KARELIAN
DIAMOND RESOURCES

2007 Annual Report and Financial Statements

Contents

Professor Richard Conroy
Chairman

Chairman's Statement

Dear Shareholder,

I have great pleasure in presenting your Company's Annual Report and Financial Statements for the year ended 31 May 2007.

Your Company was established with the objective of finding commercial diamond deposits in Finland, a country that is a relative newcomer to diamond exploration. Finland hosts the same geological structure in which two world-class diamond deposits have been found over the border in Russia. Since geology recognises no country or political boundary, the logic for seeking similar diamond deposits in Finland is very clear.

Successful diamond exploration requires a systematic approach and painstaking attention to detail. It also requires expertise, energy and enthusiasm, all of which your Company has in abundance. We hold the largest diamondiferous kimberlite pipe found so far in Finland and will continue our drilling and evaluation programme on it this winter. We are also in the process of following up numerous kimberlite indicator mineral ("KIM") trains which are bringing us closer to the kimberlites which are the primary source of those minerals.

Clearly, our diamond search is now entering an advanced and exciting stage.

As your Company continues to advance its search for world-class diamond deposits in Finland, I think that it is opportune for me to use this year's annual report to appraise shareholders of the reason we are exploring in Finland, as well as commenting on the progress achieved to date and outlining our plans and expectations for the year ahead.

One of the rarest of minerals, diamonds are formed under conditions of great pressure and temperature which occur beneath thick blocks (+200km) of ancient crustal rocks or cratons that are found only in certain parts of the world. Diamonds are brought to the surface in volcanic rocks, predominantly kimberlites, that erupt from those great depths.

Having the "right geological address" is therefore all important for a diamond explorer and it is for this reason that your Company is focussing its efforts on Finland, a politically stable country with a long mining tradition. A large part of Finland is comprised of the ancient Karelian craton. This craton extends across the border into Russia where it hosts two of the world's largest and richest diamond discoveries – the Grib and Arkhangelskaya kimberlite pipes.

Though larger than Canada's Slave Craton, in which the rich Ekati and Diavik diamond mines are located, the Finnish section of the Karelian Craton remains relatively under-explored for diamonds.

The availability of high-quality basic geoscientific data and technical services in Finland and the country's excellent infrastructure have enabled your Company's diamond exploration programme to proceed somewhat more expeditiously than would be the case in other regions. Despite Finland's relatively short diamond exploration history, more than 20 kimberlites have been discovered there to date. A very high proportion of these are diamondiferous, including your Company's Seitaperä pipe in the Kuhmo area.

With a surface area of 4.2ha, Seitaperä is the largest known kimberlite pipe in Finland. We have recently exposed fresh kimberlite just beneath the surface in a number of trenches excavated across

The Arkhangelskaya diamond mine under development. The Arkhangelsk area is a prime example of world class diamond deposits hosted within the Karelian Craton.

the pipe. Over two tonnes of kimberlite have been collected, and several 100kg samples have been sent for micro-diamond analysis at SGS Lakefield Laboratories in Canada. Results are expected by the end of the year.

We have successfully outlined the surface expression of the pipe and selected a number of sites for drill-testing during the coming winter. Our work to date has also indicated a possible south-west extension to the pipe which could increase its overall size, and this will be further investigated in the coming year.

Elsewhere in Finland, your Company has continued its exploration on several locations where previously identified KIM trains are now known to converge with a series of aeromagnetic anomalies. This convergence is particularly exciting as it suggests possible multiple kimberlite sources in the area.

Demand for diamonds continues to rise, but mine production is declining, few new diamond mines are in the pipeline and world inventories of mined diamonds are depleted. Clearly a major new discovery by your Company would be welcomed by the world diamond markets.

Your Company's diamond exploration programme in Finland has, by world standards, made great progress in a very short period. We have an exciting year ahead of us, with further significant progress expected at Seitaperä. With regard to other exploration activities, we look forward to our ongoing work bringing us closer to new kimberlite sources, of which there could be several. Your Company is steadily progressing towards meeting its objective of finding one or more major diamond deposits.

Chairman's Statement

Financials

The loss after taxation for the year ended 31 May 2007 was €125,334 (31 May 2006: Loss €135,952) and the net assets as at 31 May 2007 were €2,641,737 (31 May 2006: €2,742,471).

Subsequent to year end the Company raised £1,025,000 (€1.5m) through the issue of 15,770,000 ordinary shares of €0.01 each at 6.5p sterling together with one warrant, exercisable at 10p sterling during the three years following admission of the Placing Shares, for every three shares allotted.

The directors have also considered the build-up of current liabilities. These liabilities arise mainly from the accrual of unpaid directors' fees and remuneration since incorporation. By foregoing payment of their fees and remuneration, the directors effectively allowed the Company's exploration work on the ground to proceed on a greater and more effective scale with the funds available to the Company.

The directors have agreed to waive their entitlement to all fees accrued up to 31 August 2005 amounting to €83,183. Since 1 September 2005, the date of Admission to AIM, the non-executive directors fees have been paid on a current basis. The executive directors have not taken their salary entitlements or fees and have agreed to waive the amounts accruing up to 30 November 2007. The amount due for the period up to 30 November 2007 would be €518,750 making the total amount waived €601,933 (£416,779).

After careful consideration, and discussions with the Company's advisors, the Board has decided, subject to ratification by the shareholders at the Annual General Meeting, to issue a total of 12,852,377 warrants to the individual directors for nil consideration exercisable over 10 years at a subscription price of €0.10 (Stg7p per share). A resolution to this effect has therefore been included in the agenda for the AGM.

The number of warrants proposed to be issued to each director is as follows:

Name of Warrant Holder	*Number of Warrants*
R.T.W.L. Conroy	5,521,049
M.T.A. Jones	4,191,275
J.P. Jones	2,604,389
S.P. FitzPatrick	232,201
L.J. Maguire	232,201
R.I. Chaplin	71,262

I welcome this action by the directors as it represents a strong vote of confidence in your Company and its prospects.

In the light of the excellent exploration results achieved to date, your directors are considering how best to fund your Company's activities going forward. Options being studied include joint venture and farm-out, as well as such other arrangements as may be appropriate for advancing the interests of your Company.

Electronic Communication

An amendment to the Articles of Association is proposed to enable electronic communication to become another method of communication for the Company in so far as the law permits. Shareholders will continue to be entitled to ask the Company to provide a paper copy of any information which has been provided electronically.

Auditors

I would like to take the opportunity of thanking the partners and staff of Deloitte & Touche for their services to your Company during the course of the year.

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 very considerable progress and success which your Company has achieved.

Future Outlook

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

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 Registrars
Unit 5
Manor Street Business Park
Manor Street
Dublin 7
www.capitaregistrars.ie

Nominated Adviser

John East & Partners Ltd
10 Finsbury Square
London
EC2A 1AD

Broker

City Capital Corporation Limited
Sion Hall
56 Victoria Embankment
London
EC4Y 0DZ

Legal Advisors

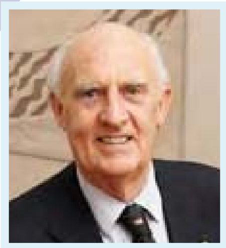
William Fry Solicitors
Fitzwilton House
Wilton Place
Dublin 2

Roschier-Holmberg
Keskuskatu 7A
00 100 Helsinki
Finland

Head Office

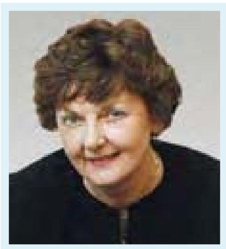
Karelian Diamond Resources PLC
10 Upper Pembroke Street
Tel: 353-1-661 8958
Fax: 353-1-662 1213
www.kareliandiamondresources.com

Board of Directors



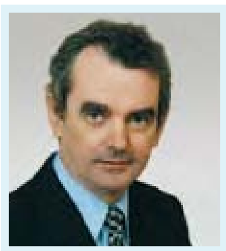
Professor Richard Conroy
Chairman

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.



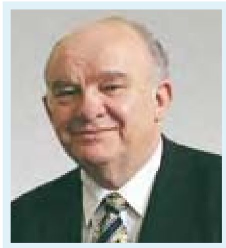
Maureen Jones
Managing Director

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 €2 billion assets under management. He is Chairman of Young's Bluecrest Limited, and was Chairman of 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 2007

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 2007.

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 2007

The profit and loss account for the year ended 31 May 2007 and the balance sheet at that date are set out on pages 13 and 14 respectively. The Company recorded a loss for the financial year of €125,334 (2006: loss €135,952).

Important Events since the Year End

On 17 July 2007 the Company raised £1,025,000 (€1.5m) through the issue of 15,770,000 ordinary shares of €0.01 each at 6.5p sterling and granted one warrant, exercisable at 10p sterling during the three years following admission of the Placing Shares, to the allottees for every three shares allotted in the placing.

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, Miss Maureen Jones and Mr. James Jones 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 2006 and 31 May 2007 were as follows:

	At 31 May 2006		At 31 May 2007	
	Ordinary shares of €0.01 each	**Warrants**	**Ordinary shares of €0.01 each**	**Warrants**
R.T.W.L. Conroy	28,531,701*	1,000,000	28,531,701*	1,000,000
M.T.A. Jones	125,836	750,000	125,836	750,000
J.P. Jones	58,335	500,000	58,335	500,000
R. I. Chaplin	20,000	200,000	20,000	200,000
S.P. FitzPatrick	666	200,000	666	200,000
L.J. Maguire	51,668	200,000	51,668	200,000

Directors' Report

For the year ended 31 May 2007

* Of the 28,531,701 (2006: 28,531,701) Ordinary Shares beneficially held by Professor Richard Conroy, 27,815,030, (2006: 27,815,030) 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 excercisable at any time up to 1 September 2015 at a subscription price of 5p sterling.

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 2006 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, 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*

19 November 2007

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 2007 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 20. 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 responsibility, as independent auditors, is 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 2006 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 consider 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.

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 2007 and of the loss for the year then ended; and
- have been properly prepared in accordance with the Companies Acts, 1963 to 2006, and the European Communities (Companies: Group Accounts) Regulations 1992.

Mineral Interests – Emphasis of Matter

Without qualifying our opinion we draw your attention to the disclosures made in Notes 1 and 7 in the financial statements which indicate that the realisation of intangible assets of €3,617,723 included in the balance sheet is dependent on the successful further development and ultimate production of the mineral reserves

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 2007 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

19 November 2007

Profit and Loss Account

For the year ended 31 May 2007

	Note	2007 €	2006 €
Operating Expenses	**3**	(125,404)	(139,599)
Other income		70	3,647
Loss for the Financial Year	**4**	(125,334)	(135,952)
Loss per ordinary share	**5**	€0.0028	€0.0032

All recognised gains and losses for both the current year and the previous period are included in the profit and loss account. 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 19 November 2007

Balance Sheet

As at 31 May 2007

	Note	2007 €	2006 €
Fixed Assets			
Mineral interests	**7**	3,617,723	3,541,406
Tangible assets	**8**	1,341	1,509
Financial assets	**9**	4	4
		3,619,068	3,542,919
Current Assets			
Debtors	**10**	2,324	13,661
Cash at bank and in hand		115,402	112,791
		117,726	126,452
Creditors: Amounts falling due within one year	**11**	(63,759)	(442,117)
Net Current Assets/(Liabilities)		53,967	(315,665)
Total Assets less Current Liabilities		3,673,035	3,227,254
Creditors: Amounts falling due after more than one year	**12**	(1,031,298)	(484,783)
Net Assets		2,641,737	2,742,471
Capital and Reserves			
Called up share capital	**14**	447,716	447,716
Share premium account	**14**	2,529,648	2,529,648
Profit and loss account	**15**	(360,227)	(234,893)
Share based payments reserve	**16**	24,600	-
Shareholders' Funds – all equity	**16**	2,641,737	2,742,471

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 19 November 2007

Cash Flow Statement

For the year ended 31 May 2007

	Note	2007	2006
		€	€
Net Cash (Outflow)/Inflow from Operating Activities	**17A**	(305,458)	53,753
Capital Expenditure and Financial Investments	**17B**	(263,046)	(657,252)
Net Cash Outflow before Financing		(568,504)	(603,499)
Financing	**17B**	571,115	716,287
Increase in Cash	**17C**	2,611	112,788

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

R.T.W.L. Conroy
Director

J.P. Jones
Director

Approved by the Directors on 19 November 2007

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 2006 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 with in 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. Tangible Assets

Tangible 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 Assets

Financial 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.

H. Share Based Payments

For equity-settled share based payment transactions (i.e. the granting of share options and share warrants), the Company measures the services and the corresponding increase in equity at fair value at the measurement date (which is the grant date) using a recognised valuation methodology for the pricing of financial instruments (Binomial Lattice Model). Given that the share options and warrants granted do not vest until the completion of a specified period of service the fair value is determined on the basis that the services to be rendered by employees as consideration for the granting of share options and warrants will be received over the vesting period, which is assessed as the grant date. The expense in the income statement in relation to the share options and warrants represents the product of the total number of options and warrants expected to vest and the fair value of those options and warrants. The resulting amount is allocated to accounting periods over the vesting period.

Notes to the Financial Statements

For the year ended 31 May 2007

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 P.l.c., 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

	2007	**2006**
	€	€
Management services and operating expenses	211,583	393,435
Transfer to Mineral Interests (Note 7)	(86,179)	(253,836)
	125,404	139,599

Subsequent to the year-end, the directors agreed that unpaid directors fees due at 31 August 2005 (date of admission to AIM) and remuneration due to the executive directors up to 30 November 2007 be waived. The amount due at 31 May 2007, was €484,777 of which €233,411 had been accrued in the previous year. The waiver is reflected in the management services and operating expenses charge for the year.

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:

	2007	**2006**
	€	€
Auditors' remuneration	8,500	8,500
Directors' emoluments		
- fees	30,000	71,075
- other remuneration	17,528	112,500
Depreciation	168	168

The directors' remuneration charged during the year included stock option costs of €17,528.

5. Loss per ordinary share

The calculation of the loss per ordinary share of €0.0028 (2006 – €0.0032) is based on the loss for the financial year of €125,334 (2006 – Loss €135,952) and the weighted average number of ordinary shares on a basic and fully diluted basis during the year of 44,771,676 (2006 – 42,271,676). Share options and warrants are not included in the calculation of fully diluted shares since the Company incurred a loss in 2007 and 2006 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 2007 (2006: Nil).

7. Mineral Interests

Costs held outside cost pool:

	2007	2006
	€	€
Cost		
At 31 May 2006	3,541,406	2,885,831
Expenditure during the period		
- licences and appraisal	176,867	401,739
- other operating costs (Note 3)	86,179	253,836
- write back of directors remuneration (Note 11)	(186,729)	-
At 31 May 2007	3,617,723	3,541,406

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 Assets

Office Equipment	2007	2006
	€	€
Cost		
1 June 2006	1,677	-
Additions	-	1,677
31 May 2007	1,677	1,677
Accumulated Depreciation		
1 June 2006	168	-
Charge for year	168	168
31 May 2007	336	168
Net Book Value		
31 May 2007	1,341	1,509
31 May 2006	1,509	-

9. Financial Assets

	2007	2006
	€	€
Investment in subsidiaries	4	4

Financial 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

	2007	2006
	€	€
VAT recoverable	2,324	13,661
	2,324	13,661

11. Creditors: Amounts falling due within one year

	2007	2006
	€	€
Trade creditors and accruals	63,759	442,117
	63,759	442,117

Subsequent to the year-end the directors considered the financial position of the Company and in particular the level of current liabilities which mainly arose from the accrual of unpaid directors' fees and executive directors' remuneration since incorporation. The relevant individual directors agreed to waive their entitlement to all amounts accruing up to 30 November 2007, amounting to €601,933, of which €484,777 was due at 31 May 2007. The net amount that had been allocated to the exploration programme, €186,729 was credited to mineral interests (Note 7) and the balance was credited to the profit and loss account.

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

	2007	2006
	€	€
Due to Conroy P.l.c.	354,518	296,045
Shareholders' loans	676,780	188,738
	1,031,298	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. Subsequent events

On 17 July 2007 the Company issued 15,770,000 ordinary shares of €0.01 each at 6.5p sterling. This resulted in funds of £1,025,000 (€1,500,000) being raised.

The Board has decided, subject to ratification by shareholders at the Annual General Meeting, to issue a total of 12,852,377 warrants to individual directors for nil consideration exercisable over 10 years at a subscription price of €0.10 (Sterling 7p per share).

14. Called up Share Capital and Share Premium

Authorised:

	2007	2006
	€	€
500,000,000 ordinary shares of €0.01 each	5,000,000	5,000,000

Issued and Fully Paid:

	Number	Share Capital €	Share Premium €
At start of year and end of year	44,771,676	447,716	2,529,648
	44,771,676	447,716	2,529,648

The share price at 31 May 2007 was 8.5p sterling. During the year the price ranged from 3p to 8.5p sterling.

15. Profit and Loss Account

	2007	2006
	€	€
At 1 June 2006	(234,893)	(98,941)
Loss for the financial year	(125,334)	(135,952)
At 31 May 2007	(360,227)	(234,893)

16. Reconciliation of Movement in Shareholders' Funds

	2007	2006
	€	€
At 1 June 2006	2,742,471	2,488,751
Shares issued, net	-	389,672
Loss for financial year/period	(125,334)	(135,952)
Share based payments reserve	24,600	-
At 31 May 2007	2,641,737	2,742,471

17. Notes to the Cash Flow Statement

A. Reconciliation of Loss to Net Cash (Outflow)/Inflow from Operating Activities:

	2007	2006
	€	€
Operating Loss	(125,334)	(135,952)
Depreciation	168	168
Write back of directors' remuneration – credited to mineral interests	186,729	-
(Decrease)/Increase in Creditors	(378,358)	202,538
Derease/(Increase) in Debtors	11,337	(13,001)
Net Cash (Outflow)/Inflow from Operating Activities	(305,458)	53,753

B. Analysis of Cash Flows:

	2007 €	2006 €
Capital expenditure and Financial Investment		
Investment in mineral interests	(263,046)	(655,575)
Purchase of tangible fixed assets	-	(1,677)
	(263,046)	(657,252)
Financing		
Shareholders' loans	546,515	326,615
Issue of share capital	-	730,000
Share issue expenses	-	(340,328)
Share based payments reserve	24,600	-
	571,115	716,287

C. Analysis and Reconciliation of Net Funds:

	1 June 2006	Cash Flow	31 May 2007
Cash at bank	112,791	2,611	115,402

18. Commitments and Contingencies

At 31 May 2007 there were no capital commitments or contingent liabilities.

19. Share Based Payments

The Company elected to estimate the fair value of employee stock options and warrants awards using the Binomial Lattice Model. The determination of the fair value of share based payment awards on the date of grant using the Binomial Lattice Model is affected by Karelian Diamond Resources Plc stock price as well as assumptions regarding a number of subjective variables. These variables include the expected term of the awards, the expected stock price volatility over the term of the awards, the risk free interest rate associated with the expected term of the awards and the expected dividends.

In 2007, the Company's Binomial Lattice option model included the following weighted average assumptions for the Company's employee stock option and warrants.

	Stock options	Stock warrants
Dividend yield	0%	0%
Expected volatility	70%	70%
Risk free interest rate	4.2%	4.1%
Expected life (in years)	10	10

20. Approval of Financial Statements

These financial statements were approved by the Board on 19 November 2007.

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 Westbury Hotel, Grafton Street, Dublin 2 on Monday 17th December 2007 at 3.30 p.m. for the purposes of transacting the following business:

1. To receive and consider the Financial Statements for the year ended 31 May 2007 together with the Directors' and Independent Auditors' Reports thereon (Resolution No. 1).
2. To re-elect as Directors the following persons:
   Miss Maureen Jones (Resolution No.2 (a))
   Mr James Jones (Resolution No.2 (b))
3. To authorize 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 the grant of the following warrants to subscribe for Ordinary Shares of €0.01 each in the capital of the Company at a subscription price of €0.10 (Stg. 7p) per share effected by the directors on 16 November 2007 be and are hereby confirmed and ratified."

Name of Warrant Holder	*Number of Warrants*
R T W L Conroy	5,521,049
M T A Jones	4,191,275
J P Jones	2,604,389
S P FitzPatrick	232,201
L J Maguire	232,201
R I Chaplin	71,262

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

   "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 16 December, 2012 unless previously renewed, varied or revoked by the Company."
6. To consider and, if thought fit, pass the following resolution as a Special Resolution (Resolution No.6):

   "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."
7. To consider and, if thought fit, pass the following Resolution as a Special Resolution:

   "That the Articles of Association of the Company be altered in the manner set out below:

   i By the insertion of ""Electronic Communication", the meaning given to such expression in section 2 of the Electronic Commerce Act, 2000." after the definition of "Directors" in Article 1(b);

   ii by the insertion of the words "Electronic Communication," after the word "lithography" in Article 1(c)(iii).

   iii By the insertion of a new Article 11 (b) in place of the existing Article 11 (b) as follows:-

   "11(b) (in addition to the authority conferred by paragraph (a)), the allotment of equity securities (including, without limitation, any shares purchased by the Company pursuant to the provisions of the 1990 Act and held as Treasury Shares) up to a maximum aggregate nominal value of fifty per cent of the issued Ordinary share capital of the Company at the date of the adoption of these Articles or, in respect of any renewal of this authority, at the close of business on the date on which such renewal shall be granted".

iv by the insertion of the following paragraph into Article 15 as Article 15 (e):

"The Company may, if and to the extent the law for the time being so permits, send or supply share certificates to members of the Company by means of Electronic Communication."

v by the insertion of the words "Electronic Communication" after the words "by post" in Article 69(b).

vi by the insertion of the words "Electronic Communication" after the word "telefax" to replace the words "electronic mail" in Article 93(b).

vii by the insertion of the words "Electronic Communication" after the word "telefax" to replace the words "electronic mail" in Article 94(b).

viii by the insertion of the words "or by way of Electronic Communication" after the words "in writing" in Article 119.

ix By the insertion of the following as an additional paragraph in Article 119:

"The Company may, if and to the extent the law for time being so permits, send or convey or supply all types of notices, documents, share certificates or information to the members by means of electronic equipment for the processing (including digital compression), storage and transmission of data, employing wires, radio optical technologies or any other electromagnetic means including without limitation, by sending such notice, documents or information by Electronic Communication or by making such notices, documents or information available on a website."

x by the insertion of the following as new sub paragraph (iv) of Article 120(a) of the Articles of Association:

"(iv) by sending the same by Electronic Communication in the manner or form approved by the Directors to the address of the member notified to the Company by the member for such purpose (or if not so notified to the address of the member last known to the Company)."

xi by the insertion of the following as new Article 120(d) and the subsequent redesignation of the existing Articles 120(d), (e), (f), (g) and (h) as Articles 120 (e), (f), (g) (h) and (i) respectively:

"(d) Where a notice or document is given, served or delivered pursuant to sub-paragraph (a)(iv) of this Article, the giving, serving or delivery thereof shall be deemed to have been affected at the expiration of twelve hours after its despatch. In proving such delivery or service, it shall be sufficient to prove that such Electronic Communication was sent to the address notified by the member to the Company for such purpose."

xii by the inclusion of the words "and (iv)" after the word "(ii)" in the newly numbered Article 120(f).

xiii by the deletion of the words "electronic mail" after the word "telefax" in the newly numbered Article 120(g).

xiv by the insertion of the words "(in electronic form or otherwise)" before the words "or printed" in Article 123.

xv by the insertion of the words "or notification" after the word "document" and the insertion of the words "thereof in any manner or, in the case of Electronic Communication, the deletion" after the word "disposal" in Article 128(c).

8. To transact any other business.

By Order of the Board
Dated this 19 day of November 2007

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 Registrars, 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.

Pursuant to Regulation 14 of the Companies Act 1990 (Uncertificated Securities) Regulations 1996, the Company specifies that only those holders of Ordinary Shares registered in the register of members of the Company as at 6:00 p.m. on 15 December 2007 shall be entitled to attend and vote at the Annual General Meeting in respect of the number of Ordinary Shares registered in their name at that time. Changes to entries on that register after that time and date shall be disregarded in determining the rights of any person to attend and vote at the meeting.

KARELIAN
DIAMOND RESOURCES

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