

Condensed Interim Financial Statements

Quest Rare Minerals Ltd.

(An Exploration & Development Stage Corporation)

For the three and six-month periods ended April 30, 2017

(Unaudited)

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NOTICE TO READER

Management has compiled the unaudited condensed interim financial statements of Quest Rare Minerals Ltd. as at April 30, 2017 and for the three and six-month periods then ended. These condensed interim financial statements have not been audited or reviewed by the Corporation's independent auditors.

Quest Rare Minerals Ltd.

**INTERIM STATEMENTS
OF FINANCIAL POSITION
(UNAUDITED)**

As at	April 30, 2017 \$	October 31, 2016 \$
	<u> </u>	<u> </u>
ASSETS [note 10]		
Current assets		
Cash [notes 1 and 13]	263,840	58,026
Investments [note 13]	1,850	750
Prepaid expenses and deposits	263,034	220,938
Commodity taxes and other receivables	85,897	82,979
Tax credits receivable	245,315	2,199,468
	<u>859,936</u>	<u>2,562,161</u>
Non-current assets		
Other non-current assets [note 7]	858,531	719,680
Government grants receivable [note 9]	73,264	66,247
Total assets	<u>1,791,731</u>	<u>3,348,088</u>
DEFICIENCY AND LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities [note 12]	3,696,012	3,140,511
Loans payable [note 8]	144,968	112,911
Deferred government grants [note 9]	354,418	417,580
Convertible debentures [notes 10 and 13]	464,039	2,270,296
Total current liabilities	<u>4,659,437</u>	<u>5,941,298</u>
Non-Current liabilities		
Accounts payable and accrued liabilities [note 12]	34,757	49,653
Total non-current liabilities	<u>34,757</u>	<u>49,653</u>
Deficiency		
Share capital [note 11(a)]	82,534,123	81,740,738
Warrants reserve [note 11(c)]	1,410,500	927,890
Equity component of convertible debentures [note 10]	—	229,873
Contributed surplus [notes 10 and 11]	22,094,305	21,782,149
Deficit	(108,941,391)	(107,323,513)
Total deficiency	<u>(2,902,463)</u>	<u>(2,642,863)</u>
Total deficiency and liabilities	<u>1,791,731</u>	<u>3,348,088</u>
Going concern uncertainty [note 1]		
Subsequent events [note 14]		
See accompanying notes		

Quest Rare Minerals Ltd.

**INTERIM STATEMENTS OF
COMPREHENSIVE LOSS
(UNAUDITED)**

	Three-month periods ended		Six-month periods ended	
	April 30		April 30	
	2017	2016	2017	2016
	\$	\$	\$	\$
REVENUES	—	—	—	—
EXPENSES				
Exploration and evaluation expenditures <i>[note 5]</i>	435,866	323,377	716,667	784,733
Administration expenses <i>[notes 6 and 12]</i>	138,594	190,073	457,900	446,467
Investor relations <i>[notes 6 and 12]</i>	99,101	59,314	153,540	95,958
Professional fees <i>[note 12]</i>	68,476	70,505	140,385	182,766
	<u>742,037</u>	<u>643,269</u>	<u>1,468,492</u>	<u>1,509,924</u>
Operating loss	<u>(742,037)</u>	<u>(643,269)</u>	<u>(1,468,492)</u>	<u>(1,509,924)</u>
Finance income	349	12,498	868	12,968
Finance expenses <i>[notes 6, 8 and 10]</i>	(46,469)	(168,625)	(151,354)	(318,303)
Unrealized gain on investments held for trading	1,050	200	1,100	350
	<u>(45,070)</u>	<u>(155,927)</u>	<u>(149,386)</u>	<u>(304,985)</u>
Net loss and comprehensive loss for the period	<u>(787,107)</u>	<u>(799,196)</u>	<u>(1,617,878)</u>	<u>(1,814,909)</u>
Net loss per share				
Basic and fully diluted	<u>(0.01)</u>	<u>(0.01)</u>	<u>(0.02)</u>	<u>(0.02)</u>
Weighted average number of outstanding shares				
Basic and fully diluted	<u>89,342,494</u>	<u>86,196,789</u>	<u>87,861,608</u>	<u>85,624,424</u>

Going concern uncertainty *[note 1]*

See accompanying notes

Quest Rare Minerals Ltd.

**INTERIM STATEMENTS OF CHANGES IN EQUITY
(UNAUDITED)**

	Share capital		Warrants reserve		Equity component of convertible debentures	Contributed surplus	Deficit	Total
	#	\$	#	\$	\$	\$	\$	\$
Balance – November 1, 2015	85,034,011	81,543,188	18,105,300	927,890	232,957	21,808,066	(104,813,781)	(301,680)
Issuance of shares <i>[note 11]</i>	1,000,000	60,000	—	—	—	—	—	60,000
Settlement of RSUs	255,000	69,825	—	—	—	(69,825)	—	—
Settlement of DSUs <i>[note 11]</i>	140,000	67,725	—	—	—	(67,725)	—	—
Redemption of convertible debentures <i>[note 10]</i>	—	—	—	—	(3,084)	—	—	(3,084)
Share-based compensation <i>[note 11(e)]</i>	—	—	—	—	—	95,031	—	95,031
Net loss and comprehensive loss for the period	—	—	—	—	—	—	(1,814,909)	(1,814,909)
Balance – April 30, 2016	86,429,011	81,740,738	18,105,300	927,890	229,873	21,765,547	(106,628,690)	(1,964,642)
Balance – November 1, 2016	86,429,011	81,740,738	18,105,300	927,890	229,873	21,782,149	(107,323,513)	(2,642,863)
Redemption of convertible debentures <i>[note 10]</i>	—	—	—	—	(229,873)	229,873	—	—
Issuance of convertible debentures <i>[note 10]</i>	—	—	550,000	73,241	—	—	—	73,241
Issue costs - convertible debentures <i>[note 10]</i>	—	—	—	(7,146)	—	—	—	(7,146)
Issuance of shares and warrants <i>[notes 10 and 11]</i>	8,100,000	1,057,200	8,650,000	562,800	—	—	—	1,620,000
Issue costs - shares and warrants <i>[notes 10 and 11]</i>	—	(237,850)	—	(126,615)	—	—	—	(364,465)
Issue costs - options issued to brokers <i>[note 10]</i>	—	(36,952)	—	(19,670)	—	56,622	—	—
Exercise of stock options <i>[note 11]</i>	100,000	10,987	—	—	—	(4,487)	—	6,500
Share-based compensation <i>[note 11(e)]</i>	—	—	—	—	—	30,148	—	30,148
Net loss and comprehensive loss for the period	—	—	—	—	—	—	(1,617,878)	(1,617,878)
Balance – April 30, 2017	94,629,011	82,534,123	27,305,300	1,410,500	—	22,094,305	(108,941,391)	(2,902,463)

Going concern uncertainty *[note 1]*

See accompanying notes

Quest Rare Minerals Ltd.**INTERIM STATEMENTS OF CASH FLOWS
(UNAUDITED)**

Six-month periods ended April 30,

	2017	2016
	\$	\$
OPERATING ACTIVITIES		
Net loss	(1,617,878)	(1,814,909)
Items not impacting cash:		
Accretion of convertible debentures <i>[note 10]</i>	83,522	205,888
Excess of redemption of convertible debentures <i>[notes 6 and 10]</i>	21,976	20,177
Unrealized (gain) on investments held for trading	(1,100)	(350)
Other non-cash expenses	17,153	—
Share-based compensation <i>[note 11e]</i>	30,148	95,031
	<u>(1,466,179)</u>	<u>(1,494,163)</u>
Net change in non-cash working capital items	2,138,228	1,330,489
Net cash flows from (used in) operating activities	<u>672,050</u>	<u>(163,674)</u>
INVESTING ACTIVITIES		
Increase in non-current assets <i>[note 7]</i>	—	(10,650)
Net cash flows (used in) investing activities	<u>—</u>	<u>(10,650)</u>
FINANCING ACTIVITIES		
Increase in loans payable <i>[note 8]</i>	25,000	105,000
Proceeds from issuance of shares and warrants <i>[note 11]</i>	1,626,500	60,000
Proceeds from issuance of convertible debentures <i>[note 10]</i>	25,678	—
Redemption of convertible debentures <i>[note 10]</i>	(1,956,580)	(158,000)
Share and warrant issue costs <i>[note 11]</i>	(186,833)	(3,712)
Net cash flows (used in) from financing activities	<u>(466,235)</u>	<u>3,288</u>
Net increase (decrease) in cash	205,815	(171,036)
Cash, beginning of year	58,026	208,925
Cash, end of year	<u>263,840</u>	<u>37,889</u>

Going concern uncertainty *[note 1]**See accompanying notes*

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

1. NATURE OF OPERATIONS AND GOING CONCERN UNCERTAINTY

Quest Rare Minerals Ltd. [“Quest” or the “Corporation”] was incorporated under the *Canada Business Corporations Act* on June 6, 2007. The registered office of Quest is located at 1155 University Street, Suite 906, Montreal, Québec, H3B 3A7. Quest is a publicly-listed Corporation and its shares are listed on the Toronto Stock Exchange under the symbol “QRM”.

Quest is a Canadian-based exploration and evaluation company which is focused on the development of its Strange Lake rare earth deposit in northeastern Québec as described in note 5 while at the same time planning the engineering and construction of a processing facility in Bécancour in southern Québec.

Going Concern Uncertainty

These condensed interim financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assume that the Corporation will continue in operation for the foreseeable future and will be able to realize its assets and discharge its obligations in the normal course of operations. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but not limited to twelve months from the end of the reporting period. The use of these principles may not be appropriate.

To date, the Corporation has not earned significant revenue and is considered to be in the exploration and development stage. Exploration and evaluation expenditures comprise a significant portion of the Corporation’s activities. Mineral exploration and development is highly speculative and involves inherent risks.

The Corporation’s current committed cash resources are insufficient to cover expected expenditures for the next 12 months and its planned Pre-feasibility study on Strange Lake. The Corporation’s ability to continue as a going concern is dependent on being able to obtain the necessary financing to satisfy its liabilities as they become due. There can be no assurance that management will be successful in securing adequate financing. In addition, while the Corporation’s Preliminary Economic Assessment (“PEA”) and future development activities in relation to its Strange Lake project look promising, there can be no assurance that the results of its planned Pre-feasibility study will confirm the existence of economically viable quantities of ore or that the project will ultimately go into production.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

1. NATURE OF OPERATIONS AND GOING CONCERN UNCERTAINTY [Cont'd]

The Corporation reported a net loss and total comprehensive loss in the six-months ended April 30, 2016 and the year ended October 31, 2016 of \$1,617,878 and \$2,509,732, respectively. As at April 30, 2017, the Corporation's current liabilities exceeded its current assets by \$3,799,501 [October 31, 2016 – \$3,379,137]. These recurring losses and the need for continued financing to further successful exploration and development activities indicate the existence of a material uncertainty that may cast significant doubt as to the Corporation's ability to continue as a going concern.

These condensed interim financial statements do not give effect to any adjustments to the carrying values and classifications of assets and liabilities that might be necessary, if the Corporation is unable to continue as a going concern. Such adjustments could be material.

2. BASIS OF PREPARATION

Statement of Compliance

The condensed interim financial statements of the Corporation for the three and six-months ended April 30, 2017 have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting. The same accounting policies and methods of computation were followed in the preparation of these condensed interim financial statements as were followed in the preparation of the financial statements for the year ended October 31, 2016. These condensed interim financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the consolidated financial statements for the year ended October 31, 2016 which have been prepared in accordance with IFRS.

The Board of Directors approved these condensed interim financial statements effective June 14, 2017.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

3. RECENT ACCOUNTING PRONOUNCEMENTS

New standards, interpretations and amendments adopted by the Corporation

The nature and the impact of the new standard, interpretation and amendment adopted by the Corporation on November 1, 2016 is described below:

IAS 34 Interim Financial Reporting

The amendment clarifies that the required interim disclosures must either be in the interim financial statements or incorporated by cross-reference between the interim financial statements and wherever they are included within the interim financial report (e.g., in the Management Discussion and Analysis). The other information within the interim financial report must be available to users on the same terms as the interim financial statements and at the same time. The amendment must be applied retrospectively and was effective for annual periods beginning on or after January 1, 2016. The adoption of this amendment did not have an impact on the Corporation's interim condensed financial statements.

4. INCOME TAXES

A reconciliation of income tax charge applicable to accounting loss before income tax at the weighted average statutory income tax rate to income tax charge at the Corporation's effective income tax rate for the three and six-month periods ended April 30 is as follows:

	Three-month periods ended April 30		Six-month periods ended April 30	
	2017	2016	2017	2016
	\$	\$	\$	\$
Loss before income tax	(787,107)	(799,196)	(1,617,878)	(1,814,909)
Income tax recovery at the combined Federal and Provincial tax rate 26.98% [2014– 26.68%]	(210,983)	(214,775)	(433,670)	(487,737)
Stock based compensation	1,333	6,197	8,081	25,539
Other non-deductible expenses	(93,588)	141,439	(120,086)	127,536
Changes in valuation allowance	303,238	67,139	545,675	334,662
Tax charge at effective income tax rate	—	—	—	—

Quest Rare Minerals Ltd.

**NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS
(UNAUDITED)**

April 30, 2017

4. INCOME TAXES [Cont'd]

The deferred tax asset and liability of the Corporation consist of the following:

	April 30, 2017	October 31, 2016
	\$	\$
Future income tax assets		
Exploration and evaluation expenditures	15,972,212	15,782,431
Non-capital loss carry-forwards	6,256,787	5,989,543
Share issue costs	244,331	196,182
Investments	5,515	5,663
	22,478,845	21,973,819
Future income tax liabilities		
Convertible debentures	(14,092)	(54,741)
Net future income tax assets	22,464,753	21,919,078
Unrecognized deferred tax assets	(22,464,753)	(21,919,078)
Net future income tax liabilities	—	—

5. EXPLORATION AND EVALUATION EXPENDITURES

The following is a breakdown by project of the exploration and evaluation expenditures incurred, net of tax credits, for the six-month period ended April 30:

	Three-month periods ended April 30,		Six-month periods ended April 30,	
	2017	2016	2017	2016
	\$	\$	\$	\$
Strange Lake (Québec)	432,221	321,148	713,022	779,204
Alterra – Strange Lake (Newfoundland & Labrador)	1,500	—	1,500	—
Strange Lake (Newfoundland & Labrador)	2,145	—	2,145	—
Total exploration and evaluation expenditures before stock-based compensation	435,866	321,148	716,667	779,204
Stock-based compensation [note 11[e]]	—	2,229	—	5,529
Total expenditures incurred	435,866	323,377	716,667	784,733

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

5. EXPLORATION AND EVALUATION EXPENDITURES [Cont'd]

Strange Lake Property, (Québec)

The Corporation's 100%-owned Strange Lake property is located adjacent to Lac Brisson situated within the George River belt located 220 km northeast of Schefferville, Québec and 125 km west of the Voisey's Bay Nickel-Copper-Cobalt Mine, and covers an area of approximately 9,367 hectares. The property is a rare earth mineralized zone and consists of 211 mining claims, all of which are in Québec.

A breakdown of exploration and evaluation expenditures incurred on the Strange Lake project are set out below:

	Six-month period ended April 30, 2017	Six-month period ended April 30, 2016	From Inception
	\$	\$	\$
Acquisition costs	12,948	—	214,083
Geochemical Surveys	—	—	42,027
Geophysical Surveys	—	—	288,651
Geological Surveys	—	37,500	13,037,117
Drilling	18,750	18,750	15,123,167
Prospecting	—	—	264,174
Prefeasibility Studies	203,391	191,326	32,118,398
Feasibility Studies	—	—	5,110,525
Metallurgical Work	—	—	2,851,112
Environmental & Permitting	161,936	167,483	2,944,019
Project Management & Support	395,478	523,728	2,772,316
Other	—	—	2,425,206
Government Tax Credits	(9,302)	(159,583)	(14,817,370)
Government Grants [note 9]	(70,179)	—	(732,648)
Total expenditures incurred	713,022	779,204	61,640,777

Other, (Newfoundland & Labrador)

On March 14, 2016, Quest staked an additional 33 contiguous claims (825 ha) in Newfoundland & Labrador. This covers available claim blocks immediately north and east of the Main Zone REE Deposit, historically referred to as the A Zone by the Iron Ore Mining Company of Canada (IOCC). This new license is adjacent to Quest's existing Mineral License, also known as the Alterra Property.

Quest Rare Minerals Ltd.

**NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS
(UNAUDITED)**

April 30, 2017

6. EXPENSES BY NATURE

The following is a breakdown of the nature of expenses included in administration expenses, investor relations and finance expenses for the three and six-month periods ended April 30:

	Three-month periods ended April 30		Six-month periods ended April 30	
	2017	2016	2017	2016
Administration expenses:				
Office expenses:				
Salaries and other employee benefits	35,787	52,305	233,263	104,194
Directors' fees	53,750	61,250	113,750	122,500
Directors' and officers' insurance	10,001	17,395	21,265	43,620
Rent	13,241	14,344	27,844	28,389
Telephone and internet	4,881	4,932	9,964	9,138
Travel costs	2,400	6,384	5,400	19,021
IT services	4,903	6,967	9,460	13,952
Education & training	—	135	—	155
Equipment lease/rental	3,448	2,699	5,956	5,278
Other office expenses	3,854	19	6,402	6,616
Bank charges	695	1,473	1,995	3,085
Foreign exchange loss (gain)	659	1,338	(7,547)	1,017
Stock-based compensation [note 11(e)]	4,975	20,832	30,148	89,502
Total	138,594	190,073	457,900	446,467

As at April 30, 2017 the expenditures incurred on separation and termination benefits and onerous lease that were unpaid and included in accounts payable and accrued liabilities amounted to \$80,460 and \$64,549 respectively [April 30, 2016 – 119,003 and \$94,421].

Quest Rare Minerals Ltd.

**NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS
(UNAUDITED)**

April 30, 2017

6. EXPENSES BY NATURE [Cont'd]

	Three-month periods ended April 30		Six-month periods ended April 30	
	2017	2016	2017	2016
Investor relations:				
Advertising	3,893	3,896	7,795	7,798
Conferences	261	—	2,277	—
Dues and subscriptions	—	255	—	510
Investor relations fees	5,100	2,100	19,000	6,675
Listing and stock transfer fees	10,742	12,223	35,782	39,143
Meetings	33,644	31,953	35,643	31,953
Printing and filing	5,472	833	8,695	1,397
Travel related costs	39,989	8,054	44,348	8,482
Total	99,101	59,314	153,540	95,958
Finance expense:				
Interest on loans payable <i>[note 8]</i>	3,858	2,236	7,057	3,191
Interest on convertible debentures <i>[note 10]</i>	13,410	44,936	38,799	89,046
Accretion of convertible debentures <i>[note 10]</i>	29,201	101,275	83,522	205,888
Excess of redemption of convertible debentures <i>[note 10]</i>	—	20,178	21,976	20,178
Total	46,469	168,625	151,354	318,303

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

7. OTHER NON-CURRENT ASSETS

A breakdown of other non-current assets as at April 30, 2016 and October 31, 2015 are as follows:

	April 30, 2017 \$	October 31, 2016 \$
SPIP Agreement – lease payments	510,360	446,652
Fraenkel Agreement – option payments	348,171	273,028
Total	858,531	719,680

8. LOANS PAYABLE

On December 15, 2015, the Corporation entered into loan agreements with a number of Directors, Officers or their related parties and others (collectively “the Lenders”) under which the Lenders agreed to loan to the Corporation a total of \$105,000 (“Tranche 1 Loan”) for the purposes of providing working capital. The Tranche 1 Loan amounts are repayable at the earlier of receipt of certain commodity taxes receivables, future private placements, future government grants, or one year from the date of the loan and bear interest at a rate of 8.5% per annum, compounded monthly, for the first twelve months and 12% per annum thereafter, compounded annually. The Corporation provided security to each Lender by way of a hypothec, in the amount 120% of the principal loan amount, over all input tax credits or input tax refunds, due from the Government of Québec.

On December 22, 2016, an existing lender agreed to loan the Corporation an additional \$25,000 (“Tranche 2 Loan”), to be used for working capital purposes. The Tranche 2 Loan was issued under the same terms and conditions as the Tranche 1 Loan.

During the three and six-month periods ended April 30, 2017, interest expense pursuant to these loans amounted to \$3,858 and \$7,057 respectively [April 30, 2016 – \$2,236 and \$3,191 respectively] [note 6].

9. GOVERNMENT GRANTS

On July 28, 2016, the Corporation entered into a Contribution Agreement (the “Agreement”) with Sustainable Development Technology Canada (“SDTC”). Under the terms of the agreement, SDTC will provide the Corporation with a grant to support its operation of a large pilot plant to produce mixed rare earth metal oxides. The grant is for a maximum of \$4,935,000 based on eligible expenditures, as defined under the Agreement.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

9. GOVERNMENT GRANTS [Cont'd]

As at April 30, 2017, all of the conditions under the Agreement were met or are expected to be met by the Corporation.

A breakdown of government grants receivable representing the holdback amount and deferred government grants as at April 30, 2017 and the respective changes during the three-month period then ended are summarized as follows:

	Government grants receivable \$	Deferred government grants \$
Outstanding, October 31, 2016	66,247	(417,580)
Earned during the period [note 5]	7,017	63,162
Outstanding, April 30, 2017	<u>73,264</u>	<u>(354,418)</u>
Current	—	(354,418)
Non-current	<u>73,264</u>	—

10. CONVERTIBLE DEBENTURES

On March 9, 2015, the Corporation entered into a Securities Purchase Agreement (the "Agreement") with Ekagrata Inc. ("Ekagrata"), an unrelated Canadian private investor, pursuant to which the Corporation issued to 2455440 Ontario Inc., an affiliate of Ekagrata, a 7% secured convertible debenture in a principal amount of \$2,250,000 (the "Ekagrata Debenture Tranche 1") and 2,250,000 common share purchase warrants.

On April 20, 2015, the Corporation issued a 7% secured convertible debenture in a principal amount of \$250,000 (the "Ekagrata Debenture Tranche 2") and 250,000 common share purchase warrants (collectively the "Ekagrata Debentures").

On March 11, 2016, the Corporation completed a partial redemption of its Ekagrata Debentures in the amount of \$158,000. The excess of the redemption amount over the carrying value of the host debt and equity components, amounting to \$20,178, was recorded in the net loss for the year ended October 31, 2016, as part of finance expenses.

On December 5, 16, and 22, 2016, the Corporation completed additional partial redemptions of its Ekagrata Debentures totaling \$1,956,580. The excess of the redemption amount over the carrying value of the host debt component, amounting to \$21,976, was recorded in the net loss for the six-month period ended April 30, 2017, as part of finance expenses [note 6].

Quest Rare Minerals Ltd.

**NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS
(UNAUDITED)**

April 30, 2017

10. CONVERTIBLE DEBENTURES [Cont'd]

On January 19, 2017, the Corporation issued a 10% secured convertible debenture in a principal amount of \$550,000 (the "2017 Debenture") by way of private placement ("the Placement") to a U.S. private equity special opportunity fund. The Corporation also issued 550,000 warrants to the private equity fund, each of which entitles the holder to acquire one common share of the Corporation at a price of \$0.18 for three years. The proceeds of the 2017 Debenture, were, in part, used to redeem in full, the remaining balance of the Ekagrata debenture and all accrued interest owing, amounting to \$385,420 and \$78,524 respectively.

As a result of the redemption of the Ekagrata debenture, the remaining portion of the equity component of the convertible debenture, amounting to \$229,873, was transferred to contributed surplus.

The 2017 Debenture matures in one year and bears interest at a rate of 10% per annum, payable semi-annually in cash and, at the holder's option, can be converted into common shares at a price of \$0.16 per share. The Debenture is secured by a first-ranking hypothec on all of the Corporation's assets, present and future, corporeal and incorporeal.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

10. CONVERTIBLE DEBENTURES [Cont'd]

The 2017 Debenture was determined to comprise two separate financial instruments, the first being a compound financial instrument comprising a host debt component and a residual equity component representing the conversion feature, and the second related to the common share purchase warrants that were issued along with the 2017 Debentures. On initial recognition, the combined fair value of these two financial instruments was estimated as outlined below and used to prorate the principal amount of the 2017 Debentures between the two. The fair value of the host or liability component of the convertible debenture was estimated by discounting the stream of future payments of interest and principal at the prevailing market rate for a similar liability of comparable credit status and providing substantially the same cash flows that do not have an associated share purchase warrant and conversion option. The fair values of the equity component representing the conversion feature of the first financial instrument and also of the warrants comprising the second financial instrument were determined based on the Black-Scholes option pricing model using the weighted average assumptions set out as follows:

Assumption	Warrants issued	Equity conversion
	January 19, 2017	feature issued January 19, 2017
Risk-free interest rate	0.76%	0.76%
Expected volatility	99.7%	97.0%
Dividend yield	Nil	Nil
Expected life [in years]	3.0	1.0
Exercise price	\$0.18	\$0.16
Share price on date of grant	\$0.24	\$0.24
Fair value at grant date	\$0.16	\$0.12

Where the prorated value of the compound financial instrument comprising the host debt component and the equity conversion feature was less than the estimated fair value of the host debt component itself, then the fair value assigned to the equity conversion feature was reduced to zero and the prorated value of the compound financial instrument was allocated entirely to the host debt component.

In connection with the Placement, the Corporation incurred issue costs amounting to \$53,660 which have been pro-rated between the host debt component of the convertible debentures, its associated equity component, and the common share purchase warrants, in the amounts of \$46,514, nil and \$7,146, respectively.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

10. CONVERTIBLE DEBENTURES [Cont'd]

As at April 30, 2017 a total of \$62,665 of issue costs were unpaid and included in accounts payable and accrued liabilities [October 31, 2016 - \$50,976]. These amounts have been excluded from the statements of cash flows. In addition, other transactions related to the convertible debentures were excluded from the statement of cash flows as they did not consist of cash inflows or outflows for the Corporation.

The debentures, net of the equity components and issue costs are accreted using the effective interest rate method over the term of the debenture, such that the carrying amount will equal the total face value of the debenture at maturity.

A breakdown of convertible debentures as at April 30, 2017 and October 31, 2016 are as follows:

	Host debt component \$	Common share purchase warrants \$	Equity component of convertible debentures \$	Total \$
Balance, November 1, 2015	1,987,238	172,036	232,957	2,392,231
Accretion	417,796	—	—	417,796
Redemptions during the year	(134,738)	—	(3,084)	(137,822)
Balance, October 31, 2016	2,270,296	172,036	229,873	2,672,205
Accretion	83,522	—	—	83,522
Redemptions during the period	(2,320,024)	—	—	(2,320,024)
Transferred to contributed surplus	—	—	(229,873)	(229,873)
Debentures issued during the period	476,759	73,241	—	550,000
Issue costs	(46,514)	(7,146)	—	(53,660)
Balance, April 30, 2017	464,039	238,131	—	702,170

Quest Rare Minerals Ltd.

**NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS
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April 30, 2017

11. SHARE CAPITAL

Authorized

Common

An unlimited number of no par value shares.

Preferred

An unlimited number of shares issuable in series, non-voting, conditions to be determined by the Board of Directors.

[a] Common shares

Issuances during the three and six-month periods ended April 30, 2017

- [i] On February 22, 2017, the Corporation issued 8,100,000 Special Warrants (“Special Warrants”) at a price of \$0.20 per Special Warrant, for total proceeds of \$1,620,000, pursuant to a private placement.

On March 23, 2017 each of the Special Warrants were exchanged, for no additional consideration, for one Quest common share and one common share purchase warrant (“Warrant”) of the Corporation. Each of the Warrants entitles its holder to purchase one additional common share at a price of \$0.275 until February 22, 2020.

Further, on February 22, 2017, the Corporation also issued broker compensation options entitling the agents for the private placement to purchase a maximum of 405,000 common shares of the Corporation at a price of \$0.275 until February 22, 2020. The total fair value of broker options was \$56,622, allocated to contributed surplus.

As at April 30, 2017, none of the broker options issued had been exercised.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

11. SHARE CAPITAL [Cont'd]

The fair value of the warrants and the broker compensation options was determined based on the Black-Scholes option pricing model using the weighted average assumptions as follows:

Assumption	Broker Compensation	
	Warrants	Options
Risk-free interest rate	0.75%	0.76%
Expected volatility	107%	105%
Dividend yield	Nil	Nil
Expected life [in years]	3.0	3.0
Share Price	\$0. 155	\$0. 230
Fair value at grant date	\$0. 083	\$0. 140

In connection with the private placement, the Corporation paid cash commissions to agents of \$113,400, issued broker compensation options of \$56,622 and incurred other professional fees and expenses of \$251,065 for a total of \$421,087 which has been prorated between the share capital and warrants of \$274,802 and \$146,285 respectively.

As at April 30, 2017 a total of \$196,549 of issue costs were unpaid and included in accounts payable and accrued liabilities. These amounts have been excluded from the statements of cash flows.

- [ii] During the six-month period ended April 30, 2017, the Corporation issued 100,000 common shares at an average exercise price of \$0.065 per share for a total cash amount of \$6,500 for stock options exercised, and an amount of \$4,487 related to exercised stock options was transferred from contributed surplus to capital stock.

Issuances during the three and six-month periods ended April 30, 2016

- [iii] On January 20, 2016, the Corporation issued 255,000 common shares in relation to the exercise of 255,000 RSUs [note 11[d]].
- [iv] On February 9, 2016, the Corporation completed a private placement with an individual investor by issuing 1,000,000 common shares at an exercise price of \$0.06 per share for gross proceeds of \$60,000.
- [iv] On April 25, 2016, the Corporation issued 140,000 common shares in relation to the exercise of 140,000 DSUs [note 11 [d]].

Quest Rare Minerals Ltd.

**NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS
(UNAUDITED)**

April 30, 2017

11. SHARE CAPITAL [Cont'd]

[b] Stock Options

The outstanding options, excluding broker options, as at April 30, 2017 and October 31, 2016 and the respective changes during the six-month period and the year then ended are summarized as follows:

	Six-month period ended April 30, 2017		Year ended October 31, 2016	
	Number of options #	Weighted average exercise price \$	Number of options #	Weighted average exercise price \$
Outstanding, beginning of period	6,821,000	1.66	5,301,000	2.42
Granted	—	—	1,920,000	0.07
Exercised	(100,000)	(0.07)	(400,000)	(4.09)
Expired/cancelled	(180,000)	(0.74)	—	—
Outstanding, end of period	6,541,000	1.71	6,821,000	1.66

The following options, excluding broker options and units, are outstanding and exercisable as at April 30, 2017:

Options outstanding					
Range of exercise price \$	Number outstanding #	Weighted average remaining contractual life (in years)	Weighted average exercise price \$	Number exercisable #	Weighted average exercise price \$
0.01 to 0.749	3,956,000	3.07	0.16	3,622,666	0.17
1.50 to 2.249	150,000	4.44	2.24	150,000	2.24
2.25 to 2.999	595,000	3.74	2.73	595,000	2.73
3.75 to 4.499	1,240,000	3.51	4.43	1,240,000	4.43
4.50 to 5.249	350,000	3.47	4.69	350,000	4.69
5.25 to 5.999	250,000	3.69	5.72	250,000	5.72
0.00 to 5.999	6,541,000	3.29	1.71	6,207,666	1.79

Quest Rare Minerals Ltd.

**NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS
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April 30, 2017

11. SHARE CAPITAL [Cont'd]

The fair value of stock options granted during the three and six-month periods ended April 30, 2016 were estimated at their respective grant dates using the Black-Scholes option pricing model, using the following weighted average assumptions:

Assumption	Three-month period ended April 30, 2016	Six-month period ended April 30, 2016
Risk-free interest rate	—	0.72%
Expected volatility	—	6.44%
Dividend yield	—	90%
Expected life [in years]	—	Nil
Share Price	—	5
Fair value at grant date	—	\$0.05

[c] Warrants

The outstanding warrants as at April 30, 2017 and October 31, 2016 and the respective changes during the quarter and year then ended are summarized as follows:

	Six-month period ended April 30, 2017		Year ended October 31, 2016	
	Number of warrants #	Weighted average exercise price \$	Number of warrants #	Weighted average exercise price \$
Outstanding balance, beginning of year	18,105,300	0.30	18,105,300	0.30
Granted	8,650,000	0.18	—	—
Exercised	—	—	—	—
Expired	—	—	—	—
Outstanding balance, end of year	26,755,300	0.26	18,105,300	0.30

As at April 30, 2017, the warrants outstanding had a weighted average life of 1.53 years [October 31, 2016 – 1.39 years]. All warrants are exercisable.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

11. SHARE CAPITAL [Cont'd]

[d] Restricted and Deferred Share Unit Plans

On March 9, 2012, the Board of Directors adopted the Restricted Share Unit ["RSU"] Plan and the Deferred Share Unit ["DSU"] Plan to complement the 2012 Stock Option Plan. Under these plans, RSUs may be granted to executives and key employees, and DSUs may be granted to directors and key executives, as part of their long-term compensation packages.

RSUs vest over the period of a "Performance Cycle", defined as the period from the date of grant of the unit to the end of the Corporation's second fiscal year after the fiscal year in which the unit was granted [a period of up to three years]. DSUs vest immediately, and DSU awards can be settled only when the holder ceases to be an employee of the Corporation.

RSUs and DSUs entitle the holder to receive a payout, at the Corporation's discretion in either: [i] common shares, on the basis of one common share per RSU or DSU vested in the holder's account or [ii] cash, based on the Corporation's share price at the relevant time. The value of the cash payout, if elected by the Corporation, is determined by multiplying the RSUs and DSUs vested at the payout date by the average closing price of the Corporation's shares over the last ten days prior to the payout date. DSU awards can be settled only when the holder ceases to be an employee of the Corporation.

Each of the RSU and DSU Plans provides that a maximum of 750,000 common shares can be issued thereunder. All RSUs and DSUs granted are classified as equity instruments in accordance with IFRS as their terms provide for settlement in either equity or cash at the sole discretion of the Corporation.

The outstanding RSUs and DSUs as at April 30, 2017 and October 31, 2016 and the respective changes during the six-month period and year then ended are summarized as follows:

	Restricted Share Units			
	Number of units #	Fair value at grant date \$	Number of units #	Fair value at grant date \$
	Six-month period ended April 30, 2017		Year ended October 31, 2016	
Outstanding, beginning of period	275,000	0.18	530,000	0.21
Exercised	—	—	(255,000)	(0.24)
Outstanding, end of period	275,000	0.18	275,000	0.18
Units exercisable	25,000	0.18	—	—

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

11. SHARE CAPITAL [Cont'd]

	Deferred Share Units			
	Number of units #	Fair value at grant date \$	Number of units #	Fair value at grant date \$
	Six-month period ended April 30, 2017		Year ended October 31, 2016	
Outstanding, beginning of period	480,000	0.48	620,000	0.48
Exercised	—	—	(140,000)	(0.48)
Outstanding, end of period	480,000	0.48	480,000	0.48
Units exercisable	—	—	—	—

[e] Stock-based compensation

For the three-month period ended April 30, 2017, the amount of stock-based compensation expenditures from all sources, included in administration expenses and exploration and evaluation expenditures in the statements of comprehensive loss, were \$4,975 and nil respectively [2016 – \$20,832 and \$2,229]. For the six-month period ended April 30, 2017, the amount of stock-based compensation expenditures from all sources, included in administration expenses and exploration and evaluation expenditures in the statements of comprehensive loss, were \$30,148 and nil respectively [2016 – \$89,502 and \$5,529].

12. RELATED PARTY TRANSACTIONS

In addition to the related party transaction disclosed in note 8, the following related party transactions occurred in the normal course of operations.

- [a] During the three and six-month periods ended April 30, 2017, the Corporation incurred fees to a law firm in which a director of the Corporation is a partner. For the three-month period ended April 30, 2017, the total amount for such services provided was \$94,775, of which \$19,100 was recorded in professional fees, \$11,119 was recorded in issue costs and \$64,556 in investor relations [2016 – \$8,721, nil, and \$8,866 respectively]. For the six-month period ended April 30, 2017, the total amount for such services provided was \$209,489, of which \$27,304 was recorded in professional fees, \$169,068 was recorded in issue costs and \$13,117 was recorded in investor relations [2016 – \$42,272, nil, and \$8,866 respectively]. As at April 30, 2017, an amount of \$390,001 [October 31, 2016 – \$193,093] owing to this law firm was included in accounts payable and accrued liabilities in respect of these fees.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

12. RELATED PARTY TRANSACTIONS [Cont'd]

- [b] During the three and six-month periods ended April 30, 2017, the Corporation incurred fees to a private investment firm of which a director of the Corporation has a related party association. For the three and six-month periods ended April 30, 2017, the total amounts for such services provided was \$12,581 and \$42,581 respectively, which were recorded in professional fees [2016 – \$30,000 and \$60,000 respectively]. As at April 30, 2017, an amount of \$186,481 [October 31, 2016 – \$143,900] owing to this firm was included in accounts payable and accrued liabilities in respect of these fees.
- [c] During the three and six-month periods ended April 30, 2017, the Corporation incurred fees to a number of management entities of which certain officers or directors of the Corporation have a related party association. For the three-month period ended April 30, 2017, the total amount for such services provided was \$84,500, of which \$12,500 was recorded in directors fees and \$72,000 was recorded in exploration and evaluation expenditures [2016 – \$12,500 and \$72,000 respectively]. For the six-month period ended April 30, 2017, the total amount for such services provided was \$161,000, of which \$25,000 was recorded in directors fees and \$136,000 was recorded in exploration and evaluation expenditures [[2016 – \$25,000 and \$147,016 respectively]. As at April 30, 2017, an amount of \$346,441 [October 31, 2016 – \$233,125] owing to these firms was included in accounts payable and accrued liabilities in respect of these fees.

[d] Compensation of key management personnel and Board of Directors

Excluding the amounts reported above, during the three and six-month periods ended April 30, 2017 and 2016, the Corporation recorded the following compensation for key management personnel and the Board of Directors:

	Three-month period ended April 30		Six-month period ended April 30	
	2017	2016	2017	2016
	\$	\$	\$	\$
Salaries and employee benefits	51,937	76,044	127,574	150,730
Directors' fees	41,250	48,750	88,750	97,500
Stock compensation	731	2,881	2,191	47,221
Total	93,918	127,675	218,515	295,451

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

13. FINANCIAL INSTRUMENTS

Principles of risk management

The Corporation's objectives when managing capital are to safeguard its ability to continue its operations as well as its acquisition and exploration programs. As such, the Corporation has relied primarily on the Loan Facility and the equity markets to fund its activities. In order to carry out planned exploration and to pay for administrative costs, the Corporation will spend its existing working capital and raise additional funds as needed. The Corporation has not paid any dividends. As well, the Corporation does not have any externally-imposed capital requirements, either regulatory or contractual, to which it is subject.

The prices of minerals fluctuate widely and are affected by many factors outside of the Corporation's control. The prices of minerals and future expectation of such prices may have a significant impact on the market sentiment for investment in mining and mineral exploration companies. This in turn may impact on the Corporation's ability to raise equity financing for its capital requirements.

The Corporation's financial instruments consist of cash and cash equivalents, tax credits and other receivables, investments, accounts payable and accrued liabilities and convertible debentures. Due to the short-term nature of cash and cash equivalents, tax credits and other receivables and accounts payable and accrued liabilities, the fair value of these financial instruments approximates their carrying value.

The Corporation's investments are classified as follows:

Classification	Fair value level	April 30, 2017		October 31, 2016		
		Carrying value \$	Fair Value \$	Carrying value \$	Fair value \$	
Financial assets						
Investments – Canadian stocks	Held-for-trading	I	1,850	1,850	750	750
Financial liabilities						
Convertible debentures	Other liabilities	I	464,039	512,947	2,270,296	2,351,023

The Corporation does not enter into financial instrument agreements, including derivative financial instruments, for speculative purposes.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

April 30, 2017

13. FINANCIAL INSTRUMENTS [Cont'd]

Credit risk

Credit risk is the risk of financial loss to the Corporation if a counter-party to a financial instrument fails to meet its contractual obligations; the Corporation's maximum exposure to credit loss is the book value of its financial instruments.

The Corporation is not exposed to any significant credit risk as at April 30, 2017. The Corporation's cash is deposited with a major Canadian chartered bank.

Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they come due. All of the Corporation's financial liabilities are due within one year.

As at April 30, 2017, the Corporation had a total of \$263,840 in cash and cash equivalents. The Corporation manages liquidity risk through the management of its capital structure. Accounts payable and accrued liabilities have contractual maturities of 30 – 90 days or less and are subject to normal trade terms, and amounts due to related parties are due on demand

Market risk analysis

Market risk is the risk that the fair value of the future cash flows of a financial instrument will fluctuate because of changes in market prices. The Corporation's only market risk exposure is to interest rate risk.

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in market interest rates. The Corporation does not carry any significant interest rate exposure on its cash balances.

Quest Rare Minerals Ltd.

**NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS
(UNAUDITED)**

April 30, 2017

14. SUBSEQUENT EVENTS

At the Corporation's Annual General Meeting, held on May 1, 2017, Quest's shareholders adopted resolutions approving amendments to the Restricted Share Unit Plan and to the Deferred Share Unit Plan of the Corporation, respectively, so as to increase in each case from 750,000 to 2,750,000 the number of common shares which are available for issuance from treasury under the Plan.

On June 5, 2017 the Corporation announced that it will apply for listing on the TSX Venture Exchange ("TSX-V") and for voluntary delisting from the Toronto Stock Exchange ("TSX"). Quest expects that the transition from the TSX to the TSX-V will be completed within the next 60 days in a seamless manner, in accordance with the streamlined listing procedures of the TSX-V for companies transferring from the TSX.