

DARNLEY BAY RESOURCES LIMITED

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REPORT TO SHAREHOLDERS FOR YEAR ENDED DECEMBER 31, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEAR ENDED DECEMBER 31, 2005

Please read this MD&A along with the audited financial statements of the Company for the years ended December 31, 2005 and 2004. Additional information about us is on our web site www.darnleybay.com.

SUMMARY

The Company is exploring for base metals and diamonds in the Northwest Territories, Canada.

The Company has a diamond joint venture agreement with Diadem Resources Limited under which Diadem, by doing certain exploration work within a stated time, can earn an interest in the Company's diamond project. In conjunction with the joint venture agreement, Darnley Bay/Diadem has a cooperation/benefits agreement with the Inuvialuit Land Corporation. These agreements are described in Note 3 to the financial statements.

During 2005, Diadem carried out exploration work in the joint venture area. This included 52,000 line-kms of an airborne magnetic survey and the processing of 223 till samples. Heavy mineral concentrates were examined for the presence of kimberlite indicator minerals. The first 44 collected samples show an additional 11 highly-rated kimberlite targets which have been added to previous results from exploration. Chemical analysis of the till samples is pending.

FINANCIAL REVIEW

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 accounting for all expenditures and cash flows. In addition to the "Balance Sheet", included are statements of "Mineral Properties and Related Expenditures" covering exploration expenditures, "Loss and Deficit" covering administrative expenses and costs applicable to the issue of shares and "Cash Flows".

As an exploration company, Darnley Bay has no operating revenues. It relies on joint venture participation and/or equity financing for exploration and administrative functions. As at December 31, 2005, the Company had a working capital deficit of about \$2.2 million which includes \$1.1 million payable to the Inuvialuit and about \$663 thousand to related parties. The Company will make proposals to creditors to deal with its liabilities. Also it will seek participation with other exploration companies and/or equity financing.

Mineral exploration is speculative, involves risks, and frequently is non-productive. There is no assurance that the Company's exploration efforts will succeed in establishing reserves. Success is the result of a number of factors, including the quality of management, level of geological and technical expertise, the quality of land available for exploration, and other factors. Once mineralization is discovered, it may take several years in the initial phases of exploration until a decision can be made that production is possible; during this time the economic feasibility of production may change. Due to these uncertainties regarding the company's mineral prospects commitments, in 2005 the Company wrote off its investment in its exploration properties

The attached schedules, Schedule 1 "Selected Annual Information" and Schedule 2 "Summary of Quarterly Results" provides a summary of the Company's financial operations for the past two years. In the two year period, share subscriptions of \$335 thousand, all received in 2004, was insufficient to cover total expenditures of \$1,079,000 resulting in an increase in the working capital deficit by \$744 thousand; \$1,494,000 at December 31, 2003 and \$2,238,000 at December 31, 2005.

Current expenditures include charges for rent, stock transfer and legal and audit services, interest payable to the Inuvialuit and other creditors and ongoing technical reviews conducted by various professionals. The professional services are being provided chiefly by the Company's senior officers and directors, and as disclosed by the "Transactions With Related Parties" (see below), payments to senior officers and directors have been deferred.

The loss for the year increased to \$6,140,403 from \$573,541 in 2004 mainly because of a write-down of mineral properties in the amount of \$6,467,111 (2004 - \$196,718). Rent was \$46,364 vs \$126,627 in 2004. Interest increased to \$99,819 in 2005 from \$23,997 in 2004. As a result of the mineral properties write-down there was a future income tax recovery of \$867,145 (2004 - \$86,556).

As disclosed by Note 2 to the financial statements, a new charge to operations is that in connection with options granted to officers and directors. When options are granted, an estimate is made of the fair present value of the options, and this estimate is recorded as an operating expense when the option take effect. This charge to operations, which is "non cash", has been recorded at \$199,000 in 2005.

LIQUIDITY AND CAPITAL RESOURCES

The Company is an exploration company and has no source of revenue. It relies on joint venture participation and/or equity financing for exploration and day to day administrative expenses. As noted previously the Company currently has a working capital deficit of about \$2.2 million. With the current signs of positive trends in venture financing, rising prices for base metals and the development of diamond operations in Canada, the Company anticipates raising funds by joint venture participation and/or equity funding.

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 2005 and 2004 and the balances remaining unpaid to them as at December 31, 2005.

Chief executive officer / director	2005	\$108,000	2004	\$100,000	\$329,250 unpaid
Chief financial officer	2005	\$ 79,500	2004	\$78,000	\$178,498 unpaid
Corporate secretary / director	2005	\$ 10,920	2004	\$31,725	\$ 42,843 .unpaid
Director (geophysicist)	2005	\$ 20,400	2004	\$13,571	\$ 20,954 unpaid
Director (lawyer)	2005	\$ 75,000	2004	\$52,425	\$ 84,335 unpaid
Director (geologist)	2005	\$ 4,187	(appointed 2005)		\$ 7,400 unpaid

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, 2005, and December 31, 2004, there were 37,116,606 outstanding common shares issued for a recorded amount of \$18,006,510. No shares were issued in 2005.

On November 5, 2004, pursuant to its stock option plan, the Company granted options on 3.6 million shares to its directors and officers for an issue price of \$0.13 per share and subsequently on August 25, 2005 it granted additional options on 100,000 shares to a director for an issue price of \$0.10 per shares. To date these options have not been exercised, The options expire on November 4, 2009.

Under the joint venture agreement with Diadem (see Note 3 to the financial statements) the Company will issue 500,000 common shares to Carnarvon Capital Corporation, the predecessor to Diadem as the joint venture partner, upon completion of its first \$2 million of expenditures applicable to the joint venture. Diadem estimates that approximately \$1.7 million has been expended to date.

Fully diluted, the shares issued and to be issued are 41,316,606 shares.

FORWARD-LOOKING STATEMENTS

Some of the statements in this discussion and analysis may be forward-looking. They are based on current expectations and are subject to known and unknown risks, uncertainties and other factors that may cause the actual results to differ from future results. The Company is subject

to a number of risk factors due to the nature of the mining business in which it is engaged, the limited extent of its assets, and the present stage of development, These include the following.

COMMODITY PRICES AND VOLATILITY

The Company's business is to explore and develop base metal and diamond properties. The Company's ability to attract capital depends on movements in the price of these commodities.

Prices fluctuate daily, and are affected by factors beyond the Company's control. If, due to a sustained decline in these prices, financing was not available to meet costs, the Company would evaluate the feasibility of continuing operations, and, if warranted, it would discontinue operations. Although these prices cannot be predicted with certainty, the Company monitors supply/demand conditions, among other issues, all of which affect world prices.

LICENSES AND PERMITS

The Company's operations require permits from government and other authorities. The Company believes that, for its present operations, it holds all necessary permits under applicable regulations and believes that it is complying with their terms. However, permits are subject to change in various circumstances. The Company cannot guarantee that it will be able to obtain or maintain all necessary licenses and permits that it may need to explore and develop its properties, to commence construction or operation of mining facilities and properties under exploration or development, or to maintain continued operations that economically justify the cost.

April 27, 2006

SELECTED ANNUAL INFORMATION

LOSS & DEFICIT	Year ended December 31		
	2005	2004	2003
	\$	\$	\$
Revenue	nil	nil	nil
Administrative and general expenses	341,407	463,379	499,273
Stock option compensation	199,030		
Write down of mineral property expenditures	6,467,111	196,718	6,500,000
Future income tax (reduction) payable	(867,145)	(86,556)	(2,625,641)
Loss for year	6,140,403	573,541	4,373,632
<i>loss per share</i>	<i>0.17</i>	<i>0.016</i>	<i>0.132</i>
<i>diluted loss per share</i>	<i>0.17</i>	<i>0.016</i>	<i>0.129</i>
Share issue expense (recovery)		nil	(2,223)
Deficit at beginning of year	14,302,789	13,729,248	9,357,839
Deficit at end of year	20,443,192	14,302,789	13,729,248
BALANCE SHEET	as at December 31		
	2005	2004	2003
	\$	\$	\$
Current assets and deposits	239,262	246,915	464,332
Less payables and advances	(2,476,915)	(2,077,359)	(1,958,691)
Working capital deficit	(2,237,653)	(1,830,444)	(1,494,359)
Mineral property and related expenditures	1	6,401,310	6,389,649
Less applicable income taxes		(867,145)	(953,701)
Net assets	(2,237,652)	3,703,721	3,941,589
Share capital	18,006,510	18,006,510	17,670,837
Stock options	199,030		
Deficit	(20,443,192)	(14,302,789)	(13,729,248)
Net equity	(2,237,652)	3,703,721	3,941,589
CASH FLOW	Year ended December 31		
	2005	2004	2003
	\$	\$	\$
Funds received from subscriptions for shares (net of commissions)	nil	335,673	548,179
Less disbursements on exploration	65,802	208,379	535,943
administration	341,407	463,379	499,273
Total disbursements	407,209	671,758	1,035,216
(Decrease) in working capital	(407,209)	(336,085)	(487,037)
Working capital (deficit) at beginning of year	(1,830,444)	(1,494,359)	(1,007,322)
Working capital (deficit) at end of year	(2,237,653)	(1,830,444)	(1,494,359)

SUMMARY OF QUARTERLY RESULTS

	1st Quarter \$	2nd Quarter \$	3rd Quarter \$	4th Quarter \$	Year \$
LOSS & DEFICIT					
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
<i>loss per share</i>	<i>0.003</i>	<i>0.003</i>	<i>0.004</i>	<i>0.006</i>	<i>0.016</i>
<i>diluted loss per share</i>	<i>0.003</i>	<i>0.003</i>	<i>0.004</i>	<i>0.006</i>	<i>0.016</i>
Year 2005					
Revenue	nil	nil	nil	nil	nil
Administrative & general expenses	82,004	151,667	59,293	247,473	540,437
Write down of mineral property	nil	nil	nil	6,467,111	6,467,111
Future income tax (reduction) payable	nil	nil	nil	(867,145)	(867,145)
Loss for period	82,004	151,667	59,293	5,847,439	6,140,403
Share issue expense	nil	nil	nil	nil	nil
Deficit for period	82,004	151,667	59,293	5,847,439	6,140,403
<i>loss per share</i>	<i>0.002</i>	<i>0.004</i>	<i>0.002</i>	<i>0.17</i>	<i>0.009</i>
<i>diluted loss per share</i>	<i>0.002</i>	<i>0.004</i>	<i>0.001</i>	<i>0.17</i>	<i>0.009</i>
CASH FLOW					
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)
Year 2005					
Share subscriptions, less commissions	nil	nil	nil	nil	nil
Expenditures					
Administration (ex stock option compensation)	82,004	75,067	57,193	127,143	341,407
Mineral property expenditures	34,291	48,290	39,127	(55,906)	65,802
	116,295	123,357	96,320	71,237	407,209
Change in working capital	(116,295)	(123,357)	(96,320)	(71,237)	(407,209)