Financial Statements

Quest Rare Minerals Ltd.

For the years ended October 31, 2016 and 2015

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Quest Rare Minerals Ltd.

We have audited the accompanying financial statements of Quest Rare Minerals Ltd. [the "Company"], which comprise the statements of financial position as at October 31, 2016 and 2015 and the statements of comprehensive loss, changes in equity and cash flows for the years then ended and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2016 and 2015, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to note 1 in the financial statements which indicates that the Company incurred a net loss and total comprehensive loss of $2,509,732 during the year ended October 31, 2016 and as of that date, the Company's current liabilities exceeded its current assets by $3,379,137. These conditions, along with other matters as set forth in note 1, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

Ernst & Young LLP[1]

Montréal, Canada
January 19, 2017

[1] CPA auditor, CA, public accountancy permit no. A122227

Quest Rare Minerals Ltd.

STATEMENTS
OF FINANCIAL POSITION

	October 31, 2016 $	October 31, 2015 $
ASSETS		
Current assets		
Cash *[notes 1 and 15]*	**58,026**	208,925
Investments *[note 15]*	**750**	650
Prepaid expenses and deposits	**220,938**	294,187
Commodity taxes and other receivables	**82,979**	189,971
Tax credits receivable	**2,199,468**	685,320
	2,562,161	1,379,053
Non-current assets		
Tax credits receivable	**—**	1,812,500
Other non-current assets *[note 8]*	**719,680**	441,655
Government grants receivable *[note 10]*	**66,247**	—
Total assets	**3,348,088**	3,633,208
DEFICIENCY AND LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities *[note 14]*	**3,140,511**	1,868,205
Loans payable *[note 9]*	**112,911**	—
Deferred government grants *[note 10]*	**417,580**	—
Convertible debentures *[note 11]*	**2,270,296**	—
Total current liabilities	**5,941,298**	1,868,205
Non-Current liabilities		
Accounts payable and accrued liabilities *[note 14]*	**49,653**	79,445
Convertible debentures *[note 11]*	**—**	1,987,238
Total non-current liabilities	**49,653**	2,066,683
Deficiency		
Share capital *[note 12]*	**81,740,738**	81,543,188
Warrants *[note 12]*	**927,890**	927,890
Equity component of convertible debentures *[note 11]*	**229,873**	232,957
Contributed surplus *[note 12]*	**21,782,149**	21,808,066
Deficit	**(107,323,513)**	(104,813,781)
Total deficiency	**(2,642,863)**	(301,680)
Total deficiency and liabilities	**3,348,088**	3,633,208

Going concern uncertainty *[note 1]*

Subsequent events [*note 16]*

See accompanying notes

Quest Rare Minerals Ltd.

STATEMENTS OF COMPREHENSIVE LOSS

Years Ended October 31,

	2016	2015
	$	$
REVENUES	**—**	—
EXPENSES		
Exploration and evaluation expenditures *[note 6]*	**704,150**	4,020,517
Administration expenses *[notes 7 and 14]*	**760,237**	1,837,610
Investor relations *[notes 7 and 14]*	**178,874**	502,215
Professional fees *[note 14]*	**266,394**	581,473
	1,909,655	6,941,815
Operating loss	**(1,909,655)**	(6,941,815)
Finance income	**17,399**	24,999
Finance expenses *[notes 7, 9 and 11]*	**(617,576)**	(395,245)
Unrealized gain (loss) on investments held for trading *[note 15]*	**100**	(300)
	(600,077)	(370,546)
Net loss and comprehensive loss for the year	**(2,509,732)**	(7,312,361)
Net loss per share		
Basic and fully diluted	**(0.03)**	(0.09)
Weighted average number of outstanding shares		
Basic and fully diluted	**86,028,916**	81,290,116

Going concern uncertainty *[note 1]*

See accompanying notes

Quest Rare Minerals Ltd.

STATEMENTS OF CHANGES IN EQUITY

	Share capital		Warrants		Equity Component of Convertible Debentures	Contributed surplus	Deficit	Total
	#	$	#	$	$	$	$	$
Balance – November 1, 2014	78,829,196	80,935,251	11,531,485	601,543	—	21,530,007	(97,501,420)	5,565,381
Issuance of shares and warrants *[note 12]*	4,579,815	356,379	4,579,815	238,997	—	—	—	595,376
Issuance of shares for exploration and evaluation expenditures *[note 12]*	1,500,000	150,000	—	—	—	—	—	150,000
Issuance of convertible debentures *[note 11]*	—	—	2,500,000	201,379	272,689	—	—	474,068
Expiry of warrants *[note 12]*	—	—	(506,000)	(72,286)	—	72,286	—	—
Share issue costs *[note 12]*	—	(12,192)	—	(12,400)	—	—	—	(24,592)
Share issue costs - convertible debentures *[note 11]*	—	—	—	(29,343)	(39,732)	—	—	(69,075)
Settlement of DSUs	125,000	113,750	—	—	—	(113,750)	—	—
Stock-based compensation *[note 12]*	—	—	—	—	—	319,523	—	319,523
Net loss and comprehensive loss for the year	—	—	—	—	—	—	(7,312,361)	(7,312,361)
Balance – October 31, 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 *[note 12]*	**1,000,000**	**60,000**	**—**	**—**	**—**	**—**	**—**	**60,000**
Settlement of RSUs *[note 12]*	**255,000**	**69,825**	**—**	**—**	**—**	**(69,825)**	**—**	**—**
Settlement of DSUs *[note 12]*	**140,000**	**67,725**	**—**	**—**	**—**	**(67,725)**	**—**	**—**
Redemption of convertible debentures *[note 11]*	**—**	**—**	**—**	**—**	**(3,084)**	**—**	**—**	**(3,084)**
Stock-based compensation *[note 12]*	**—**	**—**	**—**	**—**	**—**	**111,633**	**—**	**111,633**
Net loss and comprehensive loss for the year	**—**	**—**	**—**	**—**	**—**	**—**	**(2,509,732)**	**(2,509,732)**
Balance – October 31, 2016	**86,429,011**	**81,740,738**	**18,105,300**	**927,890**	**229,873**	**21,782,149**	**(107,323,513)**	**(2,642,863)**

Going concern uncertainty *[note 1]*

See accompanying notes

Quest Rare Minerals Ltd.

STATEMENTS OF CASH FLOWS

Years Ended October 31,

	2016	2015
	$	$
OPERATING ACTIVITIES		
Net loss	**(2,509,732)**	(7,312,361)
Items not impacting cash:		
Accretion of convertible debentures *[note 11]*	**417,796**	256,498
Excess of redemption of convertible debentures *[notes 7 and 11]*	**20,178**	—
Non-cash exploration and evaluation expenditures *[note 12]*	**—**	150,000
Unrealized (gain) loss on investments held for trading	**(100)**	300
Interest on loans payable	**7,911**	—
Stock-based compensation *[note 12]*	**111,633**	319,523
	(1,952,314)	(6,586,040)
Net change in non-cash working capital items	**1,936,001**	3,178,319
Net cash flows from operating activities	**(16,313)**	(3,407,721)
INVESTING ACTIVITIES		
Increase in non-current assets *[note 8]*	**(21,429)**	(129,264)
Net cash flows from investing activities	**(21,429)**	(129,264)
FINANCING ACTIVITIES		
Increase in loans payable *[note 9]*	**105,000**	—
Proceeds from issuance of shares and warrants *[note 12]*	**60,000**	595,376
Proceeds from issuance of convertible debentures *[note 11]*	**—**	2,344,129
Redemption of convertible debentures *[note11]*	**(158,000)**	—
Share issue costs *[note 12]*	**—**	(12,954)
Convertible debenture issue costs *[note 11]*	**(3,712)**	(153,708)
Decrease in loan facility	**—**	(169,932)
Interest paid	**(116,445)**	(138,707)
Net cash flows from financing activities	**(113,157)**	2,464,204
Net decrease in cash	**(150,899)**	(1,072,781)
Cash, beginning of year	**208,925**	1,281,706
Cash, end of year	**58,026**	208,925

Going concern uncertainty *[note 1]*

See accompanying notes

NOTES TO FINANCIAL STATEMENTS

For the years ended October 31, 2016 and 2015

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 6. The development of this Strange Lake deposit is the key focus of the Corporation.

Going Concern Uncertainty

These 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 in fiscal 2017 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.

The Corporation reported a net loss and total comprehensive loss of $2,509,732 during the year ended October 31, 2016 and as of that date, the Corporation's current liabilities exceeded its current assets by $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.

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

These financial statements do not include any adjustments to the carrying values 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 Corporation's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

The financial statements have been prepared on a historical cost basis, except for financial instruments held for trading that have been measured at fair value.

The Board of Directors approved these financial statements on January 19, 2017.

Functional and presentation currency

These financial statements are presented in Canadian dollars, which is the Corporation's functional currency.

Use of estimates and judgments

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the date of the financial statements.

The Corporation has identified the following critical accounting policies under which significant judgments, estimates and assumptions are made and where actual results may differ from these estimates under different assumptions and conditions and may materially affect financial results or the financial position reported in future periods.

2. BASIS OF PREPARATION [Cont'd]

[a] Valuation of refundable tax credits, mining duties credits and government grants - Judgment

The Corporation is entitled to refundable tax credits, mining duties credits and government grants on qualified exploration and evaluation expenditures incurred in the province of Québec. Management judgment is applied in determining whether the mine property expenses are eligible for claiming such credits and government grants and that all conditions have been or will be complied with. Those benefits are recognized when the Corporation estimates that it has reasonable assurance that the tax credits will be realized or grants have been earned and all conditions will be complied with.

[b] Share-based payments and warrants - Estimate

The estimation of share-based payments at fair value at the date of grant requires the selection of an appropriate valuation model and consideration as to the inputs necessary for the valuation model chosen. The fair value of each option or warrant is evaluated using the Black-Scholes pricing model at the date of grant. The Corporation has made estimates as to the volatility, the expected life of options or warrants, and where applicable, expected forfeiture rates. The expected life of the option or warrant is based on historical data. The expected volatility is based on the historical volatility of the Corporation`s common shares, over the period of the expected life of the stock option or warrant *[note 12]*. These estimates may not necessarily be indicative of future actual patterns.

3. PRINCIPAL ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

Exploration and evaluation expenditures

Exploration and exploration expenditures related to mining properties, which include acquisition costs for the right to explore as well as costs relating to research and analyzing exploration data, conducting geological studies, exploratory drilling and sampling, examining and testing extraction and treatment methods, compiling pre-feasibility and feasibility studies and related share-based compensation costs, net of tax credits and government grants, are charged to operations in the period incurred until such time as it has been determined that a property has economically recoverable reserves.

3. PRINCIPAL ACCOUNTING POLICIES [Cont'd]

Share-based compensation

The Corporation has two distinct share-based incentive programs for directors, executives, key employees and service providers.

[a] Options

The Corporation has stock option plans under which options to acquire the Corporation's common shares may be granted to its directors, officers, employees and consultants. The plans do not feature any options for a cash settlement.

Where employees are rewarded using share-based payments, the fair values of employees' services are determined by reference to the fair value of the equity instruments granted. The fair value of each option is evaluated using the Black-Scholes pricing model at the date of grant. Each tranche in an award with graded vesting is considered a separate grant with a different vesting date and fair value. All share-based remuneration is recognized as an expense with a corresponding increase to contributed surplus. For stock-based awards issued to non-employees, the awards are measured at the fair value of the services rendered at the date on which the services are provided.

If vesting periods or other vesting conditions apply, the expense is allocated over the vesting period, based on the best available estimate of the number of share options expected to vest. Estimates are subsequently revised, if there is any indication that the number of share options expected to vest differs from previous estimates. Any cumulative adjustment prior to vesting is recognized in the current period. No adjustment is made to any expense in prior periods if share options ultimately exercised are different from that estimated on vesting. Upon exercise of share options, the proceeds received are allocated to share capital.

[b] Restricted and Deferred Share Units

Restricted share units ["RSUs"] and Deferred share units ["DSUs"] may be granted to directors, executives and employees as part of their long-term compensation package, entitling them to receive, either common shares or cash based on the Corporation's share price at the relevant time.

3. PRINCIPAL ACCOUNTING POLICIES [Cont'd]

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 Corporation currently intends to settle RSUs and DSUs by issuing equity. For RSUs and DSUs that are expected to be settled with equity, an amount equal to compensation expense is initially credited to contributed surplus and transferred to share capital if and when the share unit is exercised. At the end of each reporting period management performs a review of historical payouts under each share unit plan and where it concludes that, in future, share units may reasonably be expected to be settled with cash, then an amount equal to the fair value at grant date of these vested units is transferred from contributed surplus and classified as a liability. Until the date of settlement, the liability associated with cash-settled share units, if any, is remeasured at the fair value at each reporting period end, with any changes in the fair value recognized as a charge to stock-based compensation.

The value of stock-based compensation recognized in respect of RSUs and DSUs is measured based on the closing price of the Corporation's common shares on the Toronto Stock Exchange at the date of grant and is based on the RSUs and DSUs that are expected to vest.

If vesting periods or other vesting conditions apply, the expense is allocated over the vesting period, based on the best available estimate of the number of share units expected to vest. Estimates are subsequently revised, if there is any indication that the number of share units expected to vest differs from previous estimates. Any cumulative adjustment prior to vesting is recognized in the current period. No adjustment is made to any expense in prior periods if share units ultimately exercised are different from that estimated on vesting.

[c] Broker compensation units and broker compensation options

Share-based payments for non-employee services, including broker compensation units and broker compensation options, are measured at the fair value of the goods or services received or the fair value of the equity instruments issued, if it is determined the fair value of the goods or services cannot be reliably measured, and are recorded at the date the goods or services are received. If the Corporation cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

3. PRINCIPAL ACCOUNTING POLICIES [Cont'd]

Exploration and research tax credits and government grants

The Corporation is entitled to refundable tax credits and government grants on qualified expenditures. Refundable tax credits and government grants earned are applied against exploration and evaluation expenditures when such expenditures are incurred provided that the Corporation has reasonable assurance the credits will be realized or the government grants have been earned and that all conditions will be complied with.

Government grants received for which eligible expenditures are not incurred are deferred and recorded as deferred government grants on the balance sheets.

Taxes

Current income taxes

Current income tax assets and liabilities for the current period are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date.

Current income tax relating to items recognized directly in other comprehensive loss or equity is recognized in other comprehensive loss or equity. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Deferred income taxes

Deferred income tax is provided using the balance sheet method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax assets are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilized. Deferred income taxes are not recognized for temporary differences which arise for initial recognition of an asset or liability that affects neither the accounting nor taxable profit or loss at the time of the transaction.

3. PRINCIPAL ACCOUNTING POLICIES [Cont'd]

Deferred income tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period. Deferred income tax assets and liabilities are presented as non-current.

The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at the end of each reporting period and are recognized to the extent that it has become probable that future taxable profit will be available to allow the deferred tax asset to be recovered.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally-enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

Commodity taxes

Expenses are recognized net of the amount of commodity taxes except where the commodity taxes incurred are not recoverable from the taxation authority, in which case, the commodity taxes are recognized as part of the cost of exploration and evaluation assets or as part of the expense item as applicable.

Provisions

The Corporation accrues provisions for onerous leases which consist of estimated costs associated with vacated premises. The provisions reflect the present value of lease payments in excess of the expected sublease proceeds on the remaining term of the lease.

Severances are recognized when a detailed formal plan identifies the business or part of the business concerned, the location and number of employees affected, a detailed estimate of the associated costs, appropriate timelines and has been communicated to those affected by such plan.

Convertible debentures

The host or liability component of the convertible debentures is recognized initially at the fair value, 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 warrants and conversion option. Subsequent to initial recognition, the liability component is measured at amortized cost using the effective interest method; the liability component is increased by accretion of the discounted amounts to reach the nominal value of the convertible debentures at maturity.

3. PRINCIPAL ACCOUNTING POLICIES [Cont'd]

The fair value of the share purchase warrants component is calculated by calculating the fair value of the warrants using the Black-Scholes option pricing model. The residual amount after deducting the liability component and warrant component from the proceeds is allocated to the conversion option. These components are considered equity and are not re-measured subsequent to initial recognition. On the exercise of warrants or conversion, the equity amounts are reclassified to share capital whereas on expiry, such amounts are transferred to contributed surplus.

Transaction costs are allocated between the above components on a pro-rata basis of their carrying amounts.

Share capital

Proceeds from share units are allocated between common shares and common share purchase warrants by calculating the fair value of the warrants using the Black-Scholes option pricing model and prorating the relative fair value to share capital and warrants. On the exercise of the warrants, the Black-Scholes related amounts are transferred from warrants to share capital whereas on expiry of the warrants, such amounts are transferred to contributed surplus.

Issuance costs

Costs incurred in connection with the issuance of units are allocated based on the fair value of each component of the units and netted against each such component.

Revenue recognition

Finance income is recorded on an accrual basis using the effective interest method.

Financial instruments

Financial assets are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments or available-for-sale financial assets, as appropriate. Financial liabilities are classified as financial liabilities at fair value through profit or loss or other liabilities. The Corporation determines the classification of its financial assets or liabilities at initial recognition. When financial assets or liabilities are recognized initially, they are measured at fair value. The subsequent measurement of financial assets and liabilities depends on their classification.

3. PRINCIPAL ACCOUNTING POLICIES [Cont'd]

The Corporation's financial assets and liabilities are classified and measured as follows:

	Classification	Measurement
Cash	Held for trading	Fair value
Investments	Held for trading	Fair value
Government grants receivable	Loans and receivable	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Convertible debentures	Other liabilities	Amortized cost
Deferred government grants	Other liabilities	Amortized cost

Fair values of financial instruments carried at fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal market or most advantageous market for the asset or liability. The fair value of financial instruments that are traded in active markets at each reporting date is determined by reference to quoted market prices or dealer price quotations [Level 1], without any deduction for transaction costs.

For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques [Level 2]. Such techniques may include using recent arm's length market transactions; reference to the current fair value of another instrument that is substantially the same; a discounted cash flow analysis or other valuation models. Other techniques [Level 3] use inputs not based on observable market data.

Investments at fair value through profit or loss

Financial assets or liabilities classified as held-for-trading are included in the category financial assets or liabilities at fair value through profit or loss. Financial assets or liabilities are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Gains or losses on these items are recognized in the net loss.

Loans and receivables

Loans and receivables are initially recognized at fair value. Such financial assets are subsequently measured at amortised cost using the effective interest method.

3. PRINCIPAL ACCOUNTING POLICIES [Cont'd]

Other liabilities

Other liabilities are recognized initially at fair value net of any directly-attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest method. Other liabilities are presented as current if payment is due within twelve months. Otherwise, they are presented as non-current liabilities. Finance expense is recognized in the statements of comprehensive loss using the effective interest method.

Impairment of financial assets

The Corporation assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets carried at amortized costs are impaired. A financial asset or a group of financial assets carried at amortized cost is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows [excluding future credit losses that have not been incurred] discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognized in net loss. Objective evidence of impairment of held-to-maturity investments and loans and receivables exists if the counter-party is experiencing significant financial difficulty, there is a breach of contract, concessions are granted to the counter-party that would not normally be granted, or it is probable that the counter-party will enter into bankruptcy or a financial reorganization.

If, in a subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously-recognized impairment loss is increased or reduced by adjusting the allowance account. Any subsequent reversal of an impairment loss is recognized in net loss, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

Foreign currency

Transactions in foreign currencies are translated at the exchange rates prevailing at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates at the reporting date. All differences that arise are recorded in net loss. Non-monetary assets measured at historical cost in a foreign currency are translated using the exchange rates at the date of the initial transactions.

3. PRINCIPAL ACCOUNTING POLICIES [Cont'd]

Leases

The Corporation's leases are classified as operating leases as the Corporation does not assume substantially all of the risks and rewards. Payments made under operating leases are recognized in net loss on a straight-line basis over the term of the lease, unless such payments can be offset and deducted against the eventual purchase of the asset in which case such payments are capitalized in other non-current assets *[note 8]*.

Net loss per share

Net loss per share computations are based upon the weighted average number of common shares outstanding during the period.

Diluted earnings per share amounts are calculated by dividing the net income attributable to ordinary shares by the weighted average number of common shares outstanding during the period plus the weighted average number of common shares that would be issued on conversion of all the dilutive potential ordinary shares into common shares. When the Corporation reports a loss, the diluted net loss per common share is equal to the basic net loss per common share due to the anti-dilutive effect of the outstanding warrants, share options and similar instruments.

4. RECENT ACCOUNTING PRONOUNCEMENTS

The following pronouncements are issued but not yet effective for the year ended October 31, 2016:

a) IFRS 9 Financial Instruments

The final version of IFRS 9, Financial instruments (IFRS 9) was issued by the IASB in July 2014 which reflects all phases of the financial instruments project and replaces IAS 39, Financial Instruments: recognition and measurement (IAS 39). The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for the Corporation on November 1, 2018. Retrospective application is required, but comparative information is not compulsory. The Corporation is currently evaluating the impact of this standard and amendments on its financial statements.

4. RECENT ACCOUNTING PRONOUNCEMENTS [Cont'd]

b) IFRS 16

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value ' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less).

At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset. Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

IFRS 16 is effective for annual periods beginning on or after November 1, 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs. The Corporation is currently evaluating the impact of this standard and amendments on its financial statements.

5. 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 years ended October 31 is as follows:

	2016	**2015**
	$	$
Loss before income tax	**(2,509,732)**	(7,312,361)
Income tax recovery at the combined Federal and Provincial tax rate 26.80% [2015 – 26.87%]	**(672,730)**	(1,965,119)
Stock-based compensation	**29,923**	85,868
Government tax credits	**34,937**	(104,540)
Other non-deductible expenses or non-taxable revenues	**5,839**	118,186
Effect of changes in tax rates on temporary items	**(12,968)**	(18,521)
Current year tax benefit not recognized	**614,999**	1,884,126
Tax recovery at an effective income tax rate	—	—

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

	October 31, 2016	**October 31, 2015**
	$	$
Future income tax assets		
Exploration and evaluation expenditures	**15,782,431**	15,308,139
Non-capital loss carry-forwards	**5,989,543**	5,823,045
Share issue costs	**196,182**	253,953
Investments	**5,663**	5,691
	21,973,820	21,390,828
Future income tax liabilities		
Convertible debentures	**(54,741)**	(86,749)
Net future income tax assets	**21,919,078**	21,304,079
Unrecognized deferred tax assets	**(21,919,078)**	(21,304,079)
Net future income tax	—	—

NOTES TO FINANCIAL STATEMENTS

For the years ended October 31, 2016 and 2015

5. INCOME TAXES [Cont'd]

Tax loss carry-forwards

At October 31, 2016, the Corporation had non-capital loss carry-forwards in the amount of $22,345,000 which are available to reduce future years' taxable income. These non-capital loss carry-forwards expire as follows:

	Non-capital losses $
2027	24,000
2028	278,000
2029	602,000
2030	1,975,000
2031	2,988,000
2032	3,993,000
2033	4,119,000
2034	3,804,000
2035	2,922,000
2036	1,640,000
	22,345,000

In addition, as at October 31, 2016, the Corporation has investment tax credits in the amount of $3,747,000 which are available to reduce future income tax liabilities and expire between 2029 and 2033.

Further, as at October 31, 2016, the Company has Scientific Research and Experimental Development ("SR&ED") tax credits available for Canadian federal and Ontario income tax purposes, amounting to approximately $1,488,000 and $57,000, respectively, which are available to reduce future income tax liabilities and expire between 2032 and 2036.

The Corporation has not recognized the tax benefit of the above tax credits.

6. EXPLORATION AND EVALUATION EXPENDITURES

The following is a breakdown by project of the exploration and evaluation expenditures incurred, net of tax credits, for the years ended October 31:

	2016 $	**2015** $
Strange Lake (Québec)	**697,186**	3,832,565
Misery Lake (Québec)	—	12,218
Alterra – Strange Lake (Newfoundland and Labrador)	—	150,000
Other projects (Canada)	—	1,522
Total exploration and evaluation expenditures before stock-based compensation	**697,186**	3,996,305
Stock-based compensation *[note 12[e]]*	**6,964**	24,212
Total expenditures incurred	**704,150**	4,020,517

During the year-ended October 31, 2016, significant changes occurred in the following properties:

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.

6. EXPLORATION AND EVALUATION EXPENDITURES [Cont'd]

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

	2016	**2015**	**From Inception**
	$	$	$
Acquisition costs	**—**	22,366	201,135
Geochemical Surveys	**—**	—	42,027
Geophysical Surveys	**—**	—	288,651
Geological Surveys	**53,125**	90,632	13,037,117
Drilling	**37,500**	41,489	15,104,417
Prospecting	**—**	718	264,174
Prefeasibility Studies	**643,387**	3,017,684	31,915,008
Feasibility Studies	**—**	—	5,110,525
Metallurgical Work	**—**	(5,533)	2,851,112
Environmental and Permitting	**289,809**	647,830	2,782,082
Project Management and Support	**1,050,414**	1,031,655	2,376,838
Other	**—**	117,630	2,425,205
Government tax credits	**(714,580)**	(1,131,906)	(14,808,068)
Government grant *[note 10]*	**(662,469)**	—	(662,469)
Total expenditures incurred	**697,186**	3,832,565	60,927,754

Misery Lake Projects, (Québec)

On April 8, 2015, the Corporation entered into an agreement with Mr. Peter Cashin, CEO and Director of Quest, for the transfer of its full ownership interest in the Misery Lake property to 2457661 Ontario ("the Purchaser"), a company controlled by Mr. Cashin. In part consideration for the transfer of the claims, Quest was granted a 2% royalty on all claims (the "Quest Royalty"). The Quest Royalty may be purchased at any time by the Purchaser for a total of $2,000,000. The purchase may be completed in up to two transactions, each representing 50% of the Quest Royalty in exchange for $1,000,000 each. Also, under the agreement, the Purchaser assumed responsibility for the demobilization of the Misery Lake camp and assumed all environmental obligations relating to the Misery Lake project. The transfer of the Misery Lake claims was completed on April 20, 2015.

The Misery Lake property is located approximately 120 km south of Strange Lake and consists of 170 mining claims in Québec and covers an area of 8,334 hectares.

6. EXPLORATION AND EVALUATION EXPENDITURES [Cont'd]

Alterra – Strange Lake Project, (Newfoundland and Labrador)

On June 15, 2010, the Corporation entered into an exploration and option agreement with Search Minerals Inc. ["Search"] and Alterra Resources Inc. ["Alterra"], a wholly-owned subsidiary of Search, pursuant to which the Corporation had an option to acquire up to a 65% undivided working interest in 30 mining claims. Under the agreement, Alterra retains a 1.5% NSR with the option for the Corporation to buy back 1% for $1,000,000.

As at October 31, 2014, the Corporation had earned a 50% undivided interest. The Corporation did not exercise its option under the exploration and option agreement to earn an additional 15% undivided interest in the working claims and as a result, this option lapsed.

On September 16, 2015 the Corporation entered into a Purchase and Sale agreement with Search, under which, the Corporation agreed to issue 1,500,000 common shares to Search *[note 12(a)]* in consideration for the acquisition of the remaining 50% ownership interest in the Alterra-Strange Lake Property. Following this transaction, which closed on October 7, 2015, Quest now has a 100% interest in the exploration rights related to the Alterra – Strange Lake Property.

The Alterra-Strange Lake Property is located in West Labrador and comprises 30 mining claims and covers 750 hectares. The land is contiguous to the east with Quest's wholly-owned Strange Lake Property in Québec, which includes the B-Zone rare earth element deposit near Lac Brisson.

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

	2016 $	**2015** $	**From Inception** $
Acquisition costs	—	150,000	307,869
Geological Surveys	—	—	107,871
Drilling	—	—	643,649
Total expenditures incurred	—	150,000	1,059,389

NOTES TO FINANCIAL STATEMENTS

For the years ended October 31, 2016 and 2015

7. EXPENSES BY NATURE

The following is a breakdown of the nature of expenses included in administration expenses, investor relations, and finance expenses for the years ended October 31:

	2016 $	2015 $
Administration expenses:		
Office Expenses:		
Salaries and other employee benefits	**197,330**	361,797
Directors' fees	**240,000**	206,622
Directors' and Officers' insurance	**66,149**	104,115
Rent	**57,733**	108,982
Travel costs	**25,021**	24,854
Telephone and internet	**17,301**	24,944
IT services	**24,147**	26,330
Education & training	**155**	463
Equipment lease and rental	**10,544**	—
Repairs and maintenance	—	397
Other office expenses	**10,434**	25,197
Bank charges	**5,370**	7,150
Foreign exchange loss	**1,384**	3,744
Stock-based compensation *[note 12(e)]*	**104,669**	295,311
Restructuring expenses:		
Separation and termination benefits	—	403,453
Onerous Lease	—	183,018
Moving expenses	—	40,133
Other	—	21,100
Total	**760,237**	1,837,610

Quest Rare Minerals Ltd.

NOTES TO FINANCIAL STATEMENTS

For the years ended October 31, 2016 and 2015

7. EXPENSES BY NATURE [Cont'd]

	2016 $	2015 $
Investor relations:		
Advertising	**15,600**	30,100
Conferences	—	13,618
Consulting services	—	20,983
Dues and subscriptions	**850**	1,226
Investor relations fees	**13,200**	165,226
Listing and stock transfer fees	**57,074**	103,271
Meetings	**54,416**	81,127
Printing and filing	**3,959**	27,931
Salaries and other employee benefits	—	6,202
Travel related costs	**33,775**	49,357
Other	—	3,174
Total	**178,874**	502,215

	2016 $	2015 $
Finance expenses:		
Interest on loan facility	—	27,281
Interest on loans payable *[note 9]*	**7,911**	—
Interest on convertible debentures *[note 11]*	**171,691**	111,425
Accretion of convertible debentures *[note 11]*	**417,796**	256,498
Excess of redemption of convertible debentures *[note 11]*	**20,178**	—
Other	—	41
Total	**617,576**	395,245

As at October 31, 2016 the expenditures incurred on separation and termination benefits and onerous lease that were unpaid and included in accounts payable and accrued liabilities amounted to $101,911 and $79,659, respectively [October 31, 2015 – $195,329 and $117,767].

8. OTHER NON-CURRENT ASSETS

On November 5, 2013, Quest entered into an option agreement with La Société du Parc Industriel et Portuaire de Bécancour (the “SPIPB Agreement”). Under the SPIPB Agreement, Quest has the right to purchase land in the Bécancour Port industrial site to build a processing facility for the ore from Strange Lake. The option was for a period of one year and could be extended by Quest for up to an additional three years to November 2017 in six increments of six months each. Quest could cancel this agreement at any time.

On July 16, 2015 Quest entered into a revised option agreement with SPIPB (the “Revised SPIPB Agreement”) effective August 1, 2015, for a second site including a servitude for the site for the placement of pipelines. The option was granted for a period of one year and can be extended by Quest for up to an additional one and a half years to January 31, 2018 in three increments of six month each. The Revised SPIPB Agreement supercedes the SPIPB Agreement. Quest can cancel the revised agreement with proper notice to SPIPB.

Payments made under the SPIPB Agreement and the Revised SPIPB Agreement may be offset and deducted against the eventual purchase price once the option is exercised. Quest therefore has capitalized the option payments as they are made until such time as either its option is exercised, cancelled or allowed to lapse by the Corporation.

On September 12, 2014, Quest entered into an option and lease agreement with 154639 Canada Inc. (the “Fraenkel Agreement”). Under the Fraenkel Agreement, Quest has the right to purchase another piece of land in the City of Bécancour to build a rare earth production facility for the ore from Strange Lake. The option is for a period of three years from March 1, 2015 and can be extended by Quest indefinitely in increments of one year each. Quest can cancel this Agreement at any time after March 1, 2016. In consideration for the Fraenkel Agreement, Quest issued 250,000 common shares to the sole shareholder of 154639 Canada Inc.

Lease payments made under the Fraenkel Agreement may be offset and deducted, against the eventual purchase price, once the option is exercised, as follows:

- 75% of lease payments made until the earlier of the date of purchase or February 28, 2018, and
- 50% of lease payments made from March 1, 2018 until the date of purchase.

For the years ended October 31, 2016 and 2015

8. OTHER NON-CURRENT ASSETS [Cont'd]

The Corporation therefore capitalizes the portion of the lease payments eligible to be offset and deducted as they are made, until such time as either the option is exercised, cancelled or allowed to lapse by the Corporation.

A breakdown of other non-current assets as at October 31, are as follows:

	2016 $	**2015** $
SPIPB Agreement – option payments	**446,652**	296,364
Fraenkel Agreement – option payments	**273,028**	145,291
Total	**719,680**	441,655

9. LOANS PAYABLE

On December 15, 2015, the Corporation entered into loan agreements with a number 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 for the purposes of providing working capital. The loaned 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. 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, present or future, including those related to the year ended October 31, 2016.

During the year ended October 31, 2016, interest expense pursuant to these loans amounted to $7,911 [October 31, 2015 – nil] *[note 7]*.

10. 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.

As at October 31, 2016, all of the conditions under the Agreement were met or are expected to be met by the Corporation.

10. GOVERNMENT GRANTS [Cont'd]

A breakdown of government grants receivable representing the holdback amount and deferred government grants as at October 31, 2016 and the respective changes during the year then ended are summarized as follows:

	Year ended October 31, 2016	
	Government grants receivable $	**Deferred government grants** $
Outstanding, October 31, 2015	**—**	**—**
Received during the year	**—**	**(1,013,802)**
Earned during the year *[note 6]*	**66,247**	**596,222**
Outstanding, October 31, 2016	**66,247**	**(417,580)**
Current	**—**	**(417,580)**
Non-current	**66,247**	**—**

11. 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 "Debenture Tranche 1") and 2,250,000 common share purchase warrants.

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

The Debentures (i) mature at the earlier of December 31, 2016 and the date on which the Corporation receives payment from the Government of Québec of QRTC and QMD for the Corporation's 2013 and 2014 fiscal years; (ii) bears interest at a rate of 7% per annum, payable semi-annually in cash, (iii) at the holder's option, can be converted into common shares of the Corporation at a price of $0.13 per share; and (iv) is secured by a first-priority security interest in, and lien upon, the Corporation's rights to QRTC and QMD for the Corporation's fiscal years 2013 and thereafter.

11. CONVERTIBLE DEBENTURES [Cont'd]

Each of the 2,500,000 common share purchase warrants entitles the holder to acquire one common share of the Corporation at a price of $0.15 for four years. In addition, under the agreement Ekagrata was given the right to nominate two directors to the Board of Directors of the Corporation, subject to prior approval by the Board. Ekagrata's first Board nominee was appointed on March 9, 2015. This appointment was ratified by shareholders at the Corporation's annual general meeting held on April 20, 2015.

The Debentures were determined to be a compound financial instrument comprising a host debt component, a component attributed to the fair value of the common share purchase warrants issued along with the Debentures and a residual equity component representing the conversion feature. The host or liability component of the convertible debenture was recognized initially at the fair value, 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 warrants and conversion option. The fair value of the warrants was determined based on the Black-Scholes option pricing model using the weighted average assumptions set out as follows:

Assumption	Debenture Tranche 1 – Issued March 9, 2015 $2,250,000	Debenture Tranche 2 – Issued April 24, 2015 $250,000
Risk-free interest rate	0.53%	0.59%
Expected volatility	66%	78.5%
Dividend yield	Nil	Nil
Expected life [in years]	4.0	4.0
Share Price	$0.15	$0.21
Fair value at grant date	$0.07	$0.14

The carrying amount of the debenture conversion feature was estimated using the residual method, comprising the difference between the principal amount and the initial carrying values of the host debt component and the common share purchase warrants.

In connection with the Agreement, the Corporation incurred issue costs amounting to $364,267 which have been pro-rated between the host debt component, common share purchase warrants, and equity component of convertible debentures in the amounts of $295,192, $29,343 and $39,732, respectively.

11. CONVERTIBLE DEBENTURES [Cont'd]

As at October 31, 2016 a total of $50,976 of issue costs were unpaid and included in accounts payable and accrued liabilities [October 31, 2015 - $54,688]. These amounts have been excluded from the statements of cash flows.

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 Debentures as at October 31, 2016 and 2015 are as follows:

	Host Debt Component $	**Common Share Purchase Warrants** $	**Equity Component of Convertible debentures feature** $	**Total** $
Balance, November 1, 2014	—	—	—	—
Debentures issued during the year	2,025,932	201,379	272,689	2,500,000
Issue costs	(295,192)	(29,343)	(39,732)	(364,267)
Accretion (effective interest rate 20%)	256,498	—	—	256,498
Balance, October 31, 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**

On March 11, 2016, the Corporation completed a partial redemption of its 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 as part of finance expenses *[notes 7 and 16]*.

NOTES TO FINANCIAL STATEMENTS

For the years ended October 31, 2016 and 2015

12. 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 year ended October 31, 2016

[i] On January 20, 2016, the Corporation issued 255,000 common shares in relation to the exercise of 255,000 RSUs *[note 12 [d]]*.

[ii] 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.

[iii] On April 25, 2016, the Corporation issued 140,000 common shares in relation to the exercise of 140,000 DSUs *[note 12[d]]*.

12. SHARE CAPITAL [Cont'd]

Issuances during the year ended October 31, 2015

[i] On April 30, 2015, the Corporation completed a private placement with Ressources Québec Inc. by issuing 4,579,815 units at a price of $0.13, for gross proceeds of $595,376 of which $356,379 was allocated to common shares and $238,997 to warrants based on relative fair value *[note 12 [c]]*. Each unit was comprised of one common share and one common share purchase warrant. Each warrant entitles its holder to purchase one additional common share at a price of $0.15 until April 30, 2019.

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

Risk-free interest rate	0.59%
Expected volatility	84%
Dividend yield	Nil
Expected life [in years]	4.0
Share Price	$0.21
Fair value at grant date	$0.14

In connection with this private placement, the Corporation incurred professional fees and expenses of $24,592 which has been pro-rated between the share capital and warrants of $12,192 and $12,400, respectively.

As at October 31, 2016 a total of $11,638 of professional fees were unpaid and included in accounts payable and accrued liabilities [October 31, 2015 – $11,638]. These amounts have been excluded from statements of cash flows.

[ii] On May 21, 2015, and June 1, 2015 the Corporation issued 50,000 and 75,000 common shares respectively in relation to the exercise of 125,000 DSUs *[note 12 [d]]*. The DSUs became exercisable on the resignation of two of the Directors of the Corporation.

[iii] On October 7, 2015, the Corporation issued 1,500,000 common shares for a total non-cash consideration of $150,000 in relation to its purchase of the remaining 50% interest in the Alterra - Strange Lake mining claims *[note 6]*.

12. SHARE CAPITAL [Cont'd]

[b] Stock options

On March 2, 2012, the Board of Directors adopted the 2012 Stock Option Plan for directors, officers and employees of, and service providers to, the Corporation [the "2012 Plan"]. The 2012 Plan replaces the Corporation's 2007 Stock Option Plan [the "2007 Plan"]. Since March 2, 2012, all stock options granted by the Corporation are granted under the 2012 Plan and no further stock options have been granted under the 2007 Plan. Options currently outstanding under the 2007 Plan may continue to be exercised in accordance with the 2007 Plan.

The aggregate number of common shares in respect of which options may be outstanding at any time under both the 2012 Plan and 2007 Plan cannot exceed 10% of the issued and outstanding common shares of the Corporation at such time. Options granted under the 2012 Plan will vest immediately unless the Board of Directors, at its discretion, sets a "vesting schedule", that is, one or more dates from which an option may be exercised in whole or in part. Under the 2012 Plan, the maximum period during which an option may be exercised is ten years from the date on which it is granted. Upon the exercise of options in accordance with the 2012 Plan and the payment of the consideration for the foregoing shares, such additional common shares will be issued as fully paid and non-assessable.

The outstanding options as at October 31, 2016 and 2015 and the respective changes during the years then ended, are summarized as follows:

	2016		**2015**	
	Number of options \#	**Weighted average exercise price** $	**Number of options** \#	**Weighted average exercise price** $
Outstanding, beginning of year	**5,301,000**	**2.42**	4,167,499	3.31
Granted	**1,920,000**	**0.07**	1,736,000	0.18
Expired/cancelled	**(400,000)**	**(4.09)**	(602,499)	(2.14)
Outstanding, end of year	**6,821,000**	**1.66**	5,301,000	2.42

No options were exercised during the year ended October 31, 2016 [2015 – nil].

12. SHARE CAPITAL [Cont'd]

The following options are outstanding and exercisable as at October 31, 2016.

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** $
0.00 to 0.749	4,181,000	3.55	0.16	3,597,666	0.18
1.50 to 2.249	205,000	3.79	2.11	205,000	2.11
2.25 to 2.999	595,000	4.23	2.73	595,000	2.73
3.75 to 4.499	1,240,000	4.01	4.43	1,240,000	4.43
4.50 to 5.249	350,000	3.97	4.69	350,000	4.69
5.25 to 5.999	250,000	4.19	5.72	250,000	5.72
0.00 to 5.999	**6,821,000**	**3.75**	**1.66**	**6,237,666**	**1.81**

The fair value of stock options granted during the years ended October 31, 2016 and 2015 was estimated at their respective grant dates using the Black-Scholes option pricing model, using the following weighted average assumptions:

	2016	**2015**
Risk-free interest rate	**0.72%**	0.87%
Forfeiture rate	**6.44%**	5.49%
Expected volatility	**90%**	78%
Dividend yield	**Nil**	Nil
Expected life [in years]	**5.00**	5.00
Fair value at grant date	**$0.05**	$0.10

12. SHARE CAPITAL [Cont'd]

[c] Warrants

The outstanding warrants as at October 31, 2016 and 2015 and the respective changes during the years then ended are summarized as follows:

	2016		2015	
	Number of warrants #	Weighted average exercise price $	Number of warrants #	Weighted average exercise price $
Outstanding balance, beginning of year	**18,105,300**	**0.30**	11,531,485	0.42
Granted	—	—	7,079,815	0.15
Exercised	—	—	—	
Expired	—	—	(506,000)	0.80
Outstanding balance, end of year	**18,105,300**	**0.30**	18,105,300	0.30

As at October 31, 2016, the warrants outstanding had a weighted average life of 1.39 years. As at October 31, 2016, all warrants are exercisable.

[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 service 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.

12. SHARE CAPITAL [Cont'd]

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 October 31, 2016 and 2015 and the respective changes during the years then ended are summarized as follows:

	2016		**2015**	
	Restricted Share Units			
	Number of units #	**Fair value at grant date** $	**Number of units** #	**Fair value at grant date** $
Outstanding, beginning of year	**530,000**	**0.21**	110,000	0.48
Granted	**—**	**—**	430,000	0.14
Exercised	**(255,000)**	**0.24**	—	—
Expired/cancelled	**—**	**—**	(10,000)	0.48
Outstanding, end of period	**275,000**	**0.18**	530,000	0.21
Units exercisable	**—**	**—**	255,000	0.24

	2016		**2015**	
	Deferred Share Units			
	Number of units #	**Fair value at grant date** $	Number of units #	Fair value at grant date $
Outstanding, beginning of year	**620,000**	**0.48**	325,000	1.06
Granted	**—**	**—**	420,000	0.16
Exercised	**(140,000)**	**(0.48)**	(125,000)	(0.91)
Expired/cancelled	**—**	**—**	—	—
Outstanding, end of period	**480,000**	**0.48**	620,000	0.48
Units exercisable	**—**	**—**	140,000	0.48

12. SHARE CAPITAL [Cont'd]

[e] Stock-based compensation

For the year ended October 31, 2016, 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 $104,669 and $6,964, respectively [2015 – 295,311 and $24,212].

13. COMMITMENTS AND CONTINGENCIES

Operating leases and purchase commitments

As at October 31, 2016, the Corporation had commitments under operating leases requiring annual rental payments, including any lease payments under the option and lease agreements (Note 8), and commitments under a financial consulting agreement with a private investment firm of which a Director of the Corporation is a related party (Note 14), as follows:

	Operating Leases	**Financial Consulting fees**	**Total**
	$	$	$
2017	362,434	42,581	405,015
2018	117,659	—	117,659
2019	14,366	—	14,366
2020	10,372	—	10,372
2021	2,593	—	2,593
	507,424	**42,581**	**550,005**

As at October 31, 2016, the Corporation had lease payments expected to be received under a sublease agreement as follows:

	$
2017	170,453
2018	170,453
2019	113,635
	454,541

13. COMMITMENTS AND CONTINGENCIES [Cont'd]

Guarantees

The Corporation's mining and exploration activities are subject to various federal, provincial and local laws and regulations governing the protection of the environment as well as obtaining permits necessary for the Corporation's operations. These laws and regulations are continually changing and generally becoming more restrictive. The Corporation believes that it conducts its operations so as to protect public health and the environment, and its operations are materially in compliance with all applicable laws and regulations and therefore it will be granted the required permits. The Corporation has made, and expects to make in the future, expenditures to comply with such laws and regulations.

14. RELATED PARTY TRANSACTIONS

Other than related party transactions noted elsewhere in these financial statements, the Corporation entered into the following related party transactions which occurred in the normal course of operations.

[a] The Corporation retains the services of certain directors of the Corporation to carry out professional activities. During the year ended October 31, 2016, the total amount charged for professional services by directors of the Corporation and recorded in exploration and evaluation expenditures was nil [2015 – $26,667].

[b] During the year ended October 31, 2016, the Corporation incurred fees to a law firm, in which a Director of the Corporation is a partner. During the year ended October 31, 2016, the total amount for such services provided was $57,985, of which $46,577 was recorded in professional fees, $9,695 was recorded in investor relations, nil was recorded in exploration and evaluation expenditures and $1,713 was recorded in issue costs [2015 – $83,628, $19,410, $12,513 and $115,175 respectively]. As at October 31, 2016, an amount of $193,093 [October 31, 2015 – $147,437] owing to these law firms was included in accounts payable and accrued liabilities in respect of these fees.

[c] During the year ended October 31, 2016, the Corporation incurred fees to a private investment firm of which a director of the Corporation is a related party. During the year ended October 31, 2016, the total amount recorded in professional fees for such services provided was $120,000 [2015 – $77,419]. As at October 31, 2016, an amount of $143,900 [October 31, 2015 – $22,600] owing to this firm was included in accounts payable and accrued liabilities in respect of these fees.

14. RELATED PARTY TRANSACTIONS [Cont'd]

[d] During the year ended October 31, 2016, the Corporation incurred fees to a number of management entities of which certain officers or directors of the Corporation is a related party. For the year ended October 31, 2016, the total amount for such services provided was $341,016, of which $50,000 was recorded in directors fees and $291,016 was recorded in exploration and evaluation expenditures [2015 – $25,000 and $278,578 respectively]. As at October 31, 2016, an amount of $233,125 [October 31, 2015 – $52,534] owing to these firms was included in accounts payable and accrued liabilities in respect of these fees.

[e] **Compensation of key management personnel and Board of Directors**

Excluding the amounts reported above, during the years ended October 31, 2016 and 2015, the Corporation recorded the following compensation for key management personnel and the Board of Directors:

	2016 $	**2015** $
Salaries, employee benefits	**298,858**	368,962
Separation and termination benefits	**—**	418,806
Directors' fees	**190,000**	181,622
Stock compensation	**51,625**	280,544
Total	**540,483**	1,249,934

15. 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 exploration programs. As such, the Corporation relies primarily on 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 used term debt financing (other than Convertible Debentures **-** *Note 11*) and 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.

15. FINANCIAL INSTRUMENTS [Cont'd]

The fair value of the convertible debentures is determined using the discounted cash flow method using discount rate that reflects rates currently available for debt on similar terms, considering the Corporation's credit risk and remaining maturity.

Below is a comparison of the carrying amount of the financial instruments and their respective fair values as at October 31:

			2016		2015	
	Classification	Fair value level	Carrying value $	Fair value $	Carrying value $	Fair value $
Financial assets						
Investments – Canadian stocks	Held-for-trading	I	**750**	**750**	650	650
Financial liabilities						
Convertible debentures	Other liabilities	I	**2,270,296**	**2,351,023**	1,987,238	2,236,171

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

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 October 31, 2016. The Corporation's cash and cash equivalents is deposited with a major Canadian chartered bank and are held in highly-liquid investments.

Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they come due. Substantially all of the Corporation's financial liabilities are due within one year. The Corporation manages liquidity risk through the management of its capital structure.

As at October 31, 2016, the Corporation had a total of $58,026 in cash. 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.

15. FINANCIAL INSTRUMENTS [Cont'd]

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 primary market exposures are 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 is exposed to interest rate risk only on its cash. The Corporation's cash carries interest and therefore, the Corporation is exposed to a variation of interest rates on amounts earned and payable. Based on its exposures to cash as at October 31, 2016 and assuming that all other variables remain constant, an increase or decrease of 100 basis points of the interest rate during the year would result in a increase or decrease of $58 respectively in comprehensive loss before income taxes.

The rates as at October 31, 2016 for Canadian and U.S. funds were 0.75% [2015 – 1.05%] and 0.05% [2015 – 0.05%], respectively.

16. SUBSEQUENT EVENTS

Subsequent to the October 31, 2016 year end, the Corporation received $1,963,455 of refundable tax credits including $1,931,957 for mining duties credits relating to fiscal years 2013 to 2015.

On January 18, 2017, the Corporation entered into a Securities Purchase Agreement (the "Agreement") with an unrelated United States private equity special opportunity fund, pursuant to which the Corporation issued a secured convertible debenture in a principal amount of $550,000 (the "Debenture") and 550,000 common share purchase warrants.

The Debenture matures in one year and bears interest at a rate of 10% per annum, payable semi-annually in cash, and can be converted, at the holder's option, into common shares of the Corporation at a price of $0.16 per share. Each of the 550,000 common share purchase warrants entitles the holder to acquire one common share of the Corporation at a price of $0.18 for three years. The Debenture is secured by a first-ranking hypothec on all of Quest's assets, present and future, corporeal and incorporeal

On January 19, 2017, the Corporation fully repaid the outstanding principal and interest owed on the Ekagrata Debentures *[note 11]*.