

August 30, 2010

DARNLEY BAY RESOURCES LIMITED - Management's Discussion and Analysis
For the six month period ended June 30, 2010

GENERAL

Darnley Bay Resources Limited was formed in 1993 to explore for and develop base metal deposits related to the 50 km x 80 km, 132 mGal Darnley Bay gravity anomaly near Paulatuk, Northwest Territories, Canada. It has discovered six diamondiferous kimberlite pipes in the same region. Darnley Bay is currently exploring and drilling for base metals on its 4,600 km² land holding. It has a 50/50 joint venture with Diadem Resources Ltd. on 33 claims that encompass ten kimberlite pipes.

BALANCE SHEET AND OPERATIONS

At June 30, 2010, assets totaled \$4,316,242 compared to \$4,777,368 at year end December 31, 2009. During the three and six month periods, the Company added \$412,421 and \$1,398,894 (\$85,591 and \$106,235 in the three and six month periods in 2009) in mineral property expense for a cumulative total of \$2,070,234 compared to \$671,340 at the year end. The current liabilities decreased to \$927,797 from \$1,877,231 at year end 2009, primarily due to a debt conversion to shares in the six month period. There were 3,707,206 shares issued in the six month period (4,179,299 shares issued in the six month period in 2009) for an increase in capital stock of \$824,052 (\$450,126 in 2009). The current stock options and warrant values incurred a stock-based compensation expense of \$1,802,818 and \$1,747,809 respectively (\$1,157,992 and \$1,691,100 at December 31, 2009). The Company reported a loss for the three and six month periods of \$209,470 and \$335,763 compared to \$273,714 and \$380,897 in 2009. 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 June 30, 2010, the Company had cash resources of \$1,934,942 remaining from the private placements of shares in 2009 and compared to \$3,965,696 at year end December 31, 2009. The Company has working capital in the amount of \$1,318,211 compared to \$2,228,815 at year end 2009 and an accumulated deficit of \$23,477,437 (\$23,141,675 at year end). The Company significantly reduced liabilities through debt conversions where allowable resulting in the issue of 3,041,361 shares. There were 100,000 options exercised at \$0.10 in the six month period and the exercise of compensation options and warrants in the three month period resulted in the receipt of \$86,877. Subsequent to the

LIQUIDITY AND CAPITAL RESOURCES continued

six month reporting period, an additional \$70,000 was received through the exercise of warrants and a private placement of units resulted in gross proceeds of \$4,250,000. In the same period in 2009, private placements of 3,511,633 shares increased the cash position by \$366,996.

The Company's current funding objective is to support a metal exploration program and fulfill its agreed upon obligations to the Inuvialuit Regional Corporation. Current funding will allow for an exploration program including geophysical analysis and drilling. At the same time, the Company is engaging in diamond exploration with Diadem Resources Ltd. The ability to raise the capital resources to undertake these projects is dependent upon the venture capital market and metal prices., among other things.

SUMMARY OF QUARTERLY RESULTS

<i>For the three month period ended</i>	<i>June 30,</i> <i>2010</i>	<i>Mar. 31</i> <i>2010</i>	<i>Dec. 31</i> <i>2009</i>	<i>Sept. 30</i> <i>2009</i>
Net loss (in thousands)	209	126	(36)	147
Loss per common share	0.01	0.01	0.01	0.01
Total assets (in thousands)	4,316	4,371	4,777	959
Shareholders' deficiency (in thousands)	3,388	3,511	2,900	(1,364)
<i>For the three month period ended</i>	<i>June 30</i> <i>2009</i>	<i>Mar. 31</i> <i>2009</i>	<i>Dec. 31</i> <i>2008</i>	<i>Sept. 30</i> <i>2008</i>
Net loss (in thousands)	274	107	141	116
Loss per common share	0.01	0.01	0.01	0.01
Total assets (in thousands)	883	592	637	523
Shareholders' deficiency (in thousands)	(1,447)	(1,539)	(1,432)	(1,457)

ANALYSIS OF MINERAL PROPERTY EXPENSE

Project development, permitting and agreement costs, drill program

<i>For the three month period ended</i>	<i>June 30,</i> <i>2010</i>	<i>June 30,</i> <i>2009</i>	<i>March 31,</i> <i>2010</i>	<i>March 31,</i> <i>2009</i>
Project management	60,660	9,000	22,397	19,009
Project consulting fees	119,450	2,040	84,597	756
Property access and Expense(travel)	51,699	74,551	23,508	828
Geophysical surveys	77,774	-	855,937	-
Drill program	102,788	-	-	-
Licences and permits	<u>50</u>	<u>-</u>	<u>34</u>	<u>50</u>
	412,421	85,591	986,473	20,643

ANALYSIS OF CORPORATE AND GENERAL EXPENSES

<i>For the three month period ended</i>	<i>June 30, 2010</i>	<i>June 30, 2009</i>	<i>March 31, 2010</i>	<i>March 31, 2009</i>
Project evaluation and management services	31,999	15,000	28,750	25,250
Administration services	25,500	25,500	24,240	24,000
Office services/supplies	10,378	17,396	11,029	9,588
Legal fees	9,220	3,218	16,977	3,690
Audit fees	17,250	21,550	-	-
Premises rent	15,257	15,477	14,938	14,740
Accounting services	24,400	11,250	11,250	11,250
Stock transfer/exchange fees	30,719	21,602	4,771	10,631
Shareholder communication	21,922	11,702	14,338	5,588
Insurance	17,820	-	-	-
Interest	-	129,132	-	1,512
Other general	<u>5,005</u>	<u>1,887</u>	<u>-</u>	<u>934</u>
	209,470	273,714	126,293	107,183

COMMON SHARES ISSUED

Common shares issued at June 30, 2010 were 92,445,920 and at December 31, 2009 were 88,738,714 and there were 52,930,380 issued at June 30, 2009. In the three month period, there were 545,845 shares issued through the exercise of compensation options at \$0.15 and 20,000 issued by exercise of warrants at \$0.25 added to the 100,000 common share issued through the exercise of options and 3,041,361 by debt conversion in the first interim period of the year. On April 8, there was a repricing to \$0.60 and extension to October 14, 2010 of the existing \$2.00 warrants. The exercise of compensation options resulted in the issue of 14,588 share purchase warrants exercisable up to December 29, 2012 at \$0.25. At the end of the period, there were 19,819,739 share purchase warrants; there were 2,787,488 compensation options with the underlying 1,393,744 warrants reserved for issue. In the three month period of 2009, there were 583,333 flow-through shares issued at \$0.12 and 2,720,000 common shares issued at \$0.10 added to the 534,000 common shares issued at \$0.12 and 133,666 flow-through shares issued at \$0.15 that were subscribed for in December 2008 and issued in January 2009. Holders of the \$0.12 shares issued in the first three months of the year are entitled to purchase an additional share for \$0.24 before December 19, 2010 and those subscribed for the \$0.15 shares have a warrant to purchase an additional flow-through share for \$0.30 for a two year period. The \$0.10 shares issued in April and May 2009 entitle the holder to purchase an additional share for \$0.20 up to April 20 and May 20, 2013 respectively; similarly, the \$0.12 shares entitle their holder to exercise the attached warrant for flow-through shares at \$0.24 on or before April 20 and May 20, 2013.

COMMON SHARES ISSUED continued

Up to the date of this report, an additional 291,667 warrants were exercised at \$0.24 and on August 25, 2010, there were 10,625,000 share purchase units sold through private placement at \$0.40 per unit. Each unit holder is entitled to one flow share and one half of one share purchase warrant. The 5,312,500 warrants are exercisable for a two year period at \$0.45. The agent received a compensation option to purchase 1,062,500 broker units with the same terms. There are 531,250 warrants reserved for issue.

Outstanding share purchase options granted to directors, officers and consultants include 2,900,000 at \$0.10 (expiring on August 5, 2011), 300,000 at \$0.15 (expiring on November 12, 2011) and 300,000 at \$0.32 (expiring on November 27, 2011), a further 300,000, exercisable for \$0.27 for a two year period, were granted on July 27 and all are in accordance with the Company's Stock Option Plan (see note 8(d) of the interim financial statements). The Company has 41,866 shares in escrow.

ACCOUNTING POLICIES

The Company's accounting policies 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 the Company's audited financial statements for the year ended December 31, 2009.

The recoverability of the carrying value of exploration properties and the Company's continued existence is dependent upon the preservation of its interests in the underlying properties, the development of economically recoverable reserves, the achievement of profitable operations, or the ability of the Company to raise additional financing, if necessary, or alternatively upon the Company's ability to dispose of its interests on an advantageous basis. Changes in future conditions could require material write-downs of the carrying values.

The Company uses the fair value method of accounting for all stock options awarded. Each year, the 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 6(e) of the 2009 audited year end statement).

NEW ACCOUNTING STANDARDS

In January 2009, the CICA approved EIC 173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments. This guidance is applicable to fiscal periods ending on or after January 20, 2009. The application of this new standard had no impact on the Company's operating results or financial position.

NEW ACCOUNTING STANDARDS continued

On March 27, 2009, the CICA approved EIC 174, "Mining Exploration Costs". This provides guidance on capitalization of exploration costs related to mining properties in particular and on impairment of long lived assets in general. The Company has applied this new abstract for the year ended December 31, 2009 resulting in no impact on the Company's financial statements.

Effective November 1, 2008, the Company adopted Section 3064 – Goodwill and Intangible Assets which replaced CICA Handbook sections 3062 and 3450, EIC 27 and part of Accounting Guideline 11. Under previous Canadian standards, more items were recognized as assets than under International Financial Reporting Standards ("IFRS"). The objectives of CICA 3064 are to reinforce the principle based approach to the recognition of assets only in accordance with the definition of an asset and the criteria for asset recognition and to clarify the application of the concept of matching revenues and expenses such that the current practice of recognizing asset items that do not meet the definition and recognition criteria is eliminated. The portions in the new standard with respect to Goodwill remain unchanged. The provisions relating to the definition and initial recognition of intangible assets intend to reduce the differences with IFRS in the accounting for intangible assets. The new standard also provides guidance for the recognition of internally developed intangible assets (including research and development activities), ensuring consistent treatment of all intangible assets.

The adoption of this standard had no impact on the Company's presentation of its financial position or results of operations as at and for the year ended December 31, 2009 nor the six months ended June 30, 2010.

In June 2007, the CICA amended Handbook Section 1400, Going Concern, to include additional requirements to assess and disclose an entity's ability to continue as a going concern. Section 1400 is effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The adoption of this standard had no impact on the Company's presentation of its financial position or results of operations as at December 31, 2009 not the six months ended June 30, 2010.

In June 2009, the CICA issued an amendment to Handbook Section 3862 to provide improvements to fair value and liquidity risk disclosures. The amendment applies to the Company's fiscal year ending December 31, 2009. This adoption resulted in additional disclosure as provided below.

The following summarizes the methods and assumptions used in estimating the fair value of the Company's financial instruments where measurement is required. The fair value of short-term financial instruments approximates their carrying amounts due to the relatively short period to maturity. These include cash and cash equivalents, receivables and accounts payable and accrued liabilities. Equity investments classified as available for sale that do not have an active trading market are recorded at cost. Fair value amounts represent point-in-time estimates and may not reflect fair value in the future. The measurements are subjective in nature, involve uncertainties and are a matter of

NEW ACCOUNTING STANDARDS continued

significant judgment. The methods and assumptions used to develop fair value measurements, for those financial instruments where fair value is recognized in the balance sheet, have been prioritized into three levels as per the fair value hierarchy included in GAAP. Level one includes quoted prices (unadjusted) in active markets for identical assets or liabilities. Level two includes inputs that are observable other than quoted prices included in level one. Level three includes inputs that are not based on observable market data.

	Level One	Level Two	Level Three
Cash	\$ 3,965,696	\$ -	\$ -
Accounts receivables	\$ -	\$ 131,823	\$ -
Accounts payable and accrued liabilities	\$ -	\$ 1,877,231	\$ -

FUTURE ACCOUNTING CHANGES

In January 2006, the Canadian Accounting Standards Board (“AcSB”) formally adopted the strategy of replacing financial reporting under Canadian GAAP with financial reporting under IFRS, for Canadian enterprises with public accountability. The current conversion timetable calls for financial reporting under IFRS for accounting periods commencing on or after January 1, 2011.

In February 2008, AcSB confirmed that publicly accountable enterprises will be required to adopt IFRS for fiscal years beginning on or after January 1, 2011, with earlier adoption permitted. Accordingly, the conversion to IFRS will be applicable to the Company’s reporting no later than the first quarter of 2011, with restatement of comparative information presented.

The conversion to IFRS could potentially have an impact on the Company’s accounting policies, information technology and data systems, internal control over financial reporting, and disclosure controls and procedures. The transition may also have an impact on business activities, such as certain contractual arrangements, foreign translation and capital requirements. The Company is currently evaluating the future impact of IFRS on its financial statements and has initiated a preliminary IFRS transition plan with a proposed timeline for the execution and completion of the transition to IFRS. The transition plan was established following a preliminary assessment of the differences between Canadian GAAP and IFRS and the potential effects of IFRS on the Company’s accounting and reporting processes, information systems, business processes and external disclosures. During 2010, the Company continues to focus its efforts on identifying specific Canadian GAAP and IFRS differences, selecting ongoing IFRS policies, determining any information technology issues and considering the impact of the transition to IFRS on internal control over financial reporting and business activities. External advisors will be retained, if necessary, to assist management with the transition.

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 from time to time. On March 31, 2010, there was a debt to insiders of \$521,049 approved for conversion. In the three and six month periods ended June 30, 2010, amounts charged for management fees, office services and rent by La Prairie Ltd. (controlled by Leon La Prairie, Chair/director) were \$29,222 and \$57,871 (\$29,157 and \$57,602 in 2009). Mr. La Prairie charged \$19,250 and \$38,500 for consulting services in the three and six month periods in 2010 and 2009 and \$1,300 in office and meeting expense (\$650 in 2009). Stephen Reford, CEO and President of the Company, charged \$36,450 in project management and \$6,750 in executive management in the three month period (\$18,000 in total in 2009) and \$54,900 for project management and \$9,450 in executive management in the six month period (\$37,000 in total in 2009) plus \$2,957 and \$26,499 in the three and six month periods for reimbursable project expenses (\$827 in 2009) including travel to the property. In addition, Reford incurred \$3,512 in meeting expense in the three month period (nil in 2009). Patricia Mannard provided corporate maintenance and accounting management services in the amount of \$24,400 and \$35,650 in the three and six month periods (\$11,250 and \$22,500 in 2009). Don Yamkowy charged \$4,740 in project development services and incurred \$5,353 in reimbursable expenses related to travel to the property in the three month period. As at June 30, 2010, accounts payable to the above total \$145,925 (\$403,198 in 2009).

At the time of this report, the directors and officers of the Company hold share purchase options. Each of Reford, La Prairie and Mannard have options to purchase 600,000 shares at \$0.10 up to August 5, 2011. An additional 900,000 options are available to three directors with the same terms. There are 300,000 options at \$0.15 expiring on November 12, 2011 and 300,000 at \$0.32 expiring on November 27, 2011 available to the remaining two directors. On July 27, 2010, there were 300,000 two year options granted to the new director Jay Richardson exercisable at \$0.27.

On August 25, 2010, related parties purchased 187,500 units in the private placement.

OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements as at June 30, 2010 or as of the date of this report.

COMMITMENTS

Notes 4 and 11 of the financial statements for the year ended December 31, 2009 and the interim period to June 30, 2010 cover the current agreement conditions with the Inuvialuit Land Corporation, Diadem Resources Ltd. and other commitments to finders and the Company's agent.

COMMITMENTS continued

On December 22, 2009, the Company renewed terms with the Inuvialuit Land Corporation for access to the property in the area surrounding Paulatuk, Northwest Territories, for the purpose of base metal exploration.

On July 7, 2010, the Company signed a memorandum of understanding to form a joint venture with Diadem Resources Ltd.; formerly an agreement held with Carnarvon Capital Corporation, to operate a diamond exploration program. The joint venture will renew a letter agreement with the Inuvialuit Land Corporation allowing access to the property that lies within the Inuvialuit Settlement Region.

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 financing necessary in the case that an economic ore reserve is established. Further, the Company is relying on its joint venture partner to fulfill its obligations as operator of the diamond exploration project and the Inuvialuit Land Corporation to allow property access and permitting for both projects.

CORPORATE GOVERNANCE

On February 22, 2007, the Company filed its initial Corporate Governance Policy document with the TSX Venture Exchange and at www.sedar.com. The policy is amended each year and appears as part of the Management Information Circular for 2009.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

In connection with Exemption Orders issued in November 2007 by each of the securities commissions across Canada, the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") of the Company will file a Venture Issuer Basic Certificate with respect to the financial information contained in the unaudited interim financial statements and the audited annual financial statements and respective accompanying Management's Discussion and Analysis.

In contrast to the certificate under Multilateral Instrument ("MI") 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings), the Venture Issuer Basic Certification includes a 'Note to Reader' stating that the CEO and CFO do not make any representations relating to the establishment and maintenance of disclosure controls and procedures and internal control over financial reporting, as defined in MI 52-109.

OUTLOOK

During the current interim period, the Company neared mobilization of field and drill crews to locate deposits of metals and diamonds in the Paulatuk, Northwest Territories area. Analysis and modelling of the geophysical and geological data led the Company to seek additional financing so that it could significantly expand its base metals drill program. The ongoing support from the Inuvialuit Regional Corporation (IRC), the community of Paulatuk and other local participants is encouraging.

Subsequent to the quarter end, the Company concluded a \$4,250,000 flow-through financing, and commenced its base metals exploration and drill program. Through a new agreement with Diadem Resources Ltd., the Company began a kimberlite pipe drill program as part of a 50/50 joint venture.

Some of the highlights from the current interim period ended June 30, 2010 include:

- Sander Geophysics Limited completed the AIRGrav gravity and magnetic survey on April 3, 2010. Preliminary results were posted on the Company's website.
- The Company continued its preparation for the drilling and exploration program, and the involvement of the Inuvialuit in the program, with ongoing discussion, meetings and travel to Paulatuk and Inuvik by Company personnel. Analysis of the new airborne survey data was initiated to locate the highest priority targets for ground follow-up and drilling.
- On April 19, 2010, Kavik-Axys submitted the Company's Project Description for the proposed 2010-2012 drill and exploration program to the Inuvialuit Environmental Impact Screening Committee. The Company's application was heard on June 3, 2010 and a positive decision received on June 15, 2010.
- The Company received the three necessary permits and licences, and commenced the field program on June 28, 2010.
- Kerry Knoll visited potential investors in Beijing and Shanghai during April 2010.
- On June 26, 2010, John Dowsett retired from the Board of Directors.
- Throughout the quarter and into the following quarter, the Company worked with Inuvialuit authorities, the Paulatuk community and agencies of the territorial and federal governments to establish a drill camp operation owned by the Paulatuk Development Corporation and implement training programs for Inuvialuit in Paulatuk to participate in the exploration program as employees.

Subsequent to the reporting period, the Company reports the following activities:

- On July 9, 2010, the Company and Diadem Resources Ltd. announced that they had reached agreement on the terms of a joint venture for diamond and mineral exploration and production over the 33 claims they hold on the Parry Peninsula, to include the following:
 - The joint venture will be co-managed by the two companies;
 - Diadem will be responsible for the first \$2 million in exploration expenditures, with \$1 million to be recovered directly by Diadem from Darnley Bay's share of the eventual diamond production of the joint venture; and

OUTLOOK continued

- Diadem has a 180-day option to extend the joint venture to include diamond exploration and production on ten prospecting permits currently held by Darnley Bay, south and southwest of Paulatuk, where the two companies previously explored for diamonds, upon payment of certain fees and expenditures to Darnley Bay.
- As a pre-condition to signing the above-mentioned agreement, Diadem paid the Company \$115,000 to settle its debt obligations.
- On July 13, 2010, the Company completed the analysis and 3D modelling of new and historical geophysical and geological data, and announced 41 new base metals targets on its 100%-owned mineral concession on the Inuvialuit lands 7(1)(a) and the adjoining prospecting permits on 7(1)(b) and Crown lands. It also announced 103 kimberlite pipe targets on these same lands.
- Through the month of July 2010, the company signed contracts and prepared to mobilize the camp, drill and other equipment for exploration of its base metals targets and kimberlite pipe targets. The camp was shipped to Paulatuk on July 30, 2010 and built over the following two weeks. During that period, ground geological and geophysical surveys commenced on both the base metals targets and Parry Peninsula kimberlite pipe targets, under the management of Lou Covello. Drilling of the first kimberlite pipe target on the Parry Peninsula commenced on August 8, 2010 (with all costs borne by Diadem). Drilling continued on the diamond targets for most of August prior to moving the drill to the base metals targets.
- Numerous Inuvialuit residents of Paulatuk were hired as employees and trainees for exploration and camp positions. The Paulatuk Hunters and Trappers Committee and the Inuvialuit Land Administration were contracted to provide wildlife and environmental monitors respectively. Services provided by Inuvialuit companies and partnerships include provision of helicopters, air transport, logistics and land surveying.
- On July 26, 2010, the Company engaged Haywood Securities Inc. to complete a best efforts private placement of flow-through units at a price per Flow-Through Unit of C\$0.40 for gross proceeds to the Company up to C\$3,000,000. Each Unit consisted of one flow-through share for purposes of the Income Tax Act (Canada) and one half of one common share purchase warrant of the Company. Each Warrant will entitle the holder to acquire one common share at an exercise price of C\$0.45 for a period of 24 months from the closing date of the Offering. The Company granted Haywood the option to increase the Offering by C\$1,000,000 for aggregate gross proceeds to the Company of up to C\$4,000,000. On August 5, 2010, the over-allotment option was increased to \$1,250,000. On August 25, 2010, the Company closed the financing for gross proceeds of \$4,250,000 and issued 10,625,000 flow-through units. Haywood Securities Inc. received a cash fee of 8.0% (\$340,000) and compensation units equal to 10.0% of the aggregate number of flow-through units. This financing allowed the company to increase its drilling budget from 2,500 m to 9,000 m for 2010 and early 2011.
- On July 27, 2010, James (Jay) Richardson was appointed to the Company's Board of Directors and to chair the Audit Committee.

OUTLOOK continued

- On August 20, 2010, the Company submitted the paperwork necessary for the Mining Recorder to transfer 50% of each of its nine claims, in the area of diamond exploration, to Diadem Resources Ltd. Diadem undertook the same process for the transfer of 50% of each of its twenty-four claims to the Company. The legal counsels for the two companies commenced preparation of a definitive joint venture agreement.

The Company is committed to pursue equity financing and seek joint venture partnerships to enable the current exploration and development program to continue.

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 INTERIM FINANCIAL STATEMENTS FOR THE PERIOD ENDED JUNE 30, 2010 THAT ARE AVAILABLE ALONG WITH ALL THE COMPANY'S PUBLIC DOCUMENTS ON WWW.SEDAR.COM

www.darnleybay.com TSX Venture Exchange Symbol DBL