KARELIAN
DIAMOND RESOURCES

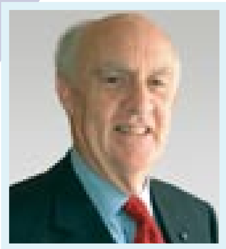
ANNUAL REPORT AND FINANCIAL STATEMENTS 2006

Karelian Diamond Resources PLC

KARELIAN
DIAMOND RESOURCES

Contents

Chairman's Statement



Professor Richard Conroy
Chairman

I have great pleasure in presenting your Company's Annual Report and Financial Statements for the year ended 31 May 2006, the first results since your Company's shares were admitted to trading on AIM in September 2005.

During the year encouraging progress has been made in the exploration of the Company's licences in the Karelian Craton of Finland.

The Company's licences cover part of a block of ancient crustal rocks occupying much of eastern and northern Finland, extending over the border into Russia where the Craton hosts a number of significant diamond deposits, including the world class Lomonosova and Grib discoveries.

Your directors believe that the Finnish sector of the Craton has the potential to host similar world-class deposits and, given its size and potential, it is under-explored by comparison with other diamond producing regions of the world.

In selecting exploration areas in Finland, your Company has made use of extensive aeromagnetic and electromagnetic data available in Finland to identify geophysical anomalies that might represent kimberlite pipes. Interpretation of the geophysical data has been followed by regional till sampling in the target areas, some of which have yielded kimberlitic and diamond indicator minerals, including G9 and G10 garnets that form at similar temperatures and pressures to diamonds.

Your Company now holds 58 diamond claims in Finland, mostly over targets that were identified using the above strategy. The claims are grouped geographically into four blocks, each of which has been independently assessed as "highly prospective for diamonds". The Kuhmo block is the largest with 49 claims, including those covering a known diamondiferous pipe at Seitaperä and the 16 other diamond indicator mineral anomalies found by your Company as a result of till sampling.

The presence of the Seitaperä kimberlite pipe shows that the right geochemical conditions to host diamonds occur in the Kuhmo area. Furthermore, because your Company has identified other diamond indicator mineral anomalies elsewhere on the Claim block, the significance of this pipe is now much greater than at the time of its discovery. When linked to the fact that kimberlite pipes typically occur in clusters, it suggests that multiple sources of diamonds may be present at Kuhmo. For this reason, it is the focus of your Company's initial exploration programme.

In the current year this programme will include further drilling of the Seitaperä pipe, which has a surface area of 4 hectares, and systematic evaluation of the other 16 known diamond indicator mineral anomalies to determine if they warrant drilling. Till sampling will also continue, as will work on your Company's three other highly prospective claim blocks.

Your Company's management has established a close working relationship with the Geological Survey of Finland (GTK) and is able to draw on its expertise, extensive knowledge of the country's geology and excellent technical and laboratory services. Your Company employs GTK staff as local consultants and to undertake fieldwork, and

Riihivaara drilling

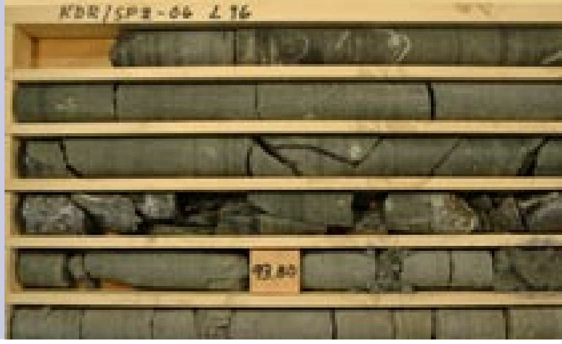
it has benefited greatly from this relationship. Karelian can also call on its senior consultant, Dr Bert Gerryts, an internationally respected diamond geologist who pioneered the use of indicator minerals and geophysics in diamond exploration.

Karelian's admission documents included an independent assessment of its diamond exploration properties and information portfolio prepared by The CSA Group, a worldwide exploration management consultancy. Amongst other things, this noted that Conroy Diamonds and Gold P.l.c, and Conroy P.l.c. (whose Finnish diamond interests were transferred into Karelian) had been active in diamond exploration in the Karelian Craton since 1994. CSA's assessment commented that "These companies had carried out a large amount of work and gained extensive exploration experience in the region, and the comprehensive data package, exclusive survey results and significant portfolio of claims transferred into your Company will provide it with a significant advantage in its future operations".

The Company has begun a follow up of its Kuhmo targets with a trenching programme designed to expose bedrock in an attempt to explain the observed magnetic anomalies

This work is also being carried out by the GTK. At the same time, additional basal till samples have been collected to further evaluate the diamond prospectivity of the potential drilling targets.

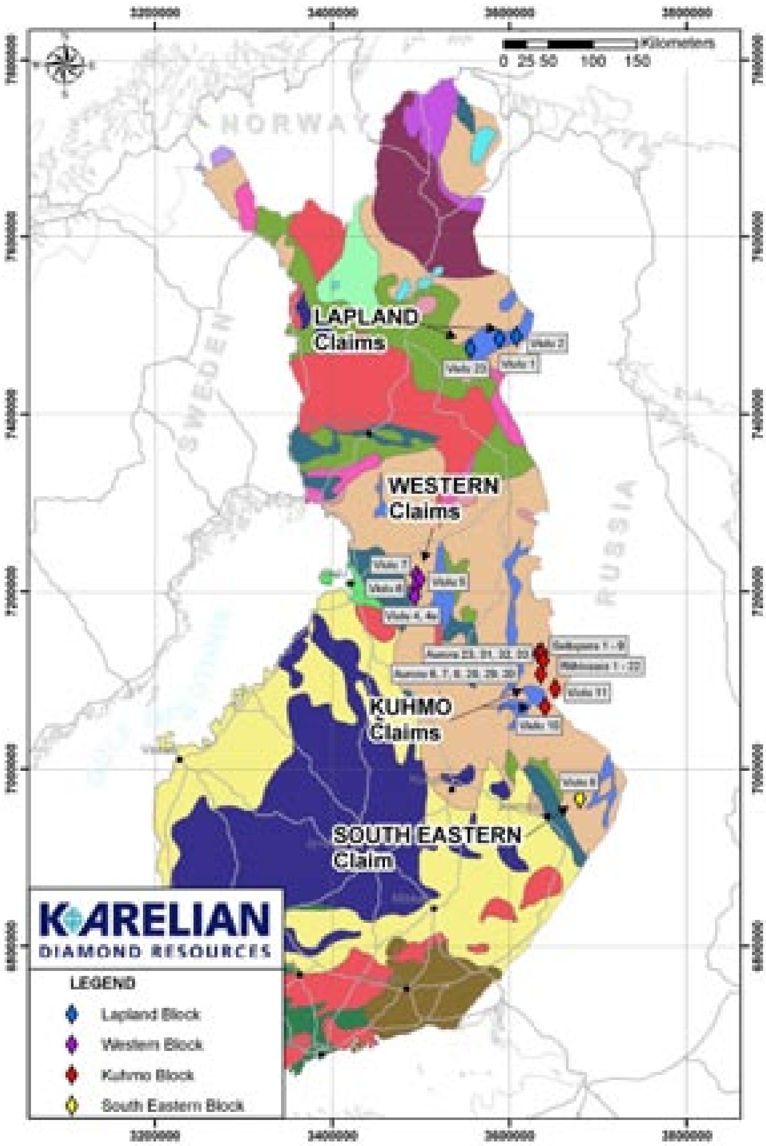
The first phase of the trenching programme is complete and results achieved to date are encouraging. One of the four trenches contains what is believed to be narrow anastomosing dikelets of kimberlitic material at the edges of an



Seitaperä Kimberlite Core Samples

8m wide "hole" in the bedrock surface caused by differential glacial scouring of weathered, soft material. Two other trenches also revealed similar "holes" in the bedrock which are further examples of preferential glacial removal of intensely altered rock types.

The bedrock surface in these "holes" is too deep for the excavator to reach, but information gained from the trenching has considerably improved the selection of drill sites to test for the presence of wider kimberlite bodies.



Financials

The loss after taxation for the year ended 31 May 2006 was €135,952 (1 March 2004 to 31 May 2005: €98,941) and the net assets as at 31 May 2006 were €2,742,471 (31 May 2005: €2,488,751).

Auditors

On 2 June 2006 Deloitte & Touche were appointed as auditors to the Company.

Directors, Consultants and Staff.

I would like to express my deep appreciation of the support and dedication of the directors, consultants and staff, which has made possible the continued progress and success which your Company has achieved.

Future Outlook

The Company will continue with its exploration programme with a view to developing the diamond interests in Finland in order to generate shareholder value.

Richard Conroy

Professor Richard Conroy

Company Information

Directors

Professor Richard Conroy
Chairman*

Roger I Chaplin
Non-Executive Director§

Seamus P FitzPatrick
Non-Executive Director+§

Maureen T.A Jones
Managing Director*

James P. Jones FCA
Finance Director*+

Louis J. Maguire
Non-Executive Director*+§

** Member of the Executive Committee*
+ Member of the Remuneration Committee
§ Member of the Audit Committee

Company Secretary and Registered Office

James P. Jones FCA
10 Upper Pembroke Street
Dublin 2

Auditors

Deloitte & Touche
Chartered Accountants
Deloitte & Touche House
Charlotte Quay,
Limerick

Registrars

Capita Corporate
Registrars P.l.c
Unit 5
Manor Street Business Park
Manor Street
Dublin 7
www.capitacorporateregistrars.ie

Nominated Adviser

John East & Partners Ltd
Crystal Gate
28-30 Worship Street
London EC2A 2AH

Broker

City Capital Securities Ltd
2 John Carpenter Street
London EC4Y 2AH

Legal Advisors

William Fry Solicitors
Fitzwilton House
Wilton Place
Dublin 2

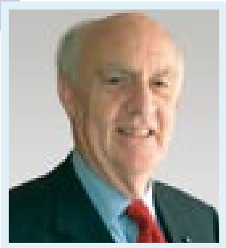
Roschier-Holmberg
Keskuskatu 7A
00 100 Helsinki
Finland

Head Office

Karelian Diamond
Resources PLC
10 Upper Pembroke Street
Dublin 2

Drilling at Seitaperä

Board of Directors



Professor Richard Conroy
Chairman

Professor Richard Conroy has been involved in natural resources for many years. He established Trans-International Oil in 1974. He also founded Conroy Petroleum and Natural Resources, which in 1986 discovered the Galmoy zinc deposit in Co. Kilkenny, Ireland, which is now in production as a major base metals mine. Conroy Petroleum was also a founding member of the Stoneboy Consortium, an exploration group that discovered the POGO gold field in Alaska. He is chairman of Conroy Diamonds and Gold P.l.c.

Maureen Jones
Managing Director

Maureen Jones has over 20 years experience of the natural resources industry. She was a member of the board of ARCON International Resources from 1986-1994. She was one of the founders of Conroy Diamonds and Gold, an AIM listed company and remains Managing Director of that company.

James Jones
Finance Director

James Jones is a chartered accountant. He became Company Secretary of Conroy Petroleum at its foundation and subsequently Finance Director from 1980-1994. He is also a founding Director of Conroy Diamonds and Gold and remains Finance Director of that company.

Louis Maguire
Non-Executive Director

Louis Maguire is an Auctioneer by profession and a land valuation expert with particular expertise in the purchase of mineral rights and in land acquisition for mining. He is also a Director of Conroy Diamonds and Gold.

Seamus FitzPatrick
Non-Executive Director

Seamus FitzPatrick has worked in both corporate finance and private equity in London and New York with Morgan Stanley, JP Morgan and Banker's Trust. In 1999 he co-founded CapVest, which has over €1.2 billion assets under management. He is chairman of Young's Bluecrest Limited, and Vaasan & Vaasan OY in Finland.

Roger Chaplin
Non-Executive Director

Roger Chaplin has some 25 years experience in mining analysis, gained initially in a major South African mining house and latterly in the City of London. Mr Chaplin was senior Vice President and Mining Analyst at T. Hoare and Co/Canaccord Capital (Europe) Limited in London from 1993-2003 and has a particular interest in precious metals and diamonds.

Directors' Report

For the year ended 31 May 2006

The Directors present their annual report together with the audited financial statements of Karelian Diamond Resources plc ('the Company') for the year ended 31 May 2006.

Principal Activities and Business Review

The Company was incorporated on 1 March 2004 as an exploration company and is currently involved in the development of mineral exploration opportunities, principally in Finland. The Company has exploration rights for certain areas and an extensive exploration programme has been undertaken.

Future Development of the Business

It is the intention of the Directors to continue to develop the activities of the Company.

Risks and Uncertainties

The Company's activities are directed towards the discovery, evaluation and development of diamond and other mineral deposits. Exploration for and development of mineral deposits is speculative. Whilst the rewards can be substantial, there is no guarantee that exploration on the Company's properties will lead to the discovery of commercially extractable mineral deposits. The future net asset value is therefore, *inter alia*, dependent on the success or otherwise of the Company's future exploration programmes. Whether a mineral deposit will be commercially viable in a mining operation depends on a number of factors, such as the grade of the deposit, prices of the commodities being exploited, currency fluctuations, proximity to infrastructure, financing costs and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, import and export regulations and environmental protection.

Results for the Year and State of Affairs at 31 May 2006

The profit and loss account for the the year ended 31 May 2006 and the balance sheet at that date are set out on pages 11 and 12 respectively. The Company recorded a loss for the financial year of €135,952 (2005: €98,941).

Important Events since the Year End

No significant events affecting the Company have taken place between 31 May 2006 and the date of the Board approval of these financial statements.

Directors

The Directors who served during the year are as follows:

R.T.W.L. Conroy
M.T.A. Jones
J.P. Jones
L.J. Maguire
S.P. FitzPatrick
R.I. Chaplin

In accordance with the Company's Articles of Association, Mr S.P. Fitzpatrick and Mr R.I. Chaplin will retire by rotation and, being eligible, will offer themselves for re-election at the Annual General Meeting.

Directors' and Secretary's Shareholdings and Other Interests

The interests of the Directors and Secretary, all of which were beneficially held, in the ordinary share capital and warrants of the Company at 31 May 2005 and 31 May 2006 were as follows:

	At 31 May 2005		At 31 May 2006	
	Ordinary shares of €0.01 each	Warrants	Ordinary shares of €0.01 each	Warrants
R.T.W.L. Conroy	25,231,701*	-	28,531,701*	1,000,000
M.T.A. Jones	125,836	-	125,836	750,000
J.P. Jones	58,335	-	58,335	500,000
R. I. Chaplin	-	-	20,000	200,000
S.P. FitzPatrick	666	-	666	200,000
L.J. Maguire	51,668	-	51,668	200,000

Directors' Report

For the year ended 31 May 2006

*Of the 28,531,701 (2005: 25,231,701) Ordinary Shares beneficially held by Professor Richard Conroy, 27,815,030, (2005: 24,515,030) are held by Conroy P.l.c., a company in which Professor Conroy has a controlling interest.

All the warrants were granted on 18 August 2005 and are exercisable at any time up to 1 September 2015 at a subscription price of 5p sterling.

Other than the subscription for shares in the placing during the year there have been no contracts or arrangements during the financial year in which a Director of the Company was materially interested and which were significant in relation to the Company's business.

Political Donations

The Company did not make any political donations during the year.

Books of Account

The measures which the Directors have taken to ensure that proper books of account are kept are the adoption of suitable policies for recording transactions, assets and liabilities, the employment of suitably qualified staff and the use of computer and documentary systems. The Company's Books of Account are kept at 10 Upper Pembroke Street, Dublin 2.

Directors' Responsibility Statement

Company law requires the Directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing the financial statements, the Directors have:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that are reasonable and prudent;
- prepared the financial statements on the going concern basis, unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Acts, 1963 to 2005 and the European Communities (Companies: Group Accounts) Regulations, 1992. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

As explained in Note 1 to the financial statements, the Directors have reviewed internal budgets and other relevant information and are satisfied that the Company will be able to continue in operation for the foreseeable future. Accordingly, the financial statements have been prepared on the going concern basis.

Auditors

The auditors, Deloitte and Touche, Chartered Accountants, were appointed during the year and have expressed their willingness to continue in office in accordance with Section 160 (2) of the Companies Act, 1963.

On behalf of the Board

R.T.W.L. Conroy	**J.P. Jones**
Director	*Director*

15 November 2006

Independent Auditors’ Report

to the Shareholders of Karelian Diamond Resources PLC

We have audited the financial statements of Karelian Diamond Resources P.l.c. for the year ended 31 May 2006 which comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Accounting Policies and the related notes 1 to 18. These financial statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the company's members, as a body, in accordance with Section 193 of the Companies Act 1990. Our audit work has been undertaken so that we might state to the company’s members those matters we are required to state to them in an auditors’ report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company’s members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report, including as set out in the Statement of Directors’ Responsibilities, the preparation of the financial statements in accordance with applicable law and accounting standards issued by the Accounting Standards Board and published by the Institute of Chartered Accountants in Ireland (Generally Accepted Accounting Practice in Ireland).

Our responsibilities, as independent auditors, are to audit the financial statements in accordance with relevant legal and regulatory requirements, the rules of the London Stock Exchange for the Alternative Investment Market and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view, in accordance with Generally Accepted Accounting Practice in Ireland, and are properly prepared in accordance with Irish statute comprising the Companies Acts, 1963 to 2005 and the European Communities (Companies: Group Accounts) Regulations 1992. We also report to you whether in our opinion: proper books of account have been kept by the company; whether, at the balance sheet date, there exists a financial situation requiring the convening of an extraordinary general meeting of the company; and whether the information given in the directors' report is consistent with the financial statements. In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit and whether the company's balance sheet and its profit and loss account are in agreement with the books of account.

We also report to you if, in our opinion, any information specified by law or the rules of the London Stock Exchange for the Alternative Investment Market regarding directors' remuneration and directors' transactions is not disclosed and, where practicable, include such information in our report.

We read the other information contained in the Annual Report and considered whether it is consistent with the audited financial statements. The other information comprises only the Report of the Directors and the Chairman’s Statement. We consider the implications for our report if we become aware of any apparent misstatement or material inconsistency with the financial statements. Our responsibilities do not extend to other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the

Independent Auditors' Report

to the Shareholders of Karelian Diamond Resources PLC

preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the company, and the group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we evaluated the overall adequacy of the presentation of information in the financial statements.

Mineral Interests

In forming our opinion we have considered the adequacy of the disclosures made in the financial statements concerning the valuation of mineral interests of €3,451,406 included in the balance sheet. The realisation of the mineral interests by the company is dependent on successful development of economic reserves. We draw attention to further details given in Notes 1 and 7. Our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with Generally Accepted Accounting Practice in Ireland, of the state of affairs of the company as at 31 May 2006 and of the loss for the year then ended; and
- have been properly prepared in accordance with the Companies Acts, 1963 to 2005 and the European Communities (Companies: Group Accounts) Regulations 1992.

We have obtained all the information and explanations we considered necessary for the purposes of our audit. In our opinion proper books of account have been kept by the company. The company's balance sheet and its profit and loss account are in agreement with the books of account.

In our opinion the information given in the directors' report is consistent with the financial statements.

The net assets of the company, as stated in the balance sheet are more than half the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 May 2006 a financial situation which, under Section 40(1) of the Companies (Amendment) Act, 1983, would require the convening of an extraordinary general meeting of the company.

Deloitte & Touche
Chartered Accountants
and Registered Auditors
Limerick

15 November 2006

Profit and Loss Account

For the year ended 31 May 2006

	Notes	Year Ended 31 May 2006 €	15 month period ended 31 May 2005 €
Operating Expenses	3	(139,599)	(98,941)
Other income		3,647	-
Loss for the Financial Year/Period	4	(135,952)	(98,941)
Loss per ordinary share	5	€0.0032	€0.0028

There are no recognised gains or losses other than the loss for the year. The above all result from continuing operations.

The accompanying notes form an integral part of this profit and loss account.

R.T.W.L. Conroy
Director

J.P. Jones
Director

Approved by the Directors on 15 November 2006

Balance Sheet

For the year ended 31 May 2006

	Notes	2006 €	2005 €
Fixed Assets			
Mineral interests	**7**	3,541,406	2,885,831
Tangible fixed assets	**8**	1,509	-
Financial assets	**9**	4	4
		3,542,919	2,885,835
Current Assets			
Debtors	**10**	13,661	660
Cash at bank and in hand		112,791	3
		126,452	663
Creditors: Amounts falling due within one year	**11**	(442,117)	(397,747)
Net Current Liabilities		(315,665)	(397,084)
Total Assets less Current Liabilities		3,227,254	2,488,751
Creditors: Amounts falling due after more than one year	**12**	(484,783)	-
Net Assets		2,742,471	2,488,751
Capital and Reserves			
Called up share capital	**13**	447,716	347,716
Share premium account	**13**	2,529,648	2,239,976
Profit and loss account	**14**	(234,893)	(98,941)
Shareholders' Funds – all equity	**15**	2,742,471	2,488,751

The accompanying notes form an integral part of this balance sheet.

R.T.W.L. Conroy
Director

J.P. Jones
Director

Approved by the Directors on 15 November 2006

Cash Flow Statement

For the year ended 31 May 2006

	Notes	Year Ended 31 May 2006 €	15 month period ended 31 May 2005 €
Net Cash Inflow from Operating Activities	**16A**	53,753	139,978
Capital Expenditure and Financial Investments	**16B**	(657,252)	(225,835)
Net Cash Outflow before Financing		(603,499)	(85,857)
Financing	**16B**	716,287	85,860
Increase in Cash	**16C**	112,788	3

The accompanying notes and statement of accounting policies form an integral part of this cash flow statement.

R.T.W.L. Conroy
Director

J.P. Jones
Director

Approved by the Directors on 15 November 2006

Statement of Accounting Policies

The financial statements have been prepared under the historical cost convention in accordance with applicable accounting standards generally accepted in Ireland and Irish statute comprising the Companies Acts, 1963 to 2005 and the European Communities (Companies: Group Accounts) Regulations, 1992. The Company's principal accounting policies are set out below. All of these policies have been applied consistently throughout the year and the previous period.

A. Mineral Interests

(i) *Exploration, appraisal and development expenditure*

The Company accounts for mineral expenditure under the 'full cost' method of accounting.
Exploration, appraisal and development expenditure is incurred on acquiring, exploring or testing exploration prospects. All lease, licence and property acquisition costs, geological and geophysical costs and other direct costs of exploration, appraisal and development are capitalised. The amount capitalised includes other operating expenses directly related to these activities.

(ii) *Cost Pools*

Costs relating to the exploration and appraisal of mineral interests which the Directors consider to be unevaluated are initially held outside the cost pool. Costs held outside the cost pool are reassessed at each period end. When a decision to develop these interests is taken, or if there is evidence of impairment, the related costs will be transferred to the cost pool or amortised to the profit and loss account as necessary. Costs will be capitalised within geographic cost pools which initially comprise Finland and the rest of the world.

Proceeds from any disposal of part or all of an interest which is outside the cost pool will be credited to that interest with any excess being credited to the cost pool.

(iii) *Ceiling Test*

When a decision to develop mineral interests is taken, and the related costs are transferred to the cost pool a ceiling test will be carried out at each balance sheet date to assess whether the net book value of capitalised costs in the pool, together with the future costs of development of undeveloped reserves, is covered by the discounted future net revenues from the reserves within the pool, calculated at prices prevailing at the period end. Any deficiency arising will be provided for to the extent that, in the opinion of the Directors, it is considered to represent a permanent diminution in the value of the related asset, and where arising, will be dealt within the profit and loss account as additional depreciation.

(iv) *Depreciation*

Expenditure within the cost pool will be depreciated using the unit of production method based on commercial reserves. Costs used in the unit of production calculation will comprise the net book value of capitalised costs plus the anticipated future costs of development of the undeveloped reserves at current year end unescalated prices. Changes in cost and reserve estimates are dealt with prospectively.

B. Other Tangible Fixed Assets

Other tangible fixed assets are stated at cost, net of depreciation. Depreciation is provided on a straight line basis to write off the cost (net of estimated residual value) over the expected useful economic lives.

C. Financial Fixed Assets

Financial fixed assets are stated at cost, less provision for any permanent diminution in value.

D. Foreign Currency

Transactions denominated in foreign currencies are recorded at actual exchange rates at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rates of exchange prevailing at the balance sheet date.

E. Issue Expenses and Share Premium Account

Issue expenses arising on the issue of equity securities are written off, in the first instance, against the share premium account, with any issue expenses in excess of the balance on the share premium account being written off to the profit and loss account.

F. Taxation

The charge for taxation is based on the result for the year. Deferred taxation is calculated on the differences between the company's taxable profits and the results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those that are recognised in the financial statements.

G. Consolidation

These financial statements present information about the Company as an individual undertaking and not about its group. The subsidiary undertakings have not been consolidated as their inclusion is not material for the purpose of giving a true and fair view.

Notes to the Financial Statements

for the year ended 31 May 2006

1. Operations and Going Concern

The Company, which was incorporated on 1 March 2004, is currently involved in the development of mineral exploration opportunities principally in Finland.

On the basis of the capital funding achieved to date and existing commitments for future capital funding together with their review of projected cash flow information and taking into account the high potential of the acreage under licence and the continued support of the major shareholder, the Directors consider it appropriate to prepare the financial statements on a going concern basis.

2. Related Party Transactions

The Company shares accommodation with Conroy Diamonds and Gold Plc., which has certain common shareholders and directors. The Company bears its appropriate share of the related costs directly.

The Company has been financed during the year by advances from its principal shareholder, Conroy P.l.c. and other shareholders (Note 12).

3. Operating Expenses

Notes	Year Ended 31 May 2006 €	15 month period ended 31 May 2005 €
Management services and operating expenses	393,435	182,246
Transfer to Mineral Interests (Note 7)	(253,836)	(83,305)
	139,599	98,941

4. Loss on Ordinary Activities before Taxation

The loss on ordinary activities before taxation is arrived at after charging the following items, which are stated at amounts prior to the re-allocation to mineral interests:

Notes	Year Ended 31 May 2006 €	15 month period ended 31 May 2005 €
Auditors' remuneration	8,500	8,500
Directors' emoluments		
- fees	71,075	65,683
- other remuneration	112,500	-
Depreciation	168	-

All losses arose from continuing operations.

5. Loss per ordinary share

The calculation of the loss per ordinary share of €0.0032 (2005 – €0.0028) is based on the loss for the financial year of €135,952 (2005 – €98,941) and the weighted average number of ordinary shares on a basic and fully diluted basis during the year of 42,271,676 (2005 – 34,771,676). Share options and warrants are not included in the calculation of fully diluted shares since the Company incurred a loss in 2006 and 2005 which results in these potential shares being anti-dilutive.

6. Tax on loss on Ordinary Activities

No taxation charge arises in the financial year due to tax losses incurred. There was no unprovided deferred taxation at 31 May 2006 (2005: Nil).

7. Mineral Interests

Costs held outside cost pool:

	2006 €	2005 €
Cost		
At 1 June 2005	2,885,831	-
Diamond interests acquired	-	2,660,000
Expenditure during the period		
- licences and appraisal	401,739	142,526
- other operating costs (Note 3)	253,836	83,305
At 31 May 2006	3,541,406	2,885,831

The Directors have considered the proposed work programmes for these mineral interests, presently held outside the cost pools. They are satisfied that there are no indications of impairment, but recognise that future realisation of the mineral interests, held outside the cost pools, is dependent on further successful exploration and appraisal activities and the subsequent economic production of the mineral reserves.

8. Tangible Fixed Assets

	Office Equipment €
Cost	
At 1 June 2005	-
Additions	1,677
31 May 2006	1,677
Accumulated Depreciation	
At 1 June 2005	-
Depreciation charge	168
31 May 2006	168
Net Book Value	
31 May 2005	-
31 May 2006	1,509

9. Financial Fixed Assets

	2006 €	2005 €
Investment in subsidiaries	4	4

Financial fixed assets represent investments of €2 in each of the Company's wholly owned subsidiary undertakings, Karelian Diamonds Limited and Nordic Diamonds Limited. The net assets of each entity is €2. Certain diamond claims in Finland are held in the name of the Company's subsidiaries.

10. Debtors

	2006	2005
	€	€
VAT recoverable	13,661	660
	13,661	660

11. Creditors: Amounts falling due within one year

	2006	2005
	€	€
Trade creditors and accruals	442,117	239,579
Due to Conroy P.l.c.	-	158,168
	442,117	397,747

12. Creditors: Amounts falling due after more than one year

	2006	2005
	€	€
Due to Conroy P.l.c.	296,045	-
Shareholders' loans	188,738	-
	484,783	-

Together with the placing on the admission of the Company on the Alternative Investment Market, the immediate funding requirements of the Company have been financed by advances from the principal shareholder, Conroy P.l.c. and other shareholders.

13. Called up Share Capital and Share Premium

Authorise:

	2006	2005
	€	€
500,000,000 ordinary shares of €0.01 each	5,000,000	5,000,000

Issued and Fully Paid:

	Number	Share Capital €	Share Premium €
Start of year	34,771,676	347,716	2,239,976
Share issue	10,000,000	100,000	630,000
Issue expenses	-	-	(340,328)
	44,771,676	447,716	2,529,648

Pursuant to the admission of the Company on the Alternative Investment Market on 1 September, 2005 10,000,000 ordinary shares of €0.01 were issued for a consideration of 5p sterling per share to fund further mineral exploration. This realised €0.073 per share resulting in a premium of €0.063 per share.

The share price at 31 May 2006 was 6.5p sterling. During the year the price ranged from 4.0p to 8.5p sterling.

14. Profit and Loss Account

Notes	2006	2005
	€	€
At 1 June 2005	(98,941)	-
Loss for the financial year/period	(135,952)	(98,941)
At 31 May 2006	(234,893)	(98,941)

15. Reconciliation of Movement in Shareholders' Funds

	2006	2005
	€	€
At 1 June 2005	2,488,751	-
Shares issued, net	389,672	2,587,692
Loss for financial year/period	(135,952)	(98,941)
At 31 May 2006	2,742,471	2,488,751

16. Notes to the Cash Flow Statement

A. Reconciliation of Loss to Net Cash Inflow from Operating Activities:

Notes	Year Ended 31 May 2006	15 month period ended 31 May 2005
	€	€
Operating Loss	(135,952)	(98,941)
Depreciation	168	-
Increase in Creditors	202,538	239,579
Increase in Debtors	(13,001)	(660)
Net Cash Inflow from Operating Activities	53,753	139,978

B. Analysis of Cash Flows:

Notes	Year Ended 31 May 2006	15 month period ended 31 May 2005
	€	€
Capital expenditure and Financial Investment		
Investment in mineral interests	(655,575)	(225,835)
Purchase of tangible fixed assets	(1,677)	-
	(657,252)	(225,835)
Financing		
Shareholders' loan	326,615	158,168
Issue of share capital	730,000	-
Share issue expenses	(340,328)	(72,308)
	716,287	85,860

C. Analysis and Reconciliation of Net Funds:

	1 June 2005	Cash Flow	31 May 2006
Cash at bank	3	112,788	112,791

17. Commitments and Contingencies

At 31 May 2006 there were no capital commitments or contingent liabilities.

18. Approval of Financial Statements

These financial statements were approved by the Board on 15 November 2006.

Notice of Annual General Meeting

NOTICE is hereby given that the Annual General Meeting of Karelian Diamond Resources plc (the "Company") will be held at the Conrad Hotel, Earlsfort Terrace, Dublin 2 on Friday 8 December 2006 at 4.00pm for the purposes of transacting the following business:

1 To receive and consider the Financial Statements for the year ended 31 May 2006 together with the Directors' and Independent Auditors' Reports thereon (Resolution No. 1).

2 To re-elect as Directors the following persons:
Mr Seamus P. Fitzpatrick (Resolution No.2 (a))
Mr Roger I. Chaplin (Resolution No.2 (b))

3 To authorise the Directors to fix the remuneration of the Auditors (Resolution No.3).

4 To consider and, if thought fit, pass the following resolution as an Ordinary Resolution (Resolution No.4):

"That, in accordance with the provisions of Section 20 of the Companies (Amendment) Act, 1983, the directors of the Company be generally and unconditionally authorised to allot 'relevant securities' (as defined by Section 20(10) of the Companies (Amendment) Act, 1983) up to the amount of the authorised but unissued share capital of the Company at the date of this resolution and to allot and issue any shares purchased by the Company pursuant to the provisions of the Companies Act, 1990 and held as treasury shares and that the authority hereby granted shall, subject to Section 20(3) of the said Act, expire on the 7 December, 2011 unless previously renewed, varied or revoked by the Company."

5 To consider and, if thought fit, pass the following resolution as a Special Resolution (Resolution No.5):

"That, for the purposes of Section 24 of the Companies (Amendment) Act, 1983 and subject to the Directors being authorized pursuant to Article 10 of the Articles of Association of the Company, the Directors be empowered to allot equity securities for cash pursuant to and in accordance with Article 11 of the Articles of Association of the Company. The authority hereby conferred shall expire at the close of business on the date of the next Annual General Meeting of the Company unless previously revoked or renewed in accordance with the provisions of the Companies (Amendment) Act, 1983."

6 To transact any other business.

By Order of the Board
Dated this 15th day of November 2006

James P Jones
Secretary

Registered Office
10 Upper Pembroke Street
Dublin 2

Notes:

The holders of the Ordinary Shares are entitled to attend and vote at the above General Meeting of the Company. A holder of Ordinary Shares may appoint a proxy or proxies to attend, speak and vote instead of him/her. A proxy need not be a member of the Company.

A Form of Proxy is enclosed for use by shareholders unable to attend the meeting. Proxies to be valid must be lodged with the Company's Registrars, Capita Corporate Registrars Plc, Unit 5, Manor Street Business Park, Manor Street, Dublin 7 not less than 48 hours before the time appointed for the holding of the meeting.

KARELIAN
DIAMOND RESOURCES

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