reduction of these taxes by $2,712,197 in 2003 and 2004 is that applicable to the "flow-through" portion of the $6.7 million of exploration expenditures written off in 2003 and 2004. No flow-through shares were issued in the year 2004 and as indicated by the balance sheet as at December 31, 2004 the liability for future income taxes is $867,145.

Exploration activities in 2004 concentrated on diamonds. Although exploration was undertaken chiefly by Diadem, the Company through the joint venture agreement will be a beneficiary with anticipated success in the exploration for diamonds. For base metals, the Company continues to seek the requisite funding to resume its exploration and is renegotiating its earlier agreements with the Inuvialuit Land Corporation (ILC) for the exploration of base metals and diamonds in the area where the ILC own the mineral rights.

The Company's current financial position is illustrated by Schedule 1, "Financial Summary", which discloses a working capital deficit of $1,830,444 as at December 31, 2004 compared with a working capital deficit of $1,494,359 as at December 31, 2003. Although $335,673 in funding was obtained in 2004 through private placements, it was not sufficient to cover ongoing overheads, $463,379 applicable to general administration and $208,379 to exploration.

LIQUIDITY AND CAPITAL RESOURCES

The Company is an exploration company and has no source of revenue. It relies on ongoing subscriptions for share capital from investors with which to finance its exploration and to cover day to day administrative expenses. As noted previously the Company currently has a working capital deficit of about $1.8 million. Currently it is seeking additional subscriptions through private placements for the purposes of both working capital and to recommence its exploration programs.

On the positive side, to date the Company has raised $16.7 million (net of costs of issuing shares) through subscriptions to share capital. With current signs of positive trends in venture financing, rising prices for base metals and the development of diamond operations in Canada, the Company anticipates a return to its previous track record for raising funds by share subscriptions.

TRANSACTIONS WITH RELATED PARTIES

Related party transactions consist of compensation paid, or payable, to the Company's senior officers and directors for management and professional services. The lack of available funds restricts cash compensation on a regular basis and settlement of arrears has been made from time to time, in the past, by the issue of common shares, issued at prevailing market values or greater. The Company's accounts includes the following compensation to the related parties for 2004 and 2003 and the balances remaining unpaid to them as at December 31, 2004.

	Year 2004	Year 2003	Unpaid
Chief executive officer / director	$100,000	$102,000	$ 164,939
Chief financial officer	$78,000	$79,500	$98,998
Corporate secretary / director	$31,725	$48,510	$40,158
Director (geophysicist)	$13,571	$60,025	$13,571
Director (lawyer)	$52,425	$38,500	$62,371

OUTSTANDING SHARE DATA

The Company's authorized capital consists of an unlimited number of common shares. There are no other class of shares authorized. All common shares have equal voting rights. As at December 31, 2004 there were 37,116,606 outstanding common shares issued for a recorded amount of $18,006,510 and at December 31, 2003 there were 35,324,107 outstanding shares for a recorded amount of $17,670,837

On November 5, 2004, pursuant to its stock option plan, the Company granted options on 3.6 millon shares to its directors and officers for an issue price of $0.13 per share. The shares are not exercisable until May 4, 2005 and expire on November 4, 2009.

Under the joint venture agreement, Carnarvon Capital Corporation, the predecessor of Diadem Resources as the joint venture partner, will be granted 500,000 common shares upon completion of its first $2 million of expenditures applicable to the joint venture.

SCHEDULE 1

SELECTED ANNUAL INFORMATION

LOSS & DEFICIT	Year ended December 31		
	2004	2003	2002
	$	$	$
Revenue	nil	nil	nil
Administrative and general expenses	463,379	499,273	626,681
Write down of mineral property expenditures	196,718	6,500,000	
Future income tax (reduction) payable	(86,556)	(2,625,641)	231,038
Loss for year	573,541	4,373,632	857,719
loss per share	*0.016*	*0.132*	*0.029*
diluted loss per share	*0.016*	*0.129*	*0.028*
Share issue expense (recovery)	nil	(2,223)	(14,196)
Deficit at beginning of year	13,729,248	9,357,839	8,514,316
Deficit at end of year	14,302,789	13,729,248	9,357,839

BALANCE SHEET	as at December 31		
	2004	2003	2002
	$	$	$
Current assets and deposits	246,915	464,332	206,789
Less payables and advances	(2,077,359)	(1,958,691)	(1,214,111)
Working capital deficit	(1,830,444)	(1,494,359)	(1,007,322)
Mineral property and related expenditures	6,401,310	6,389,649	12,353,706
Less applicable income taxes	(867,145)	(953,701)	(3,579,342)
Net assets	3,703,721	3,941,589	7,767,042
Share capital	18,006,510	17,670,837	17,124,881
Deficit	(14,302,789)	(13,729,248)	(9,357,839)
Net equity	3,703,721	3,941,589	7,767,042

CASH FLOW	Year ended December 31		
	2004	2003	2002
	$	$	$
Funds received from subscriptions for shares (net of commissions)	335,673	548,179	646,196
Less disbursements on			
exploration	208,379	535,943	490,141
administration	463,379	499,273	626,681
Total disbursements	671,758	1,035,216	1,116,822
(Decrease) in working capital	(336,085)	(487,037)	(470,626)
Working capital (deficit) at beginning of year	(1,494,359)	(1,007,322)	(536,696)
Working capital (deficit) at end of year	(1,830,444)	(1,494,359)	(1,007,322)

SCHEDULE 2

SUMMARY OF QUARTERLY RESULTS

	1st Quarter $	2nd Quarter $	3rd Quarter $	4th Quarter $	Year $
LOSS & DEFICIT					
Year 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
loss per share	*0.007*	*0.003*	*0.004*	*0.107*	*0.132*
diluted loss per share	*0.007*	*0.003*	*0.004*	*0.105*	*0.129*
Year 2004					
Revenue	nil	nil	nil	nil	nil
Administrative & general expenses	100,951	125,753	130,608	106,067	463,379
Write down of mineral property	nil	nil	nil	196,718	196,718
Future income tax (reduction) payable	nil	nil	nil	(86,556)	(86,556)
Loss for period	100,951	125,753	130,608	216,229	573,541
Share issue expense					
Deficit for period	100,951	125,753	130,608	216,229	573,541
loss per share	*0.003*	*0.003*	*0.004*	0.006	0.016
diluted loss per share	*0.003*	*0.003*	*0.004*	0.006	0.016
CASH FLOW					
Year 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
	216,960	203,702	274,775	339,779	1,035,216
Change in working capital	49,306	30,988	(227,551)	(339,779)	(487,037)
Year 2004					
Share subscriptions, less commissions	116,443	nil	219,230	nil	335,673
Expenditures					
Administration	100,951	125,753	130,608	106,067	463,379
Mineral property expenditures	45,387	52,405	50,528	60,059	208,379
	146,338	178,158	181,136	166,126	671,758
Change in working capital	(29,895)	(178,158)	38,094	(166,126)	(336,085)