

DARNLEY BAY RESOURCES LIMITED

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Management's Discussion and Analysis for the year-ended December 31, 2006

GENERAL

Darnley Bay Resources Limited was formed in 1993 to explore and develop an area of geophysical significance in the Northwest Territories of Canada. Base metal exploration fortuitously resulted in the discovery of diamonds and the area is now host to both metallic and non-metallic mineral deposit interests. The Company's objectives are to secure and maintain successful financing partnerships to continue exploration for both base metals and diamonds resulting in the development of a profitable mining camp.

SELECTED ANNUAL INFORMATION

	<i>2006</i>	<i>2005</i>	<i>2004</i>
Net loss (in thousands)	305	6,140	574
Loss per common share	0.01	0.16	0.16
Total assets (in thousands)	38	239	6,648
Shareholders' equity (in thousands)	(2,402)	(2,238)	3,704

BALANCE SHEET AND OPERATIONS

At December 31, 2006, assets totaled \$38,338 compared to \$239,263 at the 2005 year-end. A deposit of \$83,468 on mining permits advanced by the Company's joint venture partner and an environmental security deposit of \$150,000 were forfeited during the year. During the year, the Company has not capitalized any mineral property expense (\$73,433 in 2005). The Company has incurred a continuing evaluation cost of future involvement in the project. The current liability decreased to \$2,440,178 from \$2,476,915 at the 2005 year-end. The Company issued 468,146 common shares through a debt conversion at \$0.15 per share and 705,000 shares by private placement at \$0.10 per share resulting in an increase in capital stock of \$140,722 for the year (nil in 2005). The existing stock options incurred a stock-based compensation expense of \$199,030 in 2005. The options granted in 2006 did not incur this expense prior to the year-end as they did not vest in the period. The Company reported a net loss at December 31, 2006 of \$305,410 compared to \$6,140,403 in 2005 when a large portion of the mineral property cost was written down. The ongoing corporate and general expenses required to run a public company continue to be monitored closely.

LIQUIDITY AND CAPITAL RESOURCES

The Company is an exploration and development company and has no revenue. At December 31, 2006, the Company had cash resources of \$35,655 compared to \$3,808 at the 2005 year-end. There were 705,000 shares issued through private placements at \$0.10 per share on October 23, 2006. The Company has a working capital deficit of \$2,402,341 compared to \$2,471,121 at year-end 2005 and an accumulated deficit of \$20,748,602 (\$20,443,192 at the 2005 year-end). The Company is actively working to reduce liabilities through ongoing negotiations with primary creditors. During the year, a \$70,222 debt was settled through conversion to shares at \$0.15 per share. Further debt settlement is planned where allowable.

The Company is in partnership with Diadem Resources Ltd. to ensure the continuation of the diamond exploration program and is seeking additional funding through equity financing for the base metal project. On March 8, 2007, an amount of \$378,000 was received through the exercise of options and on March 26, 2007, the Company received final approval for private placements for which gross proceeds of \$684,101 were received.

The Company's current funding objective is to support a base metal exploration program that will include a review of the available geological and geophysical data relating to the area of interest and to drill the intrusive, and potential sulphide deposit, at its shallowest point. To enable the Company to carry out its plan, additional funds are now being sought. The Company's ability to raise the capital resources to undertake this objective is dependent on the venture capital market, metal prices and the replacement of a former agreement allowing access to the property for the purpose of base metal exploration.

SUMMARY OF QUARTERLY RESULTS

<i>For the quarter ended</i>	<i>Dec. 31</i> <i>2006</i>	<i>Sep. 30</i> <i>2006</i>	<i>Jun. 30</i> <i>2006</i>	<i>Mar. 31</i> <i>2006</i>
Net loss (in thousands)	305	469	229	102
Loss per common share	0.01	0.01	0.001	0.001
Total assets (in thousands)	38	210	159	237
Shareholders' equity (deficiency) (in thousands)	(2,402)	(2,487)	(2,466)	(2,340)

<i>For the quarter ended</i>	<i>Dec. 31</i> <i>2005</i>	<i>Sep. 30</i> <i>2005</i>	<i>Jun. 30</i> <i>2005</i>	<i>Mar. 31</i> <i>2005</i>
Net loss (in thousands)	6,140	59	152	82
Loss per common share	0.165	0.002	0.004	0.002
Total assets (in thousands)	239	6,813	6,731	6,684
Shareholders' equity (in thousands)	(2,238)	3,489	3,547	3,622

ANALYSIS OF MINERAL PROPERTY EXPENDITURES

	<i>2006</i>	<i>2005</i>
Project management	-	58,667
Project consulting fees	-	11,016
Property access and services	<u>-</u>	<u>3,750</u>
	-	73,433

ANALYSIS OF CORPORATE AND GENERAL EXPENSES

	<i>2006</i>	<i>2005</i>
Project evaluation and management services	113,864	22,000
Stock based compensation	-	199,030
Accounting services	49,120	79,500
Premises rent	46,307	25,648
Audit fees	24,475	23,760
Legal fees	97,731	21,964
Office services & supplies	32,158	7,459
Administration services	40,587	28,253
Stock transfer/exchange fees	21,719	23,167
Shareholder communication	19,151	9,836
Interest	53,533	99,818
Miscellaneous	<u>1,068</u>	<u>-</u>
	499,713	540,435

COMMON SHARES ISSUED

Common shares issued at the year-end 2006 were 38,289,752 (37,116,606 at the year-end 2005). During the year, 468,146 shares were issued at \$0.15 through the conversion of \$70,222 in debt and 705,000 were issued at \$0.10 per share through a private placement (no shares were issued in 2005). In 2005 share purchase options were granted to directors, officers and consultants at an exercise price of \$0.13 (3,60,000) and \$0.10 (100,000) expiring on November 4, 2009 and in accordance with the Company's Stock Option Plan (see note 5c of the interim financial statements). During the year, 500,000 options were forfeited by a former director of the Company, 220,000 options were granted at an exercise price of \$0.15 and 400,000 were granted at \$0.13 for a total at the year-end of 3,820,000. All options granted at the year-end are exercisable up to November 4, 2009. The Company will make 500,000 shares available to Carnarvon Capital Corporation when the Darnley Bay/Diadem diamond joint venture meets a \$2 million exploration expenditure target. The Company has 41,866 shares in escrow. At the time of this report an additional 2,930,770 share were issued through the exercise of options at \$0.13 (2,830,770) and \$0.10 (100,000) and 4,560,672 shares were issued at \$0.15 through unbrokered private placements. The total number of issued shares is 45,781,194. On March 30, 2007, 1,580,000 options were granted to directors and a consultant with an exercise price of \$0.25 for up to two years.

ACCOUNTING POLICIES

The Company's accounting methods are based upon Canadian Generally Accepted Accounting Principles (GAAP) applicable to resource issuers, which are applied on a consistent basis. These are outlined in full detail in note 2 of Company's audited financial statements for the year ended December 31, 2006.

The recovery of amounts capitalized as Mineral Property expenditures is dependent upon the discovery of economically recoverable ore reserves, the ability of the Company to obtain necessary financing to explore and develop potential ore reserves, future profitable production, or alternatively, upon the Company's ability to dispose of its interests on an advantageous basis. At the 2005 year end, the carrying value of the mineral exploration property was considered unrecoverable and written down to \$1 due to uncertainties in financing. In 2006, the Company continued to retain an interest in its property and looks to future funding opportunities and ongoing exploration for both base metals and diamonds.

The Company uses the fair value method of accounting for all stock options awarded. Compensation expense is recognized based on the fair value of the option on the date of the grant and is expensed over the vesting period of the option (see note 5c of the 2006 annual statement)

RELATED PARTY TRANSACTIONS

Technical and administrative support is received from directors and officers of the Company. In the absence of financial resources to pay for these services, the allowable issuance of common shares for debt is undertaken. During the year, amounts charged for management fees by La Prairie Ltd. (controlled by Leon La Prairie, CEO/director) were \$48,000 (\$46,000 in 2005). Mr. La Prairie charged \$63,500 for consulting services (2005 - \$52,000). Accounting services were provided in the amount of \$25,500 during the year (\$79,500 in 2005) by the Company's former CFO, Richard La Prairie. La Prairie received 468,146 shares through a debt conversion at \$0.15 per share, additional shares or cash will be issued to eliminate a balance of \$134,000 owing to La Prairie. William Allen, director, provided legal services to the Company during the year in the amount of \$97,731 (21,964 in 2005). Patricia Mannard provided corporate maintenance and accounting management services in the amount of \$23,620 (\$12,520 in 2005). John Dowsett, a director, provided geophysical and project development services in the amount of \$13,175 (\$6,829 in 2005). George Kent, a director, provided geological consulting services in the amount of \$3,860 (\$4,188 in 2005). Kent was granted 400,000 options exercisable at \$0.13. As at September 30, 2006, accounts payable to the above total \$753,502 (2005 - \$663,280).

In the period covered by this report and following the year-end, options were exercised by Leon La Prairie (1,000,000 at \$0.13), Allen (800,000 at \$0.13), Mannard (500,000 at \$0.13), Richard La Prairie (300,000 at \$0.13), Dowsett (230,770 at \$0.13) and Kent (100,000 at \$0.10). Leon La Prairie, CEO, was granted 1,000,000 options exercisable at

RELATED PARTY TRANSACTIONS continued

\$0.25 up to July 31, 2009 and Mannard, CFO, was granted 500,000 options with the same terms.

COMMITMENTS

Note 3 of the financial statements for the year ended December 31, 2006 covers both the governing agreements with the Inuvialuit Land Corporation and the joint venture agreement with Diadem Resources Ltd. for exploration of diamonds.

Effective November 26, 2003 the Company entered into an agreement to form a joint venture with Diadem Resources Ltd., formerly an agreement held with Carnarvon Capital Corporation, to operate diamond exploration in an area near Paulatuk in the Northwest Territories. Diadem has not met earn in requirements outlined in the agreement at the time of this report.

The joint venture entered into a letter agreement with the Inuvialuit Regional Corporation allowing access to the property that lies within the Inuvialuit Settlement Region. The Company's joint venture partner has, at the time of this report, not confirmed that the conditions of the agreement have been met however; the Company has not received a notice of default as required by the agreement.

CORPORATE GOVERNANCE

On February 22, 2007, the Company filed its Corporate Governance Policy document with the TSX Venture Exchange and on www.sedar.com.

RISKS AND UNCERTAINTIES

The inherent risks, which most profoundly affect the Company's activities, are metal prices and the ability of the Company to obtain venture capital necessary to establish economic ore reserves. Further, the Company is relying on its joint venture partner to fulfill its obligations as operator of the diamond exploration project and the Inuvialuit Regional Corporation to allow property access for diamond exploration.

OUTLOOK

The ongoing rally in metal prices and the influx of major mining companies participating in diamond exploration in the area surrounding our interests in the Northwest Territories has bolstered financing possibilities. Renewed interest from the investment community including third party interest in the diamond exploration and continuing support from the Inuvialuit Regional Corporation and other local participants is encouraging. The

OUTLOOK continued

Company anticipates the commencement of diamond target drilling by its joint venture partner. A base metal exploration schedule is in place to further define the property's potential contingent upon the receipt of funds through equity financing or joint ventures on terms most favourable for our shareholders.

This MD&A contains certain forward-looking statements related but not limited to the Company's operations, anticipated financial performance, business prospects and strategies. Forward-looking information typically contains statements with words such as "anticipate", "believe", "expect", "plan" or similar words suggesting future outcomes. Readers are cautioned to not place undue reliance on forward-looking information because it is possible that the Company will not achieve predictions, forecasts, projections and other forms of forward-looking information.

THE MANAGEMENT'S DISCUSSION AND ANALYSIS SHOULD BE READ IN CONJUNCTION WITH THE COMPANY'S AUDITED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005 WHICH ACCOMPANY THIS ANALYSIS AND, ALTERNATELY ARE AVAILABLE ALONG WITH ALL THE COMPANY'S PUBLIC DOCUMENTS ON WWW.SEDAR.COM