



ANNUAL REPORT 2006





CORPORATE VISION

TO INCREASE THE VALUE OF OUR SHAREHOLDERS' INVESTMENT IN VAALDIAM BY BECOMING A PROFITABLE PRODUCER OF ROUGH DIAMONDS FROM BOTH KIMBERLITE AND ALLUVIAL SOURCES.

2007 FOCUS

- ◆ Produce 25,000 carats from the Duas Barras Mine;
- ◆ Expansion of Duas Barras Mine through acquisition to achieve 100,000 carats of annualized alluvial production by 2009;
- ◆ Evaluate priority kimberlites on the Pimenta Bueno property by bulk sampling;
- ◆ Resource definition and bulk sampling of the Braúna kimberlites;
- ◆ Acquire and explore new Brazilian kimberlite properties; and
- ◆ Complete corporate acquisition or merger if accretive to shareholder value.



ANNUAL AND SPECIAL MEETING OF SHAREHOLDERS

4:00 p.m. • Thursday, June 14, 2007
 TSX Broadcast & Conference Centre
 The Exchange Tower,
 130 King Street West, Toronto, Ontario
 M5X 1J2

2006 HIGHLIGHTS AND 2007 TO DATE

- ◆ Commenced production at Duas Barras Mine;
- ◆ Increased Duas Barras Mine ownership to 100%;
- ◆ Commenced mini-bulk sampling program at Brauna property;
- ◆ Discovered additional kimberlites on Brauna property;
- ◆ Increased Brauna property ownership to 100%;
- ◆ Undertook mini-bulk sampling program on four Pimenta Bueno kimberlites;
- ◆ Discovered new kimberlites on Pimenta Bueno property;
- ◆ Completed mini-bulk sampling program on Artemesia kimberlite;
- ◆ Completed \$7.5 million bought deal financing;
- ◆ Obtained a TSX listing; and
- ◆ Significantly improved market liquidity for Vaaldiam's shares.

President's Message

Report to Shareholders



It is with great pleasure that I write this report at a time that coincides with our Company's graduation from diamond explorer to diamond producer. Few diamond exploration companies ever achieve the status of producer, so reaching this goal is a major milestone in the ongoing development of our Company.

Construction of the Duas Barras mine is complete and our new diamond recovery plant is steadily increasing its processing rate towards plant capacity of 150 tonnes of gravel per hour. During the remainder of 2007, our 100%-owned Duas Barras mine is projected to produce 25,000 carats of diamonds, increasing to 50,000 carats of production on an annual basis starting in 2008. Transforming the Duas Barras project from its initial status as an exploration-stage project to its new status as a producing mine has been rapid. In an industry where most diamond deposits require 12 years to develop into a producing mine, we have moved Duas Barras to the producing ranks in a period of just over two years. Credit for this rapid transformation has to be given to Vaaldiam's incredibly dedicated employees. Their skill, loyalty and hard work have proven to be the Company's greatest asset, and it clearly indicates that the future of our Company is in very capable hands.

While the construction of Vaaldiam's first diamond mine has captured the bulk of the Company's headlines during the past year, we have also been steadily advancing our two kimberlite projects through the evaluation phase of development, with a goal of reaching the feasibility stage as quickly as possible. The early results from a mini-bulk sampling program at our Braúna property indicate that the first of four kimberlite pipes sampled has good economic potential. These initial sampling results prompted our Company to purchase our joint venture partner's 40% minority interest, as a result of which Vaaldiam now owns 100% interest in this exciting property. We have now started an aggressive program to evaluate the economic potential of the kimberlite deposits discovered on the

Report to Shareholders

Braúna property. This program, consisting of a 5,000 tonne bulk sampling program and resource definition drilling, is designed to deliver grade, diamond value, and tonnage estimates to support the completion of a feasibility study in 2008.

On the Pimenta Bueno property, our joint venture partner Rio Tinto has focused on the evaluation of geophysical and geochemical anomalies, in an exploration program targeting new kimberlite discoveries. A total of eight new kimberlite occurrences were discovered by Rio Tinto during 2006, bringing the total number of kimberlites discovered to 38 pipes and 3 dike deposits. An additional 13 targets will be tested in the near future and there is good potential to further increase the number of kimberlite deposits to be discovered on the Pimenta Bueno property. Exploration will now focus on the economic evaluation of these kimberlites, through a bulk sampling program which will target the pipes that show the best potential based on exploration results received to date. We are extremely encouraged by the potential of the Pimenta Bueno district, as it continues to produce large, high-value diamonds from alluvial deposits that appear to be closely associated with kimberlite occurrences in the district. Some of the kimberlite pipes discovered to date on the property are quite large, with surface areas in excess of 20 hectares, which indicates excellent potential for large tonnage deposits. We remain confident that the Pimenta Bueno property has the potential to deliver a world-class diamond deposit.

On the corporate front, our Company reached a major milestone in its development in March 2006 when the Company's shares commenced trading on the Toronto Stock Exchange. The Company's graduation from the TSX Venture Exchange to Canada's premier exchange is a reflection of the progress made to date in the development of our Brazilian diamond projects and the Company's strong financial position. Trading volumes have recently increased as a result of an aggressive marketing campaign focused on institutional and retail investors in North America, the United Kingdom and other parts of Europe. This investor relations program has been very successful, as Vaaldiam now has a diverse shareholder base that is geographically widespread.

During 2006 Vaaldiam's common shares traded to a high of \$1.60 per share in April. Unfortunately we could not maintain that level entering the month of May, when there appeared to be a general weakness of diamond equities as a result of strong gold and base metal prices. Since that time Vaaldiam's shares have traded in a relatively tight trading range of \$0.80 to \$1.00 per share, despite the fact that during that same period the Company increased its ownership to 100% in both the Duas





Barras mine and the Braúna kimberlite property, and discovered eight new kimberlite occurrences on its Pimenta Bueno property. Management believes that the performance of our shares will improve during the remainder of 2007 with the commencement of production and cash flow from our Duas Barras mine, and continued exploration results from our advanced stage Braúna and Pimenta Bueno kimberlite properties. Strong international diamond markets, with 5% annual growth forecast for the next ten years, should also help heighten investor interest in diamond stocks, which have been lagging behind gold, base metal and uranium equities during the past twelve months.

While significant progress were made by Vaaldiam during 2006, there remains excellent potential for continued, sustained growth of our Company. Diamond production and cash flow from our Duas Barras mine will provide Vaaldiam with a strong foundation to support growth, which will be fueled by the continued development of our Braúna and Pimenta Bueno properties. In addition to evaluating merger opportunities, management is also pursuing the acquisition of additional advanced-stage diamond properties, which will accelerate our growth strategy and further increase the value of our Company.

On behalf of the Board of Directors I would like to extend our sincere appreciation to our loyal shareholders for their continued support. I would also like to take this opportunity to extend our appreciation to our dedicated and enthusiastic exploration and administrative staff in Brazil and Canada, for their significant contribution towards our Company's accomplishments during the past year. With our new Duas Barras mine in production and our kimberlite projects advancing towards feasibility, 2007 will prove to be another exciting year for our Company.

Respectfully,

A handwritten signature in black ink, appearing to read 'Ken Johnson', written over a light-colored rectangular background.

Kenneth W. Johnson
President and Chief Executive Officer

April 30, 2007

PRODUCTION

Duas Barras Diamond Mine



Vaaldiam achieved a major milestone in the Company's history with the construction of its 100%-owned Duas Barras alluvial diamond mine in the state of Minas Gerais, Brazil. On an annual basis, the mine is projected to produce 50,000 carats of high quality diamonds at an average diamond value of US\$200 per carat and 1,650 ounces of gold from the processing of approximately 550,000 tonnes of gravel.

Vaaldiam has advanced the development of the Duas Barras mine at a rapid pace since acquiring a 75% interest in the property in January 2005. Since that time, the Company has completed a drilling and bulk sampling program, the results of which provided justification for Vaaldiam to purchase the remaining 25% interest in the mine, and the incentive for a positive production decision in December 2005.

During 2006, Vaaldiam expanded its bulk sampling and drilling program to support the development of a preliminary mine plan and processing plant design by project engineers, Multigeo-Mineração Geologica e Meio Ambiente Ltda. of São Paulo, Brazil. A total of 154 percussion drill holes were completed to delineate the deposit over a distance of 1.7 kilometres. An additional 12 drill holes tested the southern portion of the deposit on a grid spacing of 100 metres. To provide a diamond grade estimate for the deposit, Vaaldiam completed a bulk sampling program which involved the processing of approximately 1,660 tonnes of gravels excavated from sample pits at two separate locations.

The initial bulk sample tested the larger, northern arm of the deposit, and yielded 102 diamonds totalling 23.31 carats from 189 tonnes of gravel for a recovered diamond grade of 12.33 carats per hundred tonnes (cpht). Individual diamonds ranged in size from 0.10 carats to 1.24 carats, and averaged of 0.23 ct/stone. Fine gold was also recovered in this bulk sample which projected to a recovered gold grade of 0.18 grams per cubic metre of gravel, or 0.003 ounces per tonne. In the area of this initial sample the basal gravel unit is 9 metres thick and is overlain by a transitional gravel sequence that is less diamond-bearing. Processing of 1,861 tonnes of this upper horizon recovered 319 diamonds with a total weight of 71.02 carats for a recovered grade of 3.82 cpht. The average size of the diamonds recovered from the transitional gravel was 0.22 carats.

A second bulk sample was excavated 400 m to the southwest of Pit #1, yielded 93 diamonds weighing 41.90 carats from two gravel samples totalling 398 tonnes for a recovered grade of 10.53 cpht, with an average size of 0.45 ct/stone.

Duas Barras Diamond & Gold Resource Estimation (compliant with NI 43-101)

Resource Classification	Tonnage	Diamond Grade (cph)	Diamond Resource (carats)	Gold Grade (oz/t)	Gold Resource (ounces)
Indicated	3,276,444	9.0	294,880	0.003	10,780
Inferred	1,521,778	9.0	136,960	0.003	5,010
Total	4,798,222	9.0	431,840	0.003	15,790

The site of Vaaldiam's initial bulk sample tested an area of the deposit adjacent to a small quarry excavated by Mineração Marly Ltda. ("Marly"), the previous owner of the Duas Barras mineral rights. In 2002 Marly reportedly recovered 1,108.34 carats of diamonds from approximately 7,673 tonnes of gravel, equating to a grade of 14.4 cph. According to Marly's records, these diamonds were sold during 2002 for total proceeds of US\$246,346, an average sales value of US\$222/ct.

Vaaldiam's diamond production from Duas Barras is expected to meet Marly's sales value of over US\$200 per carat. A total of 169.15 carats of diamonds with a lower cut-off size of 2 mm, which were recovered during Vaaldiam's bulk program, were independently valued at US\$197 per carat. The largest stone in the parcel was a white dodecahedral stone weighing 4.66 carats that was valued at US\$1,395 per carat. An additional 24 stones totalling 33.23 carats that fell within the 1 to 4 carat size range, obtained an average value of US\$354 per carat. The diamond parcel was valued in Brazil for the purposes of export by Comércio e Exportação Ltda. ("CIDAMA"), an independent diamond valuation and marketing company. During the last 15 years, CIDAMA has been responsible for the valuation of diamond production from the Domingas Mine, which up to the end of 2006, was Brazil's largest single diamond producer, located along the Jequitinhonha River 30 kilometres upstream of Vaaldiam's Duas Barras property.

The design and fabrication of components for the diamond recovery plant commenced in September 2006, and the majority of the components arrived at the Duas Barras site in January 2007 when construction of the processing plant commenced in earnest. Contract mining operations were underway by early March and initially focused on the excavation of the sterile sands that overlie the diamond-bearing gravels that will provide feed for the processing plant. Mining is completed with three tracked excavators which remove the overburden, and mine the diamond-bearing gravel. A fleet of six dump trucks transport the overburden to previously mined areas as part of Vaaldiam's reclamation program, while four dump trucks transport the ore a short distance to the diamond recovery plant for processing. Topsoil removed from surface prior to the overburden removal is stockpiled separately and replaced over the mined areas that are reclaimed. Vaaldiam has established its own greenhouse operation which produces seedlings of local plant species which are replanted in the mined areas as part of the Company's reclamation program.

With production starting in May, management expects to produce 25,000 carats of diamonds in 2007. Production from 2008 onwards is expected to double and reach 50,000 carats per year. Based on the indicated gravel resources, the mine has at least a 5 year life, which can be increased to over 8 years based on the inferred

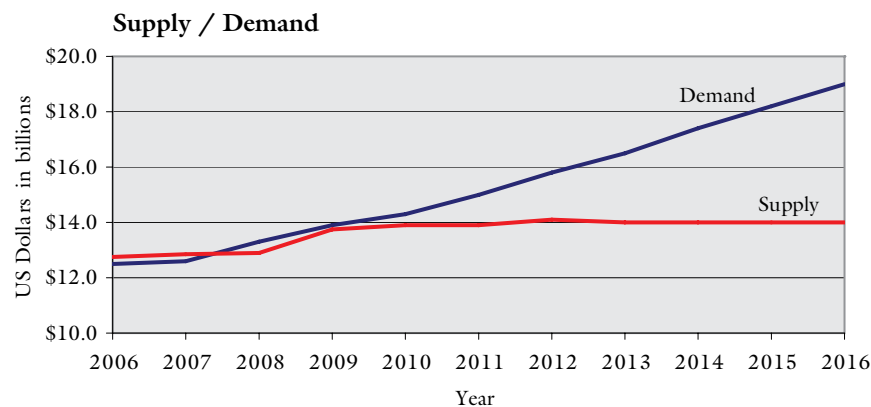
Production

gravel resources. During the remainder of 2007 the Company will conduct additional delineation drilling on a 50 metre grid spacing to better define these resources and promote these gravels to the indicated resource category. The Company is also evaluating local opportunities to further expand production in the Duas Barras Mine district to achieve 100,000 carats of annualized production by the end of 2008.

Diamond Markets

Vaaldiam is becoming a diamond producer at a time when demand for rough diamond production has never been stronger. Since the beginning of this year, average rough diamond prices have increased by approximately 6%, driven by supply shortages and increased demand from emerging markets such as China, India and Latin America. Demand is expected to continue to grow at a satisfactory rate over the next ten years, from its current annual level of US\$13 billion to almost US\$19 billion over the next ten years.

Retail diamond demand is expected to grow by 5% annually over the next decade as emerging markets purchase diamonds and consumers in the United States look to increase their jewelry holdings. This projected increase in retail demand suggests that a diamond mine that is the equivalent of US\$500 million of diamond production must open every year over the next ten years to meet the increasing demand from consumers. The demand for diamonds is forecast to outstrip the supply of rough diamonds over the next decade, as existing mine reserves are depleted, and with very few new mines scheduled to come on stream.



WWW International Diamond Consultants Ltd.

Advanced Exploration

Pimenta Bueno Diamond Property

Vaaldiam's joint venture partner, a subsidiary of Rio Tinto Mining and Exploration Limited, expended US\$6.6 million on exploration of the Pimenta Bueno property by the end of 2006, since they exercised their back-in rights to the property in June 2005. Since assuming the position of project operator, Rio Tinto has focused its exploration program on the discovery of new kimberlites on the large 248,000 hectare property that is situated in the State of Rondônia, Brazil. The program has been successful, with five new kimberlite pipes and three new kimberlite dike systems discovered during the year, bringing the total number of kimberlite occurrences

to 38 pipes and three dike systems. Some of the pipes are quite large with surface areas ranging from approximately one hectare up to 18 hectares in size. Microdiamond analysis indicates that 19 of the kimberlites are diamond-bearing. Geological mapping and age dating of the pipes has determined that there are at least four different ages of pipes, with the larger pipes being represented by crater facies kimberlite with very little erosion, to hypabyssal or root-zone kimberlites with over one kilometre of the pipe eroded. During 2006 Rio Tinto tested four kimberlite pipes with a mini-bulk sampling program which utilized a 5½ inch standard reverse circulation drill to extract the samples from a series of drill holes testing various areas within each of the pipes.

Mini-bulk sampling of the 2.5 hectare Cosmos 1 pipe resulted in the recovery of 117 commercial sized diamonds (>0.850 mm) with a total weight of 2.45 carats. The two largest diamonds recovered from the Cosmos 1 pipe weighed 0.14 carats and 0.12 carats respectively. A total of 62.2 tonnes (dry weight) of kimberlite were processed by screening and dense media separation at Rio Tinto's laboratory facility in Brasilia.

Mini-bulk sampling of the 12 hectare Cosmos 3 pipe resulted in the recovery of 16 diamonds weighing 0.28 carats from 56.5 tonnes of kimberlite. The Cosmos 3 pipe, and its satellite pipe Cosmos 4 (not tested by mini-bulk sampling) are situated 5 kilometres southwest of the Cosmos 1 pipe. A total of 12 reverse circulation drill holes were completed at the Cosmos 3 pipe. Ten reverse circulation drill holes were completed at the Pepper 4 pipe, resulting in the collection of 32.6 tonnes of kimberlite for processing. A total of 25 diamonds totalling 0.42 carats in weight were recovered from 32.6 tonnes of kimberlite. Three reverse circulation holes were completed at the Pepper 13 pipe, resulting in the recovery of one diamond with a weight of 0.05 carats from a total of 12.7 dry tonnes of kimberlite. Many of the diamonds recovered during the mini-bulk sampling program appear to have been broken during the reverse circulation drilling and recovery process. The apparent breakage adversely affects the diamond distribution curve used to project a diamond grade. Vaaldiam and Rio Tinto have agreed to complete a diamond breakage study of the diamonds recovered during the mini-bulk sampling program to assess the impact diamond breakage might have had on the sample results and the diamond distribution. In addition, mini-bulk sampling from surface of the Cosmos 1 pipe will be completed to confirm the diamond distribution within the Cosmos 1 pipe, and provide a comparison of the diamond recoveries from surface sampling to those obtained from reverse circulation drilling.

Since Rio Tinto exercised their option in June 2005, they have drilled a total 29 core holes totalling 5,247 metres delineating six of the known diamond-bearing pipes on the Pimenta Bueno property. An additional 39 drill holes totalling 3,678 metres were completed testing 12 geophysical anomalies, resulting in the discovery of five kimberlite pipes and three new dike systems. Most of Rio Tinto's exploration has focused on the pipes and geophysical targets situated in the southern half of the Pimenta Bueno property, where they have now expended over US\$5.8 million for their own account on exploration, earning them a 51% interest in that part of the property.

During 2007, four of the priority diamond-bearing kimberlite pipes will be tested by mini-bulk sampling from surface shafts, while 13 geophysical and geochemical anomalies will be tested in an effort to discover more kimberlite pipes on the Pimenta Bueno property.

Production

Braúna Diamond Property

Vaaldiam's 100% owned Braúna diamond property is situated in the state of Bahia, Brazil, approximately 400 kilometres to the northwest of the city of Salvador, the state capital. The property is comprised of five exploration concessions encompassing 19 kimberlite occurrences consisting of four kimberlite pipes and a series of parallel kimberlite dikes that have been traced over a distance of 15 kilometres. Fifteen of the 19 kimberlite occurrences that have been discovered thus far were discovered by the Brazilian subsidiary of De Beers Consolidated Mines Limited, which completed a large scale reconnaissance exploration program in the district in the early 1990s. Following the discovery of the kimberlite pipes (three discovered) and dikes, De Beers completed a limited surface sampling program which demonstrated that both the kimberlite pipes and dikes contain diamonds. No drilling was completed by De Beers during their exploration campaign, and based on the surface

work it appeared that the pipes and dikes were too small for De Beers. In addition, diamond prices were then approximately 80% lower than current prices for rough diamonds. Based on these factors, De Beers suspended exploration on the Braúna property in 1996, but maintained the rights to the ground until 2004 when they sold the property to Majescor Resources Ltd, who in turn indirectly sold a 60% interest in the property to Vaaldiam in October 2005.



Vaaldiam, as operator of the joint venture with Majescor, commenced exploration on the Braúna property in November 2005, with a comprehensive program of prospecting, ground geophysics and drilling, which resulted in the discovery of one new kimberlite pipe named Braúna 16, and three new

kimberlite dike occurrences. The joint venture also completed 5,419 metres of drilling in 37 drill holes, which focused on the delineation of the 1.7 hectare Braúna 3 pipe and 1.0 hectare Braúna 7 pipe. In November 2006, the joint venture embarked on a mini-bulk sampling program which involved the extraction of approximately 100 tonnes of kimberlite from the Braúna 3 and Braúna 7 pipes to determine the size distribution of diamonds within the pipes and obtain an early indication of the potential diamond content and variability of mineralization within the pipes.

To complete the program, and to ensure a quick turn-around on sample results, Vaaldiam constructed its own diamond recovery plant in the town of Nordestina, just five kilometres from the Braúna property. The recovery plant consists of a crushing and feed circuit, a 300 kilogram per hour dense media separation module, and a secure diamond recovery circuit. Simulated diamond “tracers” with a density similar to diamond are utilized on a daily basis to measure the efficiency of the plant and indicate a recovery rate of between 98% and 99% based on the samples processed to date.

To extract the mini-bulk samples, Vaaldiam's crews excavated small vertical shafts to a maximum depth of 20 metres. A total of 39.9 dry tonnes of kimberlite was extracted from the Braúna 3 pipe and processed through Vaaldiam's dense media diamond recovery plant. A total of 59 diamonds with a total weight of 8.29 carats were recovered using a 0.85 mm square mesh bottom screen, resulting in a recovered diamond grade of 20.80 cph. The average size of the diamonds recovered from the Braúna 3 pipe was 0.14 carats and the five largest stones weigh 1.13, 0.56, 0.55, 0.49 and 0.46 carats.

A total of 60 dry tonnes of kimberlite was extracted and processed from the Braúna 7 pipe, resulting in the recovery of 16 diamonds with a total weight of 3.07 carats, for a recovered grade of 5.11 cpht. The average size of the diamonds recovered from the Braúna 7 pipe was 0.19 carats and the five largest stones recovered weigh 0.94, 0.73, 0.38, 0.34 and 0.14 carats.

Sampling has now expanded to the other two kimberlite pipes on the property, the 1.0 hectare Braúna 4 and Braúna 16 pipes. Sampling will also be completed on the kimberlite dike occurrences, where previous sampling by De Beers has reported projected diamond grades of up to 150 cpht based on small one-tonne samples.

The initial sampling program on the Braúna 3 and Braúna 7 pipes is encouraging given the small amount of material processed thus far. The complex geology of the pipes is reflected in the sampling results with the grades for the one to two tonne sub-samples ranging from 1.13 cpht to as high as 89.28 cpht. With the extremely low costs associated with mining in Brazil, and the excellent infrastructure that the Braúna project possesses, the Braúna kimberlites appear to have excellent economic potential. Based on these encouraging results, Vaaldiam purchased Majescor Resources' 40% interest in the Braúna property for \$2.0 million cash and 1.73 million common shares of Vaaldiam. Majescor will retain a 1% gross sales royalty on diamond production from the property.

Vaaldiam will now embark on an aggressive bulk sampling and resource definition program to assess the economic potential of the kimberlite pipes and dikes on the Braúna property. The Company plans to complete a minimum 10,000 metres of core drilling to define NI 43-101 resources, and extract and process a 5,000 to 6,000 tonne bulk sample to recover over 1,000 carats of diamonds for valuation purposes. If successful, this information will provide the technical justification for the completion of a feasibility study in early 2008.

Aroeira and Umbu Kimberlite Properties

Vaaldiam increased its landholdings in the Braúna district with the acquisition of a 100% interest in the Aroeira and Umbu kimberlite deposits. Both the Aroeira and Umbu kimberlites were discovered by De Beers during their reconnaissance exploration program in the early 1990s, and surface sampling indicated that the kimberlites were diamond-bearing. Vaaldiam plans on completing ground geophysics and drilling on both the Aroeira and Umbu properties in 2007 to assess the economic potential of these diamond-bearing kimberlites.

The Aroeira property is located approximately 40 kilometres to the west of the Braúna property, and encompasses a kimberlite dike and blow system that has been traced over a distance of approximately one kilometre. Surface sampling by De Beers resulted in the recovery of nine diamonds with a total weight of 0.11 carats from a one cubic metre sample.

The Umbu kimberlite property is situated 16 kilometres to the north of the Braúna property, and is thought to represent the northern extension of the Braúna kimberlites. The Umbu kimberlite appears to be a dike-like body with an average width of approximately two metres. De Beers extracted and processed one small sample from surface which resulted in the recovery of five diamonds with a total weight of 0.08 carats from one cubic metre of material.

Management's Discussion and Analysis



Readers of the following Management's Discussion and Analysis should refer to the Company's audited consolidated financial statements for the years ended December 31, 2006 and 2005 where necessary. Those financial statements have been prepared in accordance with Canadian generally accepted accounting principles. All dollar figures included therein and in the following Management's Discussion and Analysis are quoted in Canadian dollars unless otherwise specified. The following Management's Discussion and Analysis is prepared as of March 22, 2007. Additional information relevant to the Company's activities, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com.

Forward-Looking Statements

Certain statements contained herein are forward-looking and are based on the opinions and estimates of management, or on opinions and estimates provided to and accepted by management. These opinions and estimates include those estimates and opinions that relate to all the geological, mining and commodity price and marketing parameters used by management. In certain cases, forward-looking statements can be identified by the use of words such as "plans", "expects" or "does not anticipate", or "believes", or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved".

Forward-looking statements are subject to a variety of risks and uncertainties and other factors that could cause actual events or results to differ, possibly significantly. Readers are therefore cautioned not to place undue reliance on any forward-looking statement.

Overview

Vaaldiam Resources Ltd. ("Vaaldiam" or the "Company") is a Canadian public company listed on the Toronto Stock Exchange that is engaged in diamond exploration and mine development in Brazil and to a lesser extent in Canada. The Company's vision is to become a significant producer of high quality diamonds, and a leader in the diamond exploration industry.

Vaaldiam is currently developing three advanced-stage diamond properties in Brazil, and one in Canada. In Brazil, Rio Tinto Desenvolvimento Mineral Ltda. ("Rio Tinto") is the operator of a joint venture exploration program on the Pimenta Bueno property in the state of Rondônia, where 38 kimberlite pipes and 3 kimberlite dyke and/or sill systems have been discovered. Exploration sampling indicates that approximately 50% of the kimberlites discovered on the Pimenta Bueno property are diamond-bearing.

In the state of Minas Gerais, the construction of Vaaldiam's 100%-owned Duas Barras Mine is expected to be completed during Q1-2007. Annual production from the Duas Barras Mine is expected to start at 38,000 carats, increasing to 50,000 carats during the second year of operation.

On the Braúna property in the state of Bahia, Vaaldiam is completing a mini-bulk sampling program on two of the four kimberlite pipes discovered to date on the 100%-owned property. Initial results from the mini-bulk sampling program have been encouraging, and appear to support an expansion of the bulk sampling program.

In Canada, Vaaldiam is operating a joint venture exploration program with Ashton Mining of Canada Inc. ("Ashton") on their Coronation Gulf diamond property in Nunavut. Ashton's Coronation Gulf property encompasses the three hectare Artemisia kimberlite pipe, one of five diamondiferous kimberlite occurrences situated on the property. In August 2006, Vaaldiam extracted a 100 tonne mini-bulk sample from the surface of the Artemisia pipe, to evaluate the diamond distribution within pipe. Processing of the mini-bulk sample is being completed by SGS Lakefield Laboratories in Ontario, and results are expected in Q2-2007.

Operations

Operations are conducted directly and through its subsidiaries whose relationship to Vaaldiam is reflected below.



(1) Remaining 0.001% owned by MSP Participações S.A.

(2) Remaining 0.1% owned by José Fernando Tonoli.

(3) As of March 1, 2007, the previously 40% owned by Majescor Resources Inc., a Canadian publicly listed corporation, was acquired by Vaaldiam Resources Ltd. and will be transferred to Vaaldiam do Brasil Mineração Ltda. for an exchange of 100 shares in Vaaldiam do Brasil Mineração Ltda. A nominal percentage will be held by a second shareholder to comply with Brazilian corporate laws.



Pimenta Bueno Property, Rondônia, Brazil

During 2006, Vaaldiam's joint venture partner Rio Tinto, continued to advance the development of the 247,085 hectare Pimenta Bueno property through an aggressive exploration program consisting of drilling and mini-bulk sampling. Rio Tinto assumed the position of operator of the project in June 2005 following the exercise of an option that allowed Rio Tinto to earn a 51% interest in the property in accordance with the terms of an agreement signed with Vaaldiam in November 2003. Vaaldiam granted Rio Tinto this option in return for all of Rio Tinto's exploration data, valued at approximately US\$4,000,000. The agreement provided Rio Tinto with an option to earn a 51% interest in either or both of the Northern and Southern Blocks comprising the property by spending a total of US\$12,500,000 on exploration over a three year period, US\$5,000,000 on the Southern Block and US\$7,500,000 on the Northern Block. The Southern Block is comprised of approximately 207,085 hectares while the Northern Block covers approximately 40,000 hectares. Since exercising their option, Rio Tinto has expended approximately US\$5,841,965 for its own account on exploration of the Southern Block of the property to December 31, 2006, as a result of which Rio Tinto now owns 51% of the Southern Block with Vaaldiam owning 49%. Vaaldiam's ownership of the Northern Block remains at 100%. Substantially all of Rio Tinto's exploration expenditures to date have been on the Southern Block.

The agreement also provides Rio Tinto with the opportunity to increase its interest to 70% in either or both of the Northern or Southern Blocks by completing a feasibility study on any kimberlite deposit found. The agreement specifies that the feasibility study would have to be sufficiently comprehensive to enable the Company to seek bank financing for its remaining 30% interest in the joint venture.

Management's Discussion and Analysis

Rio Tinto assumed the position of operator of the project in June 2005 and continued with the delineation drilling program started by Vaaldiam earlier in the year. At December 31, 2006 Rio Tinto had completed 8,925.15 metres of core drilling, representing 68 core holes, delineating 6 kimberlite pipes and one kimberlite sill. In addition, Rio Tinto tested 7 magnetic and 3 electromagnetic anomalies with drilling, resulting in the discovery of 5 kimberlite pipes, one kimberlite dike and one sill. Since January 2005, Vaaldiam and Rio Tinto have completed 10,093.55 metres of drilling in 78 core holes of which 54 holes tested kimberlite.

Seven new kimberlites were discovered during 2006, increasing the total number of kimberlite occurrences to 41, including 38 kimberlite pipes ranging in size from one hectare up to 18 hectares in surface area. Two kimberlite dikes, and one kimberlite sill system have also been discovered as a result of the joint venture's exploration program. Microdiamond analysis indicates that 19 of the kimberlites are diamond-bearing, and mini-bulk sampling of four kimberlite pipes has resulted in the recovery of commercial-sized diamonds. The following table presents a list of the kimberlites that have been tested by drilling by both Vaaldiam and Rio Tinto during 2005 and 2006:

Pipe Name	No. of Holes	Metres Drilled	Surface Area of Pipe (in Hectares)
Cosmos 1	5	1,148	2.3
Cosmos 3	7	1,530	12.0
Cosmos 4	5	937	5.0
Clara	2	150	Dike
Pepper 1	3	456	2.0
Pepper 3	6	854	17.0
Pepper 4	7	891	7.5
Pepper 6	3	330	Sill
Pepper 13	3	282	1.5
Pepper 18	2	379	20 (Sill)
Tumeleiro 3	3	180	3 (Sill)
Tumeleiro 9	2	247	2.0
Tumeleiro 10	1	167	3.0
Tumeleiro 11	2	286	Dike
Tumeleiro 12	1	154	2.0
Tumeleiro 13	1	200	3.0
Arara 3	1	134	2.0
Total	54	8,325	

During November 2005, Rio Tinto mobilized a reverse circulation drilling unit to the property to commence a mini-bulk sampling program designed to recover 50 tonne mini-bulk samples of kimberlite from each of four pipes that had been selected for sampling. A total of 38 reverse circulation drill holes, utilizing a 5½ inch tricone drill bit, were completed totalling 7,436 metres of drilling, which resulted in the recovery of 164 tonnes of dry kimberlite from the four pipes. The following table summarizes the results of the reverse circulation drilling completed by Rio Tinto as part of their mini-bulk sampling program:

Pipe	No. of Holes	Metres Drilled	Sample Weight (Dry Tonnes)	No. of Diamonds Recovered (>0.85 mm)	Total Diamond Weight (carats)	Estimated Recovery (%)
Cosmos 1	13	2,576	62.2	117	2.45	75%
Cosmos 3	12	2,463	56.5	16	0.28	71%
Pepper 4	10	1,896	32.6	23	0.42	71%
Pepper 13	3	501	12.7	1	0.05	82%
Total	38	7,436	164	157	3.20	75%

Granulometry tests of the kimberlite chips recovered by Rio Tinto during the reverse circulation drilling indicates that 55% of the kimberlite was reduced to a particle size of less than 2 mm. Visual inspection of the diamonds by Vaaldiam geologists, combined with an analysis of the diamond distribution, suggests that diamond breakage may have occurred during the drilling and sample collection stage. Vaaldiam and Rio Tinto have agreed to complete a diamond breakage study of the diamonds recovered during the mini-bulk sampling program, to assess the impact that any potential diamond breakage might have had on the sample results and the diamond distribution analysis. This study is expected to be completed in Antwerp, Belgium during Q2-2007. Additional mini-bulk sampling from the surface of the Cosmos 1 pipe has been recommended by Vaaldiam to confirm the diamond distribution within the Cosmos 1 pipe, and provide a comparison of the diamond recoveries from surface sampling to those obtained from reverse circulation drilling.

Vaaldiam's share of expenditure on the Pimenta Bueno property during 2006 was \$1,459,958 bringing total expenditure by the Company to December 31, 2006 to \$3,775,694. As of December 31, 2006 Rio Tinto's share of exploration expenditures on the property was \$6,789,460 (US\$5,841,965) bringing the total combined expenditures on the property by both Vaaldiam and Rio Tinto to approximately \$10,565,154. As at December 31, 2006 Vaaldiam owed \$942,665 to Rio Tinto for exploration expenditures incurred by Rio Tinto on Vaaldiam's behalf.



Duas Barras Mine, Minas Gerais, Brazil

In January 2005, Vaaldiam's subsidiary Vaaldiam do Brasil Mineração Ltda. ("VBM") (previously named Mineração Paraguaçu Indústria e Comércio Ltda.) entered into an option agreement to acquire a 70% interest in the Duas Barras property from Mineração Marly Ltda. ("Marly"). The Duas Barras property is located 150 kilometres north of the town of Diamantina in the state of Minas Gerais. The property lies along five kilometres of the left bank of the upper Jequitinhonha River, which has been a significant diamond producing area since the early 1800s. Under the terms of the January agreement, VBM could exercise its right to acquire the 70% interest by paying Marly US\$150,000 within 10 days of Marly assigning all rights, title and interest in the mineral rights of the property to the joint venture. In addition to the cash payment, VBM would provide the joint venture with the use of mining and processing equipment, and advances of working capital, with an aggregate value of US\$1,500,000. The agreement also provided VBM with the option to acquire Marly's 30% interest in the joint venture in return for a payment of US\$1,000,000. The agreement provides for a royalty to be paid to the owner of the surface rights of the Duas Barras property in the amount of 6% of gross sales revenues.

During 2005, VBM completed a detailed drilling program on the property to define the alluvial gravels comprising the Duas Barras deposit. A total of 47 percussion drill holes were completed during 2005, totalling 810 metres. In August 2005, Vaaldiam started a bulk sampling program on the Duas Barras property to determine the grade and value of the diamonds found within the alluvial gravels. To complete the bulk sampling program, the Company constructed a pilot processing plant to process a bulk sample. A total of 354 cubic metres of basal gravels were extracted and processed from two bulk sample pits, resulting in the recovery of 222 diamonds with a total weight of 72.57 carats.

Based on the favourable results generated during the drilling and bulk sampling program, VBM exercised its option to acquire the 70% interest in the Duas Barras property on December 22, 2005. On January 31, 2006 this interest was increased to 75% by an advance payment of US\$50,000 to Marly.

Following the acquisition of a 75% interest in the Duas Barras property, VBM completed an additional phase of drilling which was designed to outline an alluvial gravel resource. A total of 16 percussion drill holes totalling 282 metres, and 107 rotary drill holes totalling 2,307 metres were completed during this program, providing the basis for an estimation of the potential gravel resources available for mining. Based on the delineation drilling and bulk sampling programs completed during 2005 and 2006, the Duas Barras deposit is estimated to contain an indicated resource of approximately 1.8 million cubic metres at an estimated grade of 0.16 carats of diamonds per cubic metre and 0.18 grams of gold per cubic metre, representing an in-situ diamond resource of 295,000 carats of diamonds and 10,771 ounces of gold. An additional inferred resource of approximately 0.9 million cubic metres has also been estimated at a grade of 0.16 carats of diamonds per cubic metre and 0.18 grams of gold per cubic metre representing an in-situ diamond resource of 137,000 carats of diamonds and 5,016 ounces of gold. The resource estimate is compliant with Canadian National Instrument 43-101 and 2004 CIM Standards for Mineral Resources.

Management's Discussion and Analysis

On November 24, 2006, VBM exercised its option to acquire Marly's remaining 25% interest in accordance with the terms of the original agreement. Payment terms of the remaining consideration of US\$1,100,000 are as follows:

- US\$150,000 to be paid within 10 days after the issue of a permanent Licence of Operation by the Minas Gerais State Environmental Authority ("FEAM");
- US\$200,000 to be paid within 5 days after Marly's submission of an application to the Departamento Nacional de Produção Mineral ("DNPM") for the assignment of the Duas Barras Mining Licence to VBM's subsidiary Montes Claros (this amount was paid in February 2007);
- US\$400,000 to be paid within 10 days after the DNPM's approval and registration of the Duas Barras Mining Licence in the name of Montes Claros and the issue of a permanent Licence of Operation by FEAM; and
- US\$350,000 to be paid within 10 days after the sale of the first diamond production from the Duas Barras deposit.

On commencement of production, royalties will be payable to the Brazilian government of 0.2% of the gross revenue from the sale of diamonds and 1% of the gross revenue from the sale of gold.

Construction of the Company's diamond recovery plant is currently underway and its commissioning is expected to start towards the end of the first quarter of 2007 with commercial production expected to commence during the second quarter of 2007. This new plant has been designed to process about 80 cubic metres of gravel per hour, equivalent to an annual rate of 240,000 cubic metres, to produce an estimated 38,000 carats of diamonds and approximately 1,400 ounces of gold per year.

Improvements to the infrastructure supporting the Duas Barras Mine have also been completed, including the construction of additional accommodation for mine and construction staff, a new administration building and expanded garage facilities. Hydrological testing is also underway to measure groundwater flow in the proposed mining areas and environmental baseline studies have been completed in accordance with the environmental impact study authorized by the regulatory authorities in Brazil. In addition, the DNPM has granted VBM, on behalf of Marly, a Mining Licence for the area of the alluvial gravel deposit, as outlined by VBM's drilling program. The Licence encompasses 170.89 hectares along the left bank of the Jequitinhonha River. A temporary Licence of Operation was also granted by FEAM to VBM, on behalf of Marly, in February 2007. The final Licence of Operation is to be granted when the mine construction has been completed.

During the year ended December 31, 2006, Vaaldiam expended \$2,036,388 relating to the Duas Barras property bringing the total expenditures to December 31, 2006 to \$3,400,302.

Braúna Property, Bahia, Brazil

In August 2005, the Company acquired a 60% interest in the Braúna property from Majescor Resources Inc. ("Majescor"). Vaaldiam acquired its initial interest in the property under the terms of a purchase agreement with Majescor, whereby Vaaldiam paid De Beers Brasil Ltda. ("De Beers"), a subsidiary of De Beers Consolidated Mines Limited, the sum of \$300,000 on behalf of Majescor, which represented the balance owed by Majescor under the terms of a purchase agreement between De Beers and Majescor involving the Braúna property. In addition, Vaaldiam issued a total of 150,000 common shares to Majescor valued at time of issue at \$111,000.

The Braúna property is comprised of three exploration concessions which encompass 18 kimberlite occurrences consisting of four pipes associated with a kimberlite dyke system which has been traced over a strike length of approximately 20 kilometres. De Beers originally discovered the dike system and three of the kimberlite pipes (Braúna 3, Braúna 4, and Braúna 7) in 1992 as a result of a reconnaissance sampling program exploration. Subsequent surface sampling of the kimberlite occurrences by De Beers determined that the kimberlite occurrences were diamond-bearing.

The joint venture between Vaaldiam (60%) and Majescor (40%) commenced exploration on the Braúna property in October 2005 through the subsequently formed joint venture



company Cajueiro Mineração S.A. ("Cajueiro"). A detailed ground magnetic survey was completed during Q-4-2005, which resulted in the discovery of the Braúna 16 pipe, located just 400 metres to the northeast of the 1.0 hectare Braúna 4 pipe. An initial phase of drilling was then completed during 2006 which focused on the delineation of the Braúna 3 and Braúna 7 pipes. A total of 21 drill holes totalling 2,316 metres tested the Braúna 3 pipe to a depth of approximately 200 metres. Sixteen drill holes totalling 1,847 metres were completed at the Braúna 7 pipe, testing the pipe to a depth of 154 metres. Four drill holes totalling 418 metres were also completed at the Braúna 4 pipe, and an additional two holes were completed at the Braúna 16 pipe totalling 170 metres.

In November 2006, Vaaldiam and partner Majescor commenced a mini-bulk sampling program to confirm the presence of commercial-sized diamonds in the larger pipes on the Braúna property. A total of 100 tonnes of kimberlite was extracted from two pipes, namely the 1.7 hectare Braúna 3 pipe and the 1.0 hectare Braúna 7 pipe. The mini-bulk samples were collected through a series of vertical shafts which were being excavated through the 3 to 5 metre thick calcrete cover which overlies the pipes, to extract saprolitic kimberlite for macro diamond analysis. The extraction of the kimberlite samples from the shafts allowed the partners to maximize the kimberlite sample particle size which helped minimize diamond breakage. To provide for an efficient turnaround of the mini-bulk sample results, Vaaldiam constructed a small dense media plant which is being utilized to process the mini-bulk samples extracted from the Braúna pipes. The diamond recovery plant consists of a crushing and feed circuit, a 300 kilogram per hour dense media module, and a secure diamond recovery circuit. The recovery plant is designed as a "hands-off" unit, to ensure the security of the sample process. The plant is located within Vaaldiam's facilities in the town of Nordestina, which is situated less than five kilometres from the main cluster of pipes.

By mid-January 2007, 58 diamonds with a total weight of 7.74 carats had been recovered from 37.69 dry tonnes of kimberlite extracted from the southern lobe of the 1.7 hectare Braúna 3 pipe. The largest stones recovered weigh 1.13, 0.56, 0.49, 0.46 and 0.43 carats. The results to that date indicate a diamond grade of 20.54 carats per hundred tonnes for the southern lobe of the Braúna 3 kimberlite pipe.

On February 14, 2007, Vaaldiam signed a non-binding Letter of Intent with Majescor to acquire Majescor's 40% interest in the Braúna kimberlite property. On March 1, 2007 Vaaldiam and Majescor completed an agreement whereby Vaaldiam acquired Majescor's 40% interest in the Braúna property in return for:

- \$2,000,000 cash payment;
- \$1,500,000 paid in common shares of Vaaldiam (based on a 20-day simple average stock price at the time of closing) which amounted to 1,733,102 common shares; and
- A royalty of 1% of the gross sales revenue from diamond production from the Braúna property.

In addition to Majescor's interest in the Braúna property, Vaaldiam is undertaking due diligence regarding the proposed acquisition of Majescor's interest in the Tres Marias property. The Tres Marias property is located in the State of Minas Gerais and is comprised of 47 exploration licences covering approximately 900 km².

During the year ended December 31, 2006, the Company's Braúna property exploration expenditures were \$1,309,618. To December 31, 2006, Vaaldiam's total expenditures relating to the Braúna property amounted to \$1,783,934, including Vaaldiam's exploration expenses amounting to \$1,372,934 and Vaaldiam's acquisition costs to acquire 60% of the property of \$411,000.

Aroeira Property, Bahia, Brazil

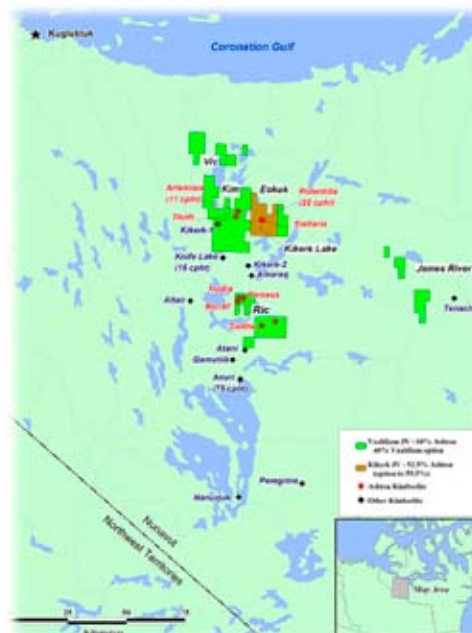
In June 2006, Vaaldiam acquired, through its subsidiary VBM, a 1,400 hectare exploration licence covering the Aroeira kimberlite. The Aroeira kimberlite is located 50 kilometres to the west of Vaaldiam's Braúna property. The property was awarded to VBM upon application to the DNPM. The Aroeira kimberlite is a one metre wide dike system that was discovered by De Beers in 1993 during an alluvial sampling campaign. The kimberlite occurrence has never been sampled or drilled.

In November 2006, Vaaldiam acquired ownership of De Beers exploration dataset for the Aroeira area. The Aroeira dataset covers an area of approximately 165,000 hectares and includes exploration results from 645 samples. Vaaldiam acquired this dataset as a result of an agreement with De Beers to purchase De Beers' exploration dataset for the Traira diamond district in northern Mato Grosso state, together with a claim owned by De Beers in the Traira area covered by the dataset. As a result of environmental restrictions, De Beers were unable to transfer ownership of the Traira claim to Vaaldiam. Therefore, in November 2006, De Beers offered and Vaaldiam accepted, the dataset for the Aroeira diamond district in the state of Bahia, to offset the inability to transfer ownership of the Traira claim to Vaaldiam. Vaaldiam has conducted no material exploration within the Aroeira district to date and the amount of \$111,710 reflected as the carrying value of the asset as at December 31, 2006 relates to the cost of acquiring the dataset from De Beers.

Coronation Gulf Property, Nunavut, Canada

In July 2006, Vaaldiam reached an agreement with Ashton Mining of Canada Inc. ("Ashton") which provides Vaaldiam with an exclusive option to acquire a 40% joint venture interest in Ashton's Coronation Gulf Property. The Coronation Gulf Property is comprised of 88 mineral claims encompassing 91,400 hectares in the Coronation Gulf area of Nunavut, approximately 525 kilometres north of the city of Yellowknife, Northwest Territories. Vaaldiam can earn its 40% interest in the Coronation Gulf Property by spending a total \$3.0 million on exploration by December 31, 2008, of which \$1.0 million must be spent by December 31, 2006. In addition, the agreement requires, subject to regulatory approval, that Vaaldiam issue Ashton a total of 195,000 common shares over the three-year term of the options, 65,000 shares not later than April 1, 2007 (deferred to May 1, 2007) and 130,000 shares not later than April 1, 2008. No shares have as yet been issued under the option agreement. Vaaldiam is the operator for the 2006 program with Ashton retaining the right of operatorship after 2006.

Prior exploration including till sampling, prospecting, drilling and airborne and ground geophysical surveys by Ashton resulted in the discovery of 11 kimberlites on the Coronation Gulf Property between 1999 and 2005. Eight of these have proven to be diamondiferous. In addition, a number of high priority airborne geophysical targets, unsourced kimberlite float and diamond indicator mineral dispersion trains remain to be evaluated on the properties.



The three hectare Artemisia pipe is the largest kimberlite pipe found to date on the Coronation Gulf Property. In August 2006, Vaaldiam collected a 100 tonne surface sample from the Artemisia pipe to confirm the presence of commercial sized diamonds, and determine whether the size distribution and quantity of the diamonds is sufficient to justify a larger bulk sampling program during 2007. Processing of this 100 tonne mini-bulk sample commenced in December 2006 at SGS Lakefield Research Limited, with results expected during Q2-2007. The mini-bulk sample represents the largest volume of kimberlite extracted from the Artemisia pipe. In addition to the 100 tonne mini-bulk sample collected from the Artemisia pipe, Vaaldiam also collected a one tonne sample from the Perseus kimberlite, located 37 kilometres south of the Artemisia pipe, to assess the diamond distribution within this kimberlite dyke system. This sample will also be processed at SGS Lakefield Research Limited following the completion of the processing of the Artemisia sample.

To December 31, 2006, Vaaldiam had spent \$1,396,460 in relation to the exploration of the Coronation Gulf Property, which has included the collection of the 100 tonne mini-bulk sample from the Artemisia kimberlite.

Hotish Mountain Property, Quebec, Canada

In April 2005, Vaaldiam negotiated an option agreement with Dios Exploration Inc. ("Dios") whereby the Company could have earned a 51% interest in the Hotish Mountain property by incurring exploration expenditures of \$2,000,000 as follows:

Deadline	Expenditures
On or before April 12, 2006	\$ 300,000 (completed)
On or before April 12, 2007	\$ 700,000
On or before April 12, 2008	\$ 1,000,000

In addition, Vaaldiam was required to issue a total of 100,000 common shares to Dios as follows:

Issue Date	Number of Shares
Forthwith on receiving Toronto Stock Exchange approval	25,000 shares (issued)
April 12, 2006	25,000 (not issued)
April 12, 2007	50,000 shares (not issued)

The Hotish Mountain property is situated in the Otish Mountain district of northern Quebec. The property covers approximately 50,000 hectares, and is situated approximately 100 kilometres south of the diamondiferous Renard kimberlite cluster.

In August and November 2005, an indicator sampling program was completed on the Hotish Mountain property involving the collection of 150 glacial till samples to determine the source of indicator mineral anomalies. Dios granted Vaaldiam a 30 day extension of the anniversary date of the option agreement to provide the Company with an opportunity to review the sampling results to date, and make a decision regarding the continuation of the option. In May 2006, Vaaldiam notified Dios that, based on results to date, the Company would not be undertaking further exploration of the property.

To end March 2006, \$439,160 had been spent on the exploration of the Hotish property, in addition to which \$14,500 of option expenditures had been made for total expenditures of \$453,660, which amount was written off effective March 31, 2006. In April 2006 an additional \$2,683 was expended on the Hotish property, which amount was also written off giving rise to a total of \$456,343 being written off in 2006 in relation to this property.



Haute Kotto Property, Central African Republic

In March 2004, the Company was granted a 2,000 square kilometres reconnaissance permit in the Haute Kotto District of southeastern Central African Republic ("CAR"). The area is prospective for both kimberlite and alluvial diamond deposits. In February 2005, the Company was granted an exploration permit covering an area of 682.1 square kilometres within the area of the reconnaissance permit. The exploration permit is valid for a period of three years and is subject to a minimum expenditure on exploration of approximately \$35,000 per year.

Following a review of the Haute Kotto property and the alternative uses for the cash which would otherwise be required to be spent in the future on the property, Vaaldiam decided that its cash resources should be concentrated on the Company's more advanced projects. While the Company will endeavour to maintain the property with a view to divestiture or joint venture, it was considered prudent to write off the expenditures to December 31, 2006 associated with the property in the amount of \$709,335.

Selected Financial Information

	2006	2005	2004
Net sales	-	-	-
Net loss - total	\$ 3,517,506	\$ 1,007,251	\$ 742,419
- per share	\$ 0.044	\$ 0.018	\$ 0.020
Cash and cash equivalents	\$ 12,318,783	\$ 6,817,542	\$ 1,816,797
Restricted cash	\$ 429,300	\$ 1,331,916	\$ 428,711
Working capital	\$ 11,455,710	\$ 7,966,995	\$ 1,972,199
Total assets	\$ 24,862,182	\$ 13,593,562	\$ 4,071,428
Total long-term financial liabilities	-	-	-
Shareholders' equity	\$ 23,344,846	\$ 13,276,648	\$ 3,751,305
Cash dividends per share	-	-	-

Summary of Quarterly Results

Quarters Ended	Net Sales	Income (Loss)	
		Total	Per Share
December 31, 2006	-	\$ (926,003)	\$ (0.014)
September 30, 2006	-	(193,701)	(0.00)
June 30, 2006	-	(382,991)	(0.00)
March 31, 2006	-	(2,014,811)	(0.03)
December 31, 2005	-	75,414	0.00
September 30, 2005	-	(357,617)	(0.00)
June 30, 2005	-	(355,848)	(0.01)
March 31, 2005	-	(369,200)	(0.01)

During the year ended December 31, 2006, a loss of \$3,517,506 or \$0.044 per share was recorded compared to a loss of \$1,007,251 or \$0.018 per share during the corresponding period of the prior year. The increased loss of \$2,510,255 arose primarily from an increase in stock based compensation expense of \$1,185,329, an increase in corporate and general expenses of \$484,790, increased property write offs of \$881,797, increased amortization of \$71,843 and reduced income tax recovery of \$308,179, all partially offset by increased interest income of \$426,332. The increased stock based compensation expense arose from an issuance of options in the first quarter of 2006 while the increase in corporate and general expenses and amortization expenses arose primarily from a higher level of activity in the recent year as compared to the corresponding period in the previous year. A lower level of flow-through shares issued accounted for the reduced income tax recovery while the increased interest income arose from a higher level of cash on deposit.

Seasonality has relatively little effect on the quarterly financial results of the Company, however, in that renunciation of Canadian Exploration Expense to flow-through share investors incurred or to be incurred, typically takes place in the last quarter of each year, a related income tax recovery has been reflected during the last quarter of 2006 and 2005. In the first quarter of 2006, an expense of \$1,185,115 was recorded relating to a grant of options, in addition to which the Hotish property in the amount of \$453,660 was written off.

During the quarter ended December 31, 2006, the main extraordinary items related to the write off of the Haute Kotto property in the CAR in the amount of \$709,335 and the recognition of an income tax recovery of \$180,600. In the quarter ended December 31, 2005 an income tax recovery of \$488,779 was recorded.

Liquidity

As at December 31, 2006, the Company had working capital of \$11,455,710, the cash and cash equivalent portions of which was \$12,318,783. Cash equivalents relate to funds kept in a Scotia Premium T-Bill Fund, which fund is administered by Scotia Securities. The Scotia Premium T-Bill Fund invests primarily in Government of Canada treasury bills and other short-term debt instruments guaranteed by the Government of Canada. In addition to the cash and cash equivalents as at December 31, 2006, the Company had \$429,300 in restricted cash which was the balance remaining from the issuance of flow-through shares.

Accounts payable and accrued liabilities at December 31, 2006 of \$1,517,336 was unusually high as this figure included a provision of \$942,665 with regard to amounts owing to Rio Tinto as Vaaldiam's share of Pimenta Bueno exploration expenditures and an advance of \$182,990 relating to exploration expenditures to be incurred on behalf of a joint venture partner on the Braúna project.

During 2006, the Company completed a financing which provided additional gross proceeds of \$7,500,000 to Vaaldiam's treasury from the issuance of 7,777,778 common shares at \$0.90 per share and 476,191 flow-through common shares at \$1.05 per share, as a result of the automatic exercise of earlier issued special warrants, following the filing of a short-form prospectus.

Also during 2006, the Company raised an additional \$4,675,375 primarily as a result of the issuance of a notice of accelerated expiry regarding 5,088,483 warrants exercisable at \$0.80 each which were originally scheduled to expire on December 16, 2006. The notice of accelerated expiry was facilitated by the trading of Vaaldiam's shares above \$1.00 for 21 consecutive trading days, an event which allowed the

Company to determine the earlier expiry date of April 3, 2006 in accordance with the terms of the warrants. The exercise of options and repayment of share purchase loans yielded an additional \$578,500 and \$133,284 respectively to the Company's treasury.

As at December 31, 2006 restricted cash amounted to \$429,300, which related to unspent flow-through share issue proceeds and which are required to be spent on eligible Canadian Exploration Expenditures prior to December 31, 2007. Unspent flow-through share issue proceeds are kept in separate bank accounts on which cheques relating to eligible Canadian Exploration Expenditures are drawn.

With no current internal sources of available cash flow, Vaaldiam is dependent on the junior mining capital markets and the exercise of outstanding warrants and options for the provision of operating capital. The availability of capital to the Company is dependent on stock market performance for junior mining stocks in general and Vaaldiam's stock in particular, exploration successes or the lack thereof, the degree to which investors view a new initiative as positive or negative for the Company, significant world socioeconomic events, recent discoveries of magnitude by peer companies and the general willingness of brokerage houses to assist the Company in the raising of funds. There is no certainty that funding will be available to Vaaldiam when required.

Vaaldiam has no debt nor lines of credit.

Capital Resources

As at March 22, 2007, Vaaldiam had cash and cash equivalents of \$8.0 million.

A potential source of additional capital would be the exercise of options. As at March 22, 2007, the Company had issued the following unexercised options.

No. of Options	Expiry Date	Exercise Price	Potential Proceeds
18,750	July 19, 2007	\$ 0.29	\$ 5,438
1,330,000	November 20, 2008	0.50	665,000
100,000	February 20, 2009	0.50	50,000
525,000	September 20, 2009	0.45	236,250
40,000	December 14, 2009	0.40	16,000
55,000	May 10, 2010	0.50	27,500
100,000	August 4, 2010	0.85	85,000
2,105,000	January 16, 2011	0.75	1,578,750
75,000	April 18, 2011	1.37	102,750
50,000	June 9, 2011	0.97	48,500
2,675,000	January 24, 2012	0.85	2,273,750
7,073,750			\$ 5,088,938

There is no assurance that the capital resources required by the Company will be available.

Off Balance Sheet Arrangements

Under the terms of the Company's office lease, the Company is committed to pay a minimum annual amount of approximately \$103,000 in total over the period January 1, 2007 to November 30, 2009, which amount includes rent, operating costs and realty taxes.

Transactions with Related Parties

During 2004, as part of the \$2,580,000 private placement of units and flow-through shares completed during September, four directors subscribed for a total of 531,975 units of Vaaldiam, at \$0.45 per unit for a total of \$212,790; each unit consisting of one common share and one half of a common share purchase warrant; each whole warrant being exercisable to acquire one common share of the Company at an exercise price of \$0.50 per share on or before the twelve months anniversary of date of issue. The funding to acquire the units was provided by initially short-term interest free loans extended by the Company to the four directors. The term of these loans was subsequently extended, so that the loans were repayable in full on or before June 30, 2006. In addition, during the quarter ended September 30, 2005, a short-term interest free loan, repayable on or before June 30, 2006, was granted to a director and officer to acquire common shares of Vaaldiam in the amount of \$20,494. All unpaid share purchase loans to directors since January 1, 2006 bear interest at Canadian prime rate plus 3%. As at March 22, 2007 all directors' loans relating to the purchase of shares had been repaid in full plus interest.

In May 2006, a loan bearing interest at the Canadian prime rate plus 3%, repayable on demand in the amount of \$40,000, was granted to an officer and director and was still outstanding on March 22, 2007.

During 2006 an amount of approximately \$38,503 was paid to a company owned by a significant shareholder for accounting and administrative services provided to the Company's Brazilian subsidiaries during 2006.

Proposed Transactions

On a continuous basis, the Company reviews additional exploration properties with a view to their acquisition for exploration and development and other diamond companies with the view to merger or acquisition. From time to time the Company pursues opportunities to restructure its ownership in its existing properties where this is deemed advantageous.

Management Report

Management's Responsibility for Consolidated Financial Statements

The accompanying audited consolidated financial statements of the Company are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include certain estimates that reflect management's best judgments. Financial information reflected in this Management's Discussion and Analysis is consistent with these financial statements.

The Company's Board of Directors has approved the information contained in the audited consolidated financial statements and this Management's Discussion and Analysis. The Board of Directors fills its responsibility regarding the financial statements mainly through its Audit Committee, which has a written mandate which complies with the current requirements of Canadian securities legislation. The Audit Committee meets at least on a quarterly basis.

Management's Assessment of Disclosure Controls and Procedures

Based on their evaluations as of December 31, 2006 the President and Chief Executive Officer, and the Vice-President and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective in providing reasonable assurance in ensuring that information relating to the Company and its consolidated subsidiaries which is required to be disclosed in reports filed under relevant securities legislation is recorded, summarized and reported within the time periods specified by such legislation, and that the information is accumulated and communicated to the Company's senior management, including the President and Chief Executive Officer, and the Vice-President and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management's Assessment of Internal Control over Financial Reporting

Management is also responsible for establishing and maintaining adequate internal control over the Company's financial reporting. The internal control system was designed to provide reasonable assurance to the Company's management regarding the preparation and presentation of the consolidated financial statements.

Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The President and Chief Executive Officer, and the Vice-President and Chief Financial Officer have reviewed the internal control procedures in existence as of December 31, 2006, and concluded that the Company's internal controls over financial reporting have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles ("GAAP"). During the most recent interim period, there has been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Critical Accounting Estimates

Under the accounting rules used by Vaaldiam, the fair value of stock based compensation (option grants) is expensed for income statement purposes. The determination of fair value of options granted is generally provided by the Black-Scholes formula. Some of the parameters used in this formula are highly subjective, in particular the assumption of future price volatility. In addition, using the Black-Scholes model assumes that a satisfactory active market for the options exists whereas ownership of the options granted by Vaaldiam cannot be transferred under the rules of the Toronto Stock Exchange and the Company's Stock Option Plan. During the year ended December 31, 2006, \$1,418,100 was expensed as the cost of options issued under the Company's Stock Option Plan. The amount of \$1,418,100 expensed or debited on the Consolidated Statement of Loss and Deficit was offset by a corresponding credit of the same amount to the Stock Option Account included in Shareholder's Equity, as a result of which, on a net basis, the expensing of stock options had no effect on the overall Shareholder's Equity of the Company.

An additional critical accounting estimate related to the assumed recoverability of the carrying value of exploration properties which is dependent on the assumed discovery of economically recoverable reserves, the assumed ability of the Company to obtain financing or other means to complete development of the properties and assumed future profitable production or proceeds from the disposition of the properties. As at December 31, 2006, exploration properties were reflected in the Company's balance sheet at \$10,468,100.

Changes in Accounting Policies Including Initial Adoption

Vaaldiam's accounts are stated using Canadian GAAP. With the exception of the adoption by the Company of the four new Canadian Institute of Chartered Accountants' standards referred to in Note 3 to the audited consolidated financial statements, the adoption of which had no impact on the 2006 consolidated financial statements, the Company's accounting policies have not changed during 2006 and no future changes are contemplated except as may be required to conform with future changes in Canadian GAAP.

Financial Instruments and Other Instruments

An amount of \$10,637,733 of the Company's cash assets as at December 31, 2006 were invested in a Scotiabank, mainly Government of Canada, Treasury Bills Account which is considered to be a low risk interest bearing account.

Management's Discussion and Analysis

Disclosure of Outstanding Share Data

As at March 22, 2007, the following were the undiluted and fully diluted common shares outstanding:

Undiluted common shares outstanding as at December 31, 2006	81,449,352
Shares issued to acquire 40% of Cajueiro (Braúna property)	1,733,102
Undiluted common shares outstanding as at March 22, 2007	83,182,454
Shares issuable on exercise of options as at March 22, 2007	7,073,750
Fully diluted shares outstanding as at March 22, 2007	90,256,204

Corporate and General Expenses

The following is a comparison of Corporate and General Expenses incurred during the year ended December 31, 2006 compared to the corresponding period of the prior year.

	2006	2005	(Increase) Decrease
Administration	\$ 475,856	\$ 289,400	\$ (186,456)
Investor Relations	275,072	173,663	(101,409)
Directors' Fees and Performance Bonuses	59,400	139,000	79,600
Health Insurance	43,057	30,871	(12,186)
Office Rent	72,808	51,614	(21,194)
Insurance	27,466	14,853	(12,613)
Stationery and Printing	15,716	29,405	13,689
Telephone and Fax	25,618	16,714	(8,904)
Audit, Tax and Professional Fees	69,080	47,400	(21,680)
General Travel	10,869	15,179	4,310
Project Development	6,688	-	(6,688)
IT Support	7,330	-	(7,330)
Sundry Expenses	40,164	34,781	(5,383)
Capital Tax	5,989	-	(5,989)
General Legal Fees	35,968	20,563	(15,405)
Filing Fees	42,092	9,018	(33,074)
TSX Listing Expenses	120,322	48,133	(72,189)
Registrar's Fees	14,439	13,203	(1,236)
Annual Meeting Expenses (including annual report)	54,653	19,752	(34,901)
Bank Charges	2,027	414	(1,613)
Tax on Unspent Flow Through Shares	48,475	14,336	(34,139)
	\$ 1,453,089	\$ 968,299	\$ (484,790)

During the year ended December 31, 2006 Corporate and General Expenses were \$1,453,089, an increase of \$484,790 over the prior year's level of \$968,299. In general, the increase in Corporate and General Expenses in 2006 reflects a higher level of corporate activity compared to the prior year and expenses associated with securing a Toronto Stock Exchange listing.

Umbu Duas Barras



CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2006 and 2005



Aroeira
Pimenta Bueno
Umbu
Araúna

Auditors' Report

**To the Shareholders of
Vaaldiam Resources Ltd.**
(A Development Stage Entity)

We have audited the consolidated balance sheet of Vaaldiam Resources Ltd. (a Development Stage Entity) as at December 31, 2006 and the consolidated statements of loss and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. These standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at and for the year ended December 31, 2005 were audited by another firm of chartered accountants who expressed an opinion without reservation in their report dated March 31, 2006.

Ernst & Young LLP

Ernst & Young LLP
Chartered Accountants
March 16, 2007

Consolidated Financial Statements

Vaaldiam Resources Ltd.

(A Development Stage Entity)

Consolidated Balance Sheets

(As at December 31, 2006 and 2005)

ASSETS

	<u>Notes</u>	<u>2006</u>	<u>2005</u>
CURRENT			
Cash and cash equivalents		\$ 12,318,783	\$ 6,817,542
Restricted cash	15(b)	429,300	1,331,916
Sundry receivables and prepayments		224,963	134,451
TOTAL CURRENT ASSETS		<u>12,973,046</u>	<u>8,283,909</u>
PROPERTY AND EQUIPMENT	4	819,202	369,604
ASSETS UNDER CONSTRUCTION	5	601,834	-
EXPLORATION PROPERTIES	6	10,468,100	4,940,049
		<u>\$ 24,862,182</u>	<u>\$ 13,593,562</u>

LIABILITIES

CURRENT			
Accounts payable and accrued liabilities	7	\$ 1,517,336	\$ 316,914

SHAREHOLDERS' EQUITY

MINORITY INTEREST IN EQUITY		<u>168,778</u>	<u>-</u>
COMMON SHARES	8(a)	26,437,578	13,315,518
COMMON SHARE PURCHASE WARRANTS	8(b)	277,333	1,147,751
STOCK OPTIONS	8(c)	1,868,910	703,626
DEFICIT		(5,407,753)	(1,890,247)
		<u>23,176,068</u>	<u>13,276,648</u>
TOTAL SHAREHOLDERS' EQUITY		<u>23,344,846</u>	<u>13,276,648</u>
		<u>\$ 24,862,182</u>	<u>\$ 13,593,562</u>

COMMITMENTS AND CONTINGENCIES	6 and 15
SUBSEQUENT EVENTS	6 and 16

See accompanying notes to consolidated financial statements.

APPROVED ON BEHALF OF THE BOARD:



Director



Director

Vaaldiam Resources Ltd.

(A Development Stage Entity)

Consolidated Statements of Loss and Deficit

(For the years ended December 31, 2006 and 2005)

	<u>Notes</u>	<u>2006</u>	<u>2005</u>
EXPENSES			
Corporate and general		\$ 1,453,089	\$ 968,299
Stock-based compensation	8(c)	1,418,100	232,771
Amortization		167,758	95,915
Loss on foreign exchange		16,068	12,296
		<u>3,055,015</u>	<u>1,309,281</u>
Less: Interest income		523,464	97,132
		<u>2,531,551</u>	<u>1,212,149</u>
LOSS BEFORE THE FOLLOWING		(2,531,551)	(1,212,149)
OTHER EXPENSES			
Write-off of exploration properties	6	<u>(1,165,678)</u>	<u>(283,881)</u>
LOSS BEFORE INCOME TAXES		(3,697,229)	(1,496,030)
INCOME TAX RECOVERY	10	<u>180,600</u>	<u>488,779</u>
NET LOSS BEFORE MINORITY INTEREST		(3,516,629)	(1,007,251)
MINORITY INTEREST		<u>(877)</u>	<u>-</u>
NET LOSS FOR THE YEAR		(3,517,506)	(1,007,251)
DEFICIT, beginning of year		<u>(1,890,247)</u>	<u>(882,996)</u>
DEFICIT, end of year		\$ <u>(5,407,753)</u>	\$ <u>(1,890,247)</u>
Basic and diluted loss per share	9	\$ <u>(0.044)</u>	\$ <u>(0.018)</u>

See accompanying notes to consolidated financial statements.

Vaaldiam Resources Ltd.

(A Development Stage Entity)

Consolidated Statements of Cash Flow

(For the years ended December 31, 2006 and 2005)

	<u>2006</u>	<u>2005</u>
OPERATING ACTIVITIES		
Net loss for the year	\$ (3,517,506)	\$ (1,007,251)
Amortization	167,758	95,915
Write-off of exploration properties	1,165,678	283,881
Stock-based compensation	1,418,100	232,771
Future income tax recovery	(180,600)	(488,779)
Minority interest	877	-
	<u>(945,693)</u>	<u>(883,463)</u>
Change in non-cash components of working capital		
Sundry receivables and prepayments	(90,512)	(87,637)
Accounts payable and accrued liabilities	72,416	(199,791)
	<u>(18,096)</u>	<u>(287,428)</u>
Cash provided by (used in) operating activities	<u>(963,789)</u>	<u>(1,170,891)</u>
INVESTING ACTIVITIES		
Purchase of property and equipment	(1,219,190)	(354,753)
Mineral exploration expenditures	(5,565,723)	(3,233,508)
Restricted cash	902,616	(903,205)
Cash used in investing activities	<u>(5,882,297)</u>	<u>(4,491,466)</u>
FINANCING ACTIVITIES		
Net proceeds from issuance of common shares and common share purchase warrants	12,179,426	10,663,102
Proceeds from issuance of shares in subsidiary to minority interest	167,901	-
Cash provided by financing activities	<u>12,347,327</u>	<u>10,663,102</u>
CHANGES IN CASH AND CASH EQUIVALENTS	5,501,241	5,000,745
CASH AND CASH EQUIVALENTS, beginning of year	<u>6,817,542</u>	<u>1,816,797</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 12,318,783</u>	<u>\$ 6,817,542</u>
CASH AND CASH EQUIVALENTS ARE COMPRISED OF THE FOLLOWING:		
Cash	\$ 1,681,050	\$ 1,276,579
Short-term investments	10,637,733	5,540,963
	<u>\$ 12,318,783</u>	<u>\$ 6,817,542</u>

Supplementary cash flow information (Note 14)

See accompanying notes to consolidated financial statements.

1. NATURE OF OPERATIONS

Vaaldiam Resources Ltd. (a development stage entity) (the “Company”) is a publicly held company incorporated under the Canada Business Corporations Act. The Company is engaged in the investigation, acquisition, exploration and development of mineral properties. Substantially, all of the efforts of the Company are devoted to these business activities. The recoverability of the amounts shown for exploration properties is dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of those reserves, upon future profitable production and/or the proceeds from the disposition thereof. To date, the Company has not earned revenue and is considered to be in the development stage.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles.

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company, its 99.999% owned subsidiary, Vaaldiam do Brasil Mineração Ltda. (“VBM”), formerly Mineração Paraguaçu Indústria e Comércio Ltda., VBM’s 99.9% owned subsidiary, Mineração Montes Claros Ltda. (“Montes Claros”) and VBM’s 60.0% owned subsidiary Cajueiro Mineração S.A (“Cajueiro”), all incorporated in Brazil. All inter-company balances and transactions have been eliminated on consolidation.

(b) Cash and Cash Equivalents

Cash and cash equivalents include all cash on hand, bank balances and all highly liquid short-term investments. The Company considers all highly liquid short-term investments with a maturity of three months or less at the date of purchase to be cash equivalents.

(c) Property and Equipment

The Company’s property and equipment is recorded at cost and is amortized over the useful life of the assets as follows:

Leasehold improvements	-	30%, declining balance basis
Exploration machinery	-	30%, declining balance basis
Vehicles	-	30%, declining balance basis
Furniture and fixtures	-	20%, declining balance basis
Computers	-	30%, declining balance basis

(d) Assets Under Construction

The Company’s assets under construction are recorded at cost and are transferred to property and equipment together with any pre-production revenues at the commencement of commercial production.

(e) Exploration Properties

The Company considers its exploration costs to have the characteristics of property, plant and equipment. As such, the Company defers all exploration costs including acquisition costs, field exploration and field supervisory costs relating to specific properties, until those properties are brought into production, at which time they will be amortized on a unit-of-production basis based on proven and probable reserves or until the properties are abandoned, sold or considered to be impaired in value, at which time, an appropriate charge would be made.

The recoverability of the carrying value of exploration properties is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain financing or other means to complete development of the properties, and the future profitable production or proceeds from the disposition of the properties.

Notes to Consolidated Financial Statements

The amounts capitalized represent costs to be charged to operations in the future and do not necessarily reflect the present or future values of particular properties.

(f) Future Income Taxes

The Company uses the liability method of accounting for income taxes. Under this method of tax allocation, future income and mining tax assets and liabilities are determined based on differences between the financial statement carrying values and their respective income tax bases (temporary differences). Future income tax assets and liabilities are measured using the enacted tax rates and laws expected to be in effect when the temporary differences are likely to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the year in which the change is enacted or substantially enacted. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

(g) Stock-based Compensation

The Company has a stock-based compensation plan, which is described in Note 8(c). The Company accounts for all stock-based payments using the fair value method, calculated based on the Black-Scholes valuation model. Under this method, compensation cost attributable to options granted is measured at fair value at the grant date and amortized at that date if the options granted vest immediately. Options normally vest immediately under Company policy. As the amount of compensation cost amortized is offset by a credit to stock options in the shareholders' equity account, the compensation cost amortized has therefore no effect on total shareholders' equity.

(h) Loss Per Share

Basic loss per share is computed by dividing loss available to common shareholders by the weighted average number of common shares outstanding during the year. The treasury stock method is used to calculate diluted loss per share. Diluted loss per share is similar to basic loss per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding assuming that options and warrants, with average market prices for the year greater than their exercise prices, were exercised and the proceeds used to repurchase common shares.

(i) Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, particularly mineral properties, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(j) Long-Lived Assets

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. To the extent that the carrying amount is not recoverable, an impairment loss is recognized if the carrying amount of the asset exceeds its fair value.

(k) Asset Retirement Obligations

The Company accrues the legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal operation of a long-lived asset.

The fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred. When the liability is initially recorded, the cost is capitalized by increasing the carrying amount of the related long-lived asset. Upon settlement of the liability, a gain or loss is recorded.

(l) Foreign Currency Translation

The Company's foreign subsidiaries are operationally and financially dependent and as such, are translated using the temporal method. Under this method, monetary assets and liabilities are translated into Canadian dollars at the rate of exchange in effect at the consolidated balance sheet date and non-monetary assets and liabilities are translated at the historical rate of exchange. Revenues and expenses are translated into Canadian dollars at the annual average exchange rates. Foreign currency gains and

losses are recognized in the consolidated statements of loss and deficit.

The Company's foreign currency balances and transactions are translated under the same method as its subsidiary.

(m) Flow-Through Common Shares

The Company has financed a portion of its exploration activities through the issuance of flow-through shares, which transfer the tax deductibility of exploration expenditures to the investor. The proceeds received on the issuance of such shares have been credited to share capital and the related exploration costs are deferred to exploration properties when incurred. Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. When these expenditures are renounced, temporary taxable differences created by the renunciation will reduce share capital.

3. NEW ACCOUNTING POLICIES

Effective January 1, 2006, the Company adopted four new Canadian Institute of Chartered Accountants' standards related to financial instruments. Adoption of these standards had no impact on the consolidated financial statements of the Company for 2006.

(a) Financial Instruments – Recognition and Measurement (Section 3855)

This standard specifies when a financial asset, financial liability or non-financial derivative is to be recognized on the balance sheet and what measures are to be used, and how gains and losses in respect of these financial instruments are to be presented.

(b) Financial Instruments – Disclosure and Presentation (Section 3861)

This standard specifies the presentation of financial instruments and non-financial derivatives and identifies the information that should be disclosed.

(c) Hedges (Section 3865)

This standard specifies how hedge accounting is to be applied and what disclosures are to be required.

(d) Comprehensive Income (Section 1530)

This standard specifies how comprehensive income is to be reported and presented. Comprehensive income is the change in shareholders' equity of a company other than those resulting from investments by owners and distributions to owners. These items include holding gains and losses on certain investments, gains and losses on certain derivative instruments, and foreign currency gains and losses related to self-sustaining foreign operations.

4. PROPERTY AND EQUIPMENT

	<u>2006</u>		<u>2005</u>	
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Cost</u>	<u>Accumulated Amortization</u>
Leasehold improvements	\$ 140,979	\$ 19,740	\$ 43,021	\$ 2,735
Exploration machinery	591,109	138,196	239,190	50,474
Vehicles	221,902	91,089	126,854	54,838
Furniture and fixtures	73,192	16,019	36,890	6,185
Computers	90,782	33,718	54,653	16,772
	<u>\$ 1,117,964</u>	<u>\$ 298,762</u>	<u>\$ 500,608</u>	<u>\$ 131,004</u>
Net book value	<u>\$819,202</u>		<u>\$369,604</u>	

Notes to Consolidated Financial Statements

5. ASSETS UNDER CONSTRUCTION

During 2006, construction of the Duas Barras mine began, with a diamond recovery plant and infrastructure being built. Commissioning is scheduled for the second quarter of 2007.

6. EXPLORATION PROPERTIES

	<u>Balance</u> <u>December 31,</u> <u>2004</u>	<u>Additions</u> <u>2005</u>	<u>Balance</u> <u>December 31,</u> <u>2005</u>	<u>Additions</u> <u>2006</u>	<u>Balance</u> <u>December 31,</u> <u>2006</u>
Brazil					
a. Pimenta Bueno Property					
Acquisition cost	\$ -	\$ -	\$ -	\$ 265,311	\$ 265,311
Exploration expenditures	1,327,836	987,900	2,315,736	1,194,647	3,510,383
	<u>1,327,836</u>	<u>987,900</u>	<u>2,315,736</u>	<u>1,459,958</u>	<u>3,775,694</u>
b. Brauna Property					
Acquisition cost	-	411,000	411,000	-	411,000
Exploration expenditures	-	63,316	63,316	1,309,618	1,372,934
	<u>-</u>	<u>474,316</u>	<u>474,316</u>	<u>1,309,618</u>	<u>1,783,934</u>
c. Duas Barras Property					
Acquisition cost	33,899	-	33,899	-	33,899
Exploration expenditures	-	1,330,015	1,330,015	2,036,388	3,366,403
	<u>33,899</u>	<u>1,330,015</u>	<u>1,363,914</u>	<u>2,036,388</u>	<u>3,400,302</u>
d. Arocira Area					
Acquisition cost	-	-	-	111,710	111,710
e. Alto Paraguai Area					
Exploration expenditures	28,173	(28,173)	-	-	-
f. Colorado do Oeste Area					
Exploration expenditures	28,173	(28,173)	-	-	-
	<u>28,173</u>	<u>(28,173)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Canada					
g. Coronation Gulf Property					
Exploration expenditures	-	-	-	1,396,460	1,396,460
	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,396,460</u>	<u>1,396,460</u>
h. Hotish Mountain Property ⁽¹⁾					
Acquisition cost	-	14,500	14,500	(14,500)	-
Exploration expenditures	-	431,110	431,110	(431,110)	-
	<u>-</u>	<u>445,610</u>	<u>445,610</u>	<u>(445,610)</u>	<u>-</u>
i. Otish Property					
Acquisition cost	15,750	(15,750)	-	-	-
Exploration expenditures	95,101	(95,101)	-	-	-
	<u>110,851</u>	<u>(110,851)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Central African Republic					
j. CAR-Haute Kotto Property ⁽²⁾					
Exploration expenditures	51,909	288,564	340,473	(340,473)	-
k. CAR-Kimberlite Project					
Exploration expenditures	87,499	(87,499)	-	-	-
Total Exploration Properties	<u>\$ 1,668,340</u>	<u>\$ 3,271,709</u>	<u>\$ 4,940,049</u>	<u>\$ 5,528,051</u>	<u>\$ 10,468,100</u>

⁽¹⁾ Property written off included an additional \$10,733 of exploration expenditures incurred during 2006.

⁽²⁾ Property written off included an additional \$368,862 of exploration expenditures incurred during 2006.

Brazilian Properties

(a) Pimenta Bueno Property

The Pimenta Bueno property, located in the southeastern part of the state of Rondonia, Brazil, consists of exploration permits and mining concessions in two blocks, covering an area of approximately 247,085 hectares in total. Exploration is being conducted for the discovery of diamond bearing kimberlites which can be economically developed.

In November 2003, the Company reached an agreement with Rio Tinto Desenvolimentos Minerais Ltda. ("RTDM"), whereby RTDM was granted a right to exercise an option to earn a 51% interest in either or both of the Northern and Southern Blocks, following a due diligence review of the exploration results generated during the Company's initial phase of exploration between December 2003 and January 2005.

In June 2005, RTDM exercised its option to acquire a 51% interest in the Southern and Northern Blocks. Pursuant to the agreement, RTDM would acquire the 51% interest in the Southern Block by spending a total of US\$5,000,000 on exploration over a three year period. RTDM would also acquire a 51% interest in the Northern Block by spending a total of US\$7,500,000 over three years. As RTDM's expenditures on the Southern Block exceeded US\$5,000,000 on a cumulative basis during 2006, it earned a 51% interest in the Southern Block and the Company is obligated to share 49% of the total expenditures over US\$5,000,000 in the Southern Block to maintain the Company's interest.

The agreement also provides RTDM with the opportunity to increase its interest to 70% in either or both of the Northern or Southern Blocks by completing a feasibility study on any kimberlite deposit found. The feasibility study would have to be sufficiently comprehensive to enable the Company to seek bank financing for its interest in the joint venture. The Company also has the exclusive right to develop any kimberlite or alluvial diamond deposits within the property which do not meet the development criteria of RTDM. In this regard, the Company has the exclusive right to market diamond production from any kimberlite or alluvial diamond deposit it has developed for its own account.

In June 2006, the Company also acquired additional geological data in respect of the Pimenta Bueno property from De Beers Brasil Ltda. ("De Beers") at a cost of US\$237,500.

(b) Brauna Property

The Brauna property is located in the state of Bahia, Brazil and is comprised of three exploration concessions, covering an area of approximately 4,910 hectares. It encompasses 17 known kimberlite occurrences consisting of four pipes associated with an extensive kimberlite dyke system.

The Company acquired a 60% interest in the Brauna property in August 2005 under the terms of a purchase agreement with Majescor Resources Inc. ("Majescor") whereby the Company paid De Beers the sum of \$300,000 on behalf of Majescor which represented the balance owed by Majescor under the terms of a purchase agreement between De Beers and Majescor involving the Brauna property. In addition, the Company issued a total of 150,000 common shares to Majescor. The Company and Majescor agreed to explore the property pursuant to a joint venture agreement.

The joint venture agreement dated October 31, 2005 provided that the Company's Brazilian subsidiary VBM would own 60% of the joint venture with Majescor owning 40%. Should either party fail to provide its share of exploration expenditures on the Brauna property then that party's interest in the joint venture company would decline in accordance with an agreed formula. The shareholders of the joint venture company are entitled to appoint one director to the board of the joint venture company for each whole 20% interest held. Under the joint venture agreement the Company was appointed as manager of operations, which manager would be paid a fee of 10% of exploration expenditures incurred in accordance with the adopted exploration budget. In September 2006, Cajueiro became the joint venture company owning the Brauna property, with Cajueiro owned as to 60% by VBM and 40% by Majescor.

See Subsequent Events Note 16(b).

(c) Duas Barras Property

The Duas Barras property is an alluvial diamond property located 150 kilometres north of the town of Diamantina in the state of

Notes to Consolidated Financial Statements

Minas Gerais, Brazil. The Mining Licence covers an area of 170.89 hectares along a five kilometre length of the Jequitinhonha River.

In January 2005, VBM entered into an option agreement to acquire a 70% interest in the Duas Barras property from Mineração Marly Ltda. (“Marly”). Under the agreement, should VBM exercise the option, it would be required to pay US\$150,000 to Marly within 10 days of Marly assigning all rights, title and interest in the Mineral Rights of the property to the joint venture to be subsequently formed. VBM would also provide to the joint venture use of equipment and advances of working capital with an aggregate value of US\$1,500,000. Marly also granted VBM the option to acquire its 30% interest in the joint venture at any time in return for a payment of US\$1,000,000. In addition, the agreement provided for a royalty to be paid to the owner of the surface rights of the Duas Barras property in the amount of 6% of gross sales revenues.

On December 22, 2005 the Company exercised its option to acquire the 70% interest in the Duas Barras property. On January 31, 2006 this interest was increased to 75% by an advance payment of US\$50,000 to Marly.

By an agreement dated November 24, 2006 the Company exercised its option to acquire the remaining 25% interest in accordance with the terms of the original agreement. Payment terms of the full consideration of US\$1,100,000 are as follows:

- US\$150,000 to be paid within 10 days after the issue of a permanent Licence of Operation by the Minas Gerais State Environmental Authority (“FEAM”);
- US\$200,000 to be paid within 5 days after Marly’s submission of an application to the Departamento Nacional de Produção Mineral (“DNPM”) for the assignment of the Duas Barras Mining Licence to VBM’s subsidiary Montes Claros;
- US\$400,000 to be paid within 10 days after the DNPM’s approval and registration of the Duas Barras Mining Licence in the name of Montes Claros and the issue of a permanent Licence of Operation by FEAM; and
- US\$350,000 to be paid within 10 days after the sale of the first diamond production from the Duas Barras deposit.

On commencement of production, royalties will be payable to the Brazilian government based on 0.2% of the gross revenue from the sale of diamonds and 1% of gross revenue from the sale of gold.

In February 2007, a temporary Licence of Operation was granted by FEAM, which, together with the Mining Licence, allows Montes Claros, as operator, to commence mining operation. In February 2007, Marly submitted an application for the assignment of the Mining Licence to Montes Claros, and US\$200,000 was paid to Marly in the same month.

Construction of the infrastructure and plant at the Duas Barras mine commenced towards the end of 2006. Commissioning is expected to commence towards the end of the first quarter 2007, and production is expected to commence during the second quarter of 2007.

(d) **Aroeira Area**

In June 2006, the Company entered into an agreement with De Beers to acquire at a cost of US\$100,000 De Beer’s exploration dataset for the Traira diamond district in northern Mato Grosso state, together with a claim owned by De Beers in the area covered by the dataset. As a result of environmental restrictions, De Beers was unable to transfer ownership of the claim to the Company. In November 2006, De Beers offered and the Company accepted an additional dataset for the Aroeira diamond district in Bahia state, to offset the inability to transfer ownership of the Traira claim to the Company. The Aroeira dataset covers an area of approximately 165,000 hectares and includes exploration results from 645 samples. The Company has not conducted any material exploration work on the Aroeira district to date.

(e) **Alto Paraguai and**

(f) **Colorado do Oeste Areas**

In August 2004, the Company negotiated an option agreement with RTDM, whereby the Company acquired certain diamond geological data from RTDM relating to the Alto Paraguai area, situated in the state of Mato Grosso in Brazil, and the Colorado do Oeste area located in the state of Rondonia in Brazil.

In 2005, following a review of exploration results to date, a decision was reached to write off the expenditures associated with these projects in the amount of \$68,903.

Canadian Properties

(g) Coronation Gulf Property

The Coronation Gulf property, which covers an area of 91,400 hectares and is situated 500 kilometres north of Yellowknife and 50 kilometres south of the Coronation Gulf, is owned 100% by a wholly-owned subsidiary of Ashton Mining of Canada Inc. (“Ashton”).

In July 2006, the Company reached an agreement with Ashton under which the Company has an exclusive option to acquire a 40% joint venture interest in the Coronation Gulf property by spending a total of \$3.0 million on exploration of the properties before December 31, 2008, of which \$1.0 million must be spent by December 31, 2006. In addition, the agreement requires, subject to regulatory approval, that the Company issue Ashton a total of 195,000 of its common shares over the three-year term of the option: 65,000 shares not later than April 1, 2007, and 130,000 shares not later than April 1, 2008. No shares have as yet been issued under the Option Agreement. Under the agreement, a royalty of 1.5% of the gross proceeds from the sale of diamonds produced from the Artemisia property is payable to Ashton’s wholly-owned subsidiary which owns the property.

In 2006, the Company collected a 100 tonne mini-bulk sample from the surface of the property which is currently being processed and had incurred exploration expenditures of \$1,396,460 up to December 31, 2006.

(h) Hotish Mountain Property

The Hotish Mountain property covers approximately 50,000 hectares about 100 kilometres south of the diamondiferous Renard kimberlite cluster.

In April 2005, the Company negotiated an option agreement with Dios Exploration Inc. (“Dios”) whereby the Company could earn a 51% interest in the Hotish Mountain property by incurring exploration expenditures of \$2,000,000 by April 2008. In addition, the Company was required to issue a total of 100,000 common shares to Dios. Of these, 25,000 shares were issued in 2005. Following a 30 day extension by Dios to review the sampling results, the Company notified Dios in May 2006 that, based on the results to date, the Company would not be undertaking further exploration of the property.

To end March 2006, \$439,160 had been spent on the exploration of the Hotish property, in addition to which \$14,500 of option expenditures had been made for total expenditures of \$453,660, which amount was written off effective March 31, 2006. In April 2006, an additional \$2,683 was expended and written off, giving rise to a total of \$456,343 being written off in 2006.

(i) Otish Property

The Otish property consisted of 169 unpatented mining claim blocks covering a combined 8,844 hectares.

In May 2004, the Company negotiated an agreement with Santoy Resources Ltd. (“Santoy”) to earn a 60% interest in Santoy’s Otish diamond property in Quebec by spending \$200,000 on exploration over a period of two years and issuing to Santoy a total of 100,000 common shares of the Company. Of these, 35,000 shares were issued in June 2004. During April 2005, following a technical review of exploration results to date, the option was terminated and all capitalized expenses related to the property in the amount of \$148,414 were written off, including \$37,563 of exploration expenditures incurred in 2005.

Central African Republic Properties

(j) CAR-Haute Kotto Property

In March 2004, the Company was granted a 2,000 square kilometre reconnaissance permit in the Haute Kotto district of southeastern Central African Republic (“CAR”). The area is prospective for both kimberlite and alluvial diamond deposits.

In February 2005, the Company was granted an exploration permit covering an area of 682.1 square kilometres within the area

Notes to Consolidated Financial Statements

of the reconnaissance permit. The exploration permit is valid for a period of three years and is subject to a minimum expenditure on exploration of approximately \$35,000 per year.

Following a review of the Haute Kotto property and the alternative uses for the cash which would otherwise be required to be spent in the future on the property, the Company decided that its cash resources should be concentrated on the Company's more advanced projects. As a result, the Company wrote off the exploration expenditures to December 31, 2006 associated with the properties in the amount of \$709,335.

(k) **CAR-Kimberlite Project**

The Company owned a 100% interest in the CAR-Kimberlite Project, a reconnaissance exploration program to identify primary diamond deposits in CAR. Because of a change in strategic emphasis, the project was written off during 2005 resulting in a one-time charge of \$66,564, net of concentrates sold to De Beers Consolidated Mines Limited for \$20,935.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as at December 31, 2006 included a provision of \$942,665 with regard to amounts owed to RTDM for the Company's 49% share of exploration expenditures incurred by RTDM on the Company's behalf, and \$182,990 being an advance received from a joint venture partner in relation to exploration expenses to be incurred in the Brauna project.

8. CAPITAL STOCK

The authorized capital of the Company consists of an unlimited number of common shares.

(a) **Common Shares Issued**

	<u>Notes</u>	<u>Shares</u>	<u>Amount</u>
Balance, December 31, 2004		44,167,074	\$ 3,848,029
Warrants exercised (net of share purchase loan of \$20,494)	(i)	8,624,462	3,487,072
Allocated from warrants	8(b)	-	338,344
Private placements (net of share issue costs of \$820,937 including brokers' warrants of \$210,498 and future income tax adjustment of \$488,779)	(ii)	12,757,466	6,449,203
Allocated to warrants	(ii), 8(b)	-	(960,180)
Exercise of options	(iii)	95,000	27,550
Shares issued to option properties	(iv)	175,000	125,500
		<hr/>	
Balance, December 31, 2005		65,819,002	\$ 13,315,518
Warrants exercised	(v)	6,156,381	4,675,375
Allocated from warrants	8(b)	-	1,147,751
Repayment of share purchase loans to directors	11(b)	-	133,284
Interest received or accrued on share purchase loans	11(b)	-	10,261
Private placements (net of share issue costs of \$995,326 including brokers' warrants of \$277,333 and future income tax adjustment of \$180,600)	(vi)	8,253,969	6,324,073
Exercise of options	(vii)	1,220,000	578,500
Allocated from options	8(c)	-	252,816
		<hr/>	
Balance, December 31, 2006		81,449,352	\$ 26,437,578

- (i) During 2005, the following warrants were exercised:

<u>Date of Issue</u>	<u>Exercised</u>	<u>Exercise Price</u>	<u>Proceeds</u>
07/10/2003	283,786	\$0.24	\$ 68,109
07/10/2003	1,345,788	\$0.29	390,279
11/04/2003	3,000,000	\$0.29	870,000
02/02/2004	888,889	\$0.65	577,778
03/03/2004	100,000	\$0.65	65,000
09/15/2004	2,599,999	\$0.50	1,279,506
09/15/2004	161,000	\$0.40	64,400
06/16/2005	125,000	\$0.80	100,000
06/16/2005	120,000	\$0.60	72,000
	8,624,462		\$ 3,487,072

During September 2005, the Company granted an interest free loan totalling \$20,494 to a director and officer which was used to acquire 40,987 common shares of the Company at \$0.50 per share from the exercise of a warrant. This loan was repaid in February 2006 (Note 11(b)).

- (ii) In June 2005, the Company completed a private placement of 10,668,666 units at \$0.60 per unit for gross proceeds of \$6,401,200. Each unit consisted of one common share and one half of one common share purchase warrant. Each whole warrant entitled the holder to purchase one common share of the Company at \$0.80 per share. The warrants were to expire on December 16, 2006, however, these warrants contained a provision which permitted the expiry date to be accelerated in the event that the closing price of the Company's shares on the TSX Venture Exchange remained above \$1.00 for 21 consecutive trading days. This condition was met on February 24, 2006 and notice of the acceleration of the expiry date to April 3, 2006 was provided to all warrant holders. A value of \$960,180 was allocated to these warrants on issue.

In June 2005, the Company also issued 2,088,800 flow-through shares at \$0.65 per share for gross proceeds of \$1,357,720. A future income tax recovery of \$488,779 was recognized with respect to the issuance of these shares.

The Company also issued 765,446 compensation options to the agents of the private placements completed in June 2005. Each option entitled the holder to acquire one common share of the Company at an exercise price of \$0.60 per share at any time until June 16, 2006. A value of \$210,498 was allocated to the options.

- (iii) During 2005, the following options were exercised:

<u>Options Exercised</u>	<u>Exercise Price</u>	<u>Proceeds</u>
95,000	\$0.29	\$27,550

- (iv) In April 2005, the Company negotiated an option agreement with Dios to earn a 51% interest in Dios's Hotish diamond property (Note 6(h)). During 2005, 25,000 common shares were issued to Dios in accordance with the option agreement.

In August 2005, the Company acquired a 60% interest in the Brauna diamond property (Note 6(b)) from Majescor for \$300,000 in cash and a total of 150,000 common shares of the Company.

Notes to Consolidated Financial Statements

- (v) During 2006 the following warrants were exercised:

<u>Date of Issue</u>	<u>Warrants Exercised</u>	<u>Exercise Price</u>	<u>Proceeds</u>
September 15, 2004	301,602	\$ 0.40	\$ 120,641
June 16, 2005	5,209,333	0.80	4,167,466
June 16, 2005	645,446	0.60	387,268
	<u>6,156,381</u>		<u>\$ 4,675,375</u>

- (vi) On February 9, 2006, the Company closed a bought-deal private placement offering of Common Share and Flow-Through Share Special Warrants for aggregate gross proceeds of \$7,500,000. The offering, which was comprised of 7,777,778 Common Shares Special Warrants issued at a price of \$0.90 and 476,191 Flow-Through Share Special Warrants issued at a price of \$1.05, was fully subscribed including the underwriters' over-allotment option.

On March 24, 2006, following the issue of a final prospectus by the Company, each Common Share Special Warrant and each Flow-Through Share Special Warrant was automatically exercised into one Common Share and one Flow-Through Common Share of the Company respectively. In respect of the Flow Through Common Share, a future income tax recovery of \$180,600 has been recognized.

As part of the financing, the Company issued 495,238 common share purchase warrants to the agents of the private placement. Each warrant was exercisable for one common share of the Company at a price of \$0.90 at any time until February 9, 2007. A value of \$277,333 was allocated to the warrants.

- (vii) During 2006, the following options were exercised:

<u>Options Exercised</u>	<u>Exercise Price</u>	<u>Proceeds</u>
25,000	\$ 0.29	\$ 7,250
795,000	0.50	397,500
275,000	0.45	123,750
125,000	0.40	50,000
<u>1,220,000</u>		<u>\$ 578,500</u>

- (b) Common Share Purchase Warrants

	<u>Notes</u>	<u>Warrants</u>	<u>Amount</u>
Balance, December 31, 2004		8,731,067	\$ 315,417
Alignment adjustment ⁽ⁱ⁾		(3)	-
Issued in respect of the private placement	8(a)(ii)	5,334,333	960,180
Issued in respect of the private placement - Compensation options	8(a)(ii)	765,446	210,498
Expiration of purchase warrants		(50,000)	-
Exercise of purchase warrants	8(a)(i)	<u>(8,624,462)</u>	<u>(338,344)</u>
Balance, December 31, 2005		6,156,381	1,147,751
Issued in respect of the private placement - Brokers' warrants	8(a)(vi)	495,238	277,333
Exercise of purchase warrants	8(a)(v)	<u>(6,156,381)</u>	<u>(1,147,751)</u>
Balance, December 31, 2006		<u>495,238</u>	<u>\$ 277,333</u>

⁽ⁱ⁾ To align the warrants outstanding as at December 31, 2005 with the Company's warrant register.

The following is a summary of unexercised warrants, date of issue, exercise price and expiry date as at December 31, 2006:

<u>Number Outstanding</u>	<u>Date of Issue</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
495,238	February 9, 2006	\$ 0.90	February 9, 2007

On February 9, 2007 the 495,238 warrants expired unexercised.

(c) **Stock Options**

The Company maintains a stock option plan for directors, officers, employees and consultants of the Company. This plan was amended in June 2005, and under the amended plan, which requires approval by the shareholders on an annual basis, the maximum number of shares which may be issued under the plan cannot exceed 10% of the issued and outstanding common shares of the Company at the time of grant of any option. Since September 2005, all options have vested immediately upon issue.

	<u>2006</u>		<u>2005</u>	
	<u>Number</u>	<u>Weighted Average Price</u>	<u>Number</u>	<u>Weighted Average Price</u>
Options outstanding January 1	3,388,750	\$ 0.49	3,283,750	\$ 0.47
Issued during the year	2,230,000	0.78	200,000	0.68
Options exercised during the year	(1,220,000)	0.47	(95,000)	0.29
Options outstanding December 31	4,398,750	\$ 0.64	3,388,750	\$ 0.49

<u>Exercise Price</u>	<u>Outstanding and Exercisable December 31, 2006</u>	<u>Weighted Average Life (Years)</u>
\$ 0.29	18,750	0.00
\$ 0.40	40,000	0.03
\$ 0.45	525,000	0.33
\$ 0.50	1,330,000	0.57
\$ 0.50	100,000	0.05
\$ 0.50	55,000	0.04
\$ 0.75	2,105,000	1.94
\$ 0.85	100,000	0.08
\$ 0.97	50,000	0.05
\$ 1.37	75,000	0.07
	4,398,750	3.16

During 2006, the Company recognized a stock based compensation expense of \$1,418,100 (2005: \$232,771).

The weighted average fair value at the date of grant for options granted during 2006 was \$0.64.

The fair value of options included in the stock based compensation expense has been estimated using the Black-Scholes Option Pricing Model based on the following assumptions:

Notes to Consolidated Financial Statements

	<u>2006</u>	<u>2005</u>
Risk-free interest rate	3.9% - 4.3%	2.75%
Expected dividend yield	0.00%	0.00%
Expected share price volatility	77.5% - 80.7%	70.00%
Expected life of the options	5 years	5 years

The fair value of options outstanding at the end of the years are as follows:

	<u>2006</u>		<u>2005</u>	
	<u>Number</u>	<u>Stock Option Value</u>	<u>Number</u>	<u>Stock Option Value</u>
Options outstanding January 1	3,388,750	\$ 703,626	3,283,750	\$ 470,855
Issued during the year	2,230,000	1,418,100	200,000	232,771
Options exercised during the year	(1,220,000)	(252,816)	(95,000)	-
Options outstanding December 31	<u>4,398,750</u>	<u>\$ 1,868,910</u>	<u>3,388,750</u>	<u>\$ 703,626</u>

As at December 31, 2006, the remaining number of common shares available for issuance under the stock option plan is 3,746,185.

9. LOSS PER SHARE

For the purpose of the determination of net loss per share, the basic diluted weighted average number of common shares outstanding for the year ended December 31, 2006 was 79,188,040 – net of 250,000 shares issued on share purchase loans (2005: 54,830,819 – net of 572,962 shares issued related to share purchase loans). The determination of the weighted average number of common shares outstanding for the calculation of diluted loss per share does not include the effect of outstanding warrants and options since to do so would reduce the loss per share and would therefore be anti-dilutive.

10. INCOME TAXES

The Company is subject to income taxes in both Canada and Brazil.

The recovery of income taxes varies from the amounts that would be computed by applying the Canadian federal and provincial statutory rates of approximately 36.1% (2005 – 36.1%) to income before income taxes as follows:

	<u>2006</u>	<u>2005</u>
Expected income tax recovery using statutory income tax rates	\$ 1,216,000	\$ 540,000
Increase (decrease) in tax recovery resulting from:		
Stock based compensation	(512,000)	(84,000)
Stock issuance costs	141,000	89,000
Write down of capital property	(421,000)	-
	<u>424,000</u>	<u>545,000</u>
Tax benefit of losses not currently recognized	(243,400)	(56,221)
Future income tax provision	<u>\$ 180,600</u>	<u>\$ 488,779</u>

The tax effects of temporary differences that give rise to significant portions of the future tax assets at December 31, 2006 and 2005 are as follows:

Canada	<u>2006</u>	<u>2005</u>
Non-capital losses	\$ 1,306,000	\$ 978,000
Undepreciated capital cost	50,000	38,000
Stock issuance costs	430,000	311,000
Cumulative eligible capital	35,000	35,000
Resource allowances	428,000	573,000
	<u>2,249,000</u>	<u>1,935,000</u>
Valuation allowances	<u>(2,249,000)</u>	<u>(1,935,000)</u>
	\$ -	\$ -
Brazil		
	<u>2006</u>	<u>2005</u>
Undepreciated capital cost	\$ 87,000	\$ 37,000
Valuation allowances	<u>(87,000)</u>	<u>(37,000)</u>
	\$ -	\$ -

The Company has non-capital/capital losses for income tax purposes in Canada of approximately \$3,618,000 which may be carried forward to reduce taxable income of future years. No provision has been made in these financial statements of the potential income tax savings on the application of these losses. These losses, if unapplied, would expire in future as follows:

2007	\$ 269,000
2008	80,000
2009	127,000
2010	34,000
2011	-
2012	-
2013	-
2014	657,000
2015	1,125,000
2016	<u>1,326,000</u>
	<u>\$ 3,618,000</u>

11. RELATED PARTY TRANSACTIONS

Transactions with related parties, all of which are recorded at the exchange amount which is the amount of consideration agreed upon by the related parties, are as follows:

Notes to Consolidated Financial Statements

(a) Amounts Paid or Payable

	<u>2006</u>	<u>2005</u>
Amount paid or payable to a company controlled by the President and Chief Executive Officer:		
Management and consulting fees	\$ 37,500	\$ 125,000
Performance bonus	-	75,000
	<u>(i) \$ 37,500</u>	<u>(ii) \$ 200,000</u>
Amount paid or payable to the Vice President, Chief Financial Officer and Corporate Secretary:		
Management and consulting fees	\$ -	\$ 108,750
Performance bonus	-	30,000
	<u>\$ -</u>	<u>\$ 138,750</u>

(i) \$18,750 is capitalized into properties and \$18,750 is expensed as corporate and general expenses.

(ii) \$100,000 is capitalized into properties and \$100,000 is expensed as corporate and general expenses.

During 2005, the remuneration of the President and Chief Executive Officer and the Vice President, Chief Financial Officer and Corporate Secretary was paid as consulting fees. On April 1, 2006 the President and Chief Executive's remuneration basis changed to that of an employee while the remuneration basis of the Vice President, Chief Financial Officer and Corporate Secretary was that of employee from January 1, 2006.

During the year 2006, VBM paid \$38,503 to a major shareholder for accounting and administrative services provided to VBM (September-December 2005: \$12,577).

(b) Loans

During September 2004, the Company initially granted interest free loans totalling \$212,790 to four directors, which loans were used to acquire 531,975 units of the Company as part of a private placement. Loans totalling \$112,790 were repaid in the first quarter of 2006 including interest thereon calculated at the Canadian prime rate plus 3% from January 1, 2006. The remaining loan of \$100,000, payable on demand and bearing interest at Canadian prime rate plus 3% since January 1, 2006, was subsequently repaid together with interest accruing thereon in March 2007. This loan was secured against 250,000 common shares of the Company, the market value of which was \$222,500 as at December 31, 2006.

During September 2005, the Company initially granted an interest free loan of \$20,494 to a director and officer which was used to acquire 40,987 common shares of the Company from the exercise of a warrant. This loan was repaid in February 2006 (Note (8(a)(i))).

In May 2006, a loan, repayable on demand in the amount of \$40,000 and bearing interest at the Canadian prime rate plus 3%, was granted to an officer and director, and is still outstanding as at December 31, 2006.

12. FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amounts of the Company's financial assets and liabilities, including cash and cash equivalents, sundry receivables and prepayments, and accounts payable and accrued liabilities on the consolidated balance sheets approximate fair values due to the short-term nature of these financial instruments.

13. SEGMENTED INFORMATION

The Company operates in one industry segment, namely mineral exploration. The Company's exploration activities are carried out in Brazil, Canada, and until 2006, the Central African Republic. For the list of these exploration properties, see Note 6.

14. SUPPLEMENTARY CASH FLOW INFORMATION

The following non-cash transactions are not reflected in the consolidated statements of the cash flow:

	<u>Note</u>	<u>2006</u>	<u>2005</u>
Short-term loans granted to acquire common shares	8(a)(i), 11(b)	\$ -	\$ 20,494
Issuance of shares regarding properties	8(a)(iv)	-	125,500
Agents' warrants issued regarding private placements	8(a)(ii),(vi)	277,333	210,498
Expenditures made on exploration properties during the year that were unpaid at December 31		<u>1,128,006</u>	<u>196,582</u>

15. COMMITMENTS AND CONTINGENCIES

(a) Lease Commitments

Under the terms of the Company's office lease, the Company is committed to pay a minimum annual amount of approximately \$103,000 until November 30, 2009.

(b) Flow-Through Shares

As at December 31, 2006, the Company is obligated to incur approximately \$430,000 (2005: \$1,330,000) in eligible Canadian Exploration Expenditures prior to December 31, 2007, in order to complete obligations entered into pursuant to flow-through share purchase agreements.

Restricted cash represents cash held in a separate bank account which is to be spent on eligible flow-through activities.

(c) Duas Barras Property

In November 2006, an agreement had been reached with Marly to purchase the remaining interest in Duas Barras (Note 6(c)). Under the agreement, the Company is committed to pay amounts totalling US\$1,100,000, subject to the successful completion of certain milestones (Note 6(c)). Of these, a payment of the amount of US\$200,000 has been made in February 2007.

16. SUBSEQUENT EVENTS

(a) Options Granted

On January 24, 2007, 2,675,000 options to acquire common shares were granted to directors, officers, consultants and employees. Each option entitles the holder to purchase a common share of the Company at a price of \$0.85 on or prior to January 24, 2012.

(b) Purchase of 40% of Brauna from Majescor

On February 14, 2007, the Company signed a non-binding Letter of Intent with Majescor to acquire Majescor's 40% interest in the Brauna property, as a result of which the Company would own 100% of the Brauna diamond property.

In addition to Majescor's interest in the Brauna property, the Company may also acquire Majescor's interest in the Tres Marias property, located in the state of Minas Gerais, Brazil. The Tres Marias property is situated within the central part of the São Francisco Craton, and contains several priority kimberlite targets identified by De Beers.

Under the terms of the non-binding Letter of Intent relating to the Brauna interests, Majescor would receive the following:

Notes to Consolidated Financial Statements

- \$2,000,000 cash payment on closing;
- \$1,500,000 paid in common shares of the Company (based on a 20-day simple average stock price at the time of closing)
- 1% Gross Sales Royalty on diamond production from the Brauna property.

On March 1, 2007, an agreement relating to the Brauna acquisition was signed, and under the agreement, an amount of \$2,000,000, less the estimated amount of Brazilian withholding tax was paid to Majescor, together with 1,733,102 common shares of the Company, valued at \$1,500,000.

Due diligence is under way relating to the Tres Marias property.

(c) **Coronation Gulf Property**

As laboratory analysis of the 100 tonne mini-bulk sample has not been completed, Ashton granted the Company an extension from April 1, 2007 to May 1, 2007 of the date on which the Company would be obligated to issue 65,000 shares to Ashton.

Corporate Information

DIRECTORS

A. Lee Barker
President
Sparton Resources Inc.

Peter Bojtos
Professional Engineer
& Corporate Director

Kenneth W. Johnson
President & Chief Executive Officer
Vaalldiam Resources Ltd.

Robert Lord
President
Captaur Investments Limited

Peter Marrone
Chairman, Vaalldiam Resources Ltd.
President & Chief Executive Officer
Yamana Gold Inc.

Juvenal Mesquita Filho
President
Santa Elina Mines Corporation

Antenor Silva Jr.
Chief Operating Officer
Yamana Gold Inc.

OFFICERS AND SENIOR MANAGEMENT

Kenneth W. Johnson
President & Chief Executive Officer

Robert Yeoman
Vice President, Chief Financial Officer
& Corporate Secretary

José Ricardo Thibes Pisani
Vice President, Exploration

José Fernando Tonoli
Senior Geologist

Janet L. Reid
Manager Investor Relations & Geologist

Paul Daigle
Senior Project Geologist

Fareeda Satchu
Manager Administration

Frances Kwong
Controller

TECHNICAL ADVISORY COMMITTEE

A. Lee Barker
President
Sparton Resources Inc.

Peter Bojtos
Professional Engineer & Corporate Director

Kenneth W. Johnson
President & Chief Executive Officer
Vaalldiam Resources Ltd.

Antenor Silva Jr.
Chief Operating Officer
Yamana Gold Inc.

José Ricardo Thibes Pisani
Vice President, Exploration
Vaalldiam Resources Ltd.

REGISTRAR & TRANSFER AGENT

Equity Transfer & Trust Company
Toronto, Ontario, Canada

AUDITORS

Ernst & Young LLP
Toronto, Ontario, Canada

Units Auditores Independentes
São Paulo, Brazil

LEGAL COUNSEL

Fogler, Rubinoff LLP
Toronto, Ontario, Canada

Veirano Advogados
Rio de Janeiro, Brazil

STOCK EXCHANGE LISTING

Toronto Stock Exchange
Trading Symbol: **VAA**
CUSIP Number: 918474 20 6

Vaalldiam Resources Ltd.

55 University Avenue
11th Floor, Suite 1105
Toronto, Ontario M5J 2H7
Tel: (416) 363 6927
Fax: (416) 363 2564
Email: carats@vaalldiam.com
Web: www.vaalldiam.com



2006



exploring
developing mining
exploring
mining
developing