

Condensed Interim Financial Statements

**Quest Rare Minerals Ltd.**

(An Exploration & Development Stage Corporation)

For the three-month periods ended January 31, 2017 and 2016

(Unaudited)

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

| As at   | January 31,<br>2017<br>\$   | October 31,<br>2016<br>\$   |
|---|-----------------------------|-----------------------------|
|   | <u>                    </u> | <u>                    </u> |
| <b>ASSETS</b> <i>[note 10]</i>                              |                             |                             |
| <b>Current assets</b>                                       |                             |                             |
| Cash <i>[notes 1 and 13]</i>                                | 3,071                       | 58,026                      |
| Investments <i>[note 13]</i>                                | 800                         | 750                         |
| Prepaid expenses and deposits                               | 286,074                     | 220,938                     |
| Commodity taxes and other receivables                       | 84,493                      | 82,979                      |
| Tax credits receivable                                      | 259,512                     | 2,199,468                   |
|   | <u>633,950</u>              | <u>2,562,161</u>            |
| <b>Non-current assets</b>                                   |                             |                             |
| Other non-current assets <i>[note 7]</i>                    | 789,106                     | 719,680                     |
| Government grants receivable <i>[note 9]</i>                | 72,903                      | 66,247                      |
| <b>Total assets</b>   | <u>1,495,959</u>            | <u>3,348,088</u>            |
| <br><b>DEFICIENCY AND LIABILITIES</b>                       |                             |                             |
| <b>Current liabilities</b>                                  |                             |                             |
| Accounts payable and accrued liabilities <i>[note 12]</i>   | 3,902,500                   | 3,140,511                   |
| Loans payable <i>[note 8]</i>                               | 141,110                     | 112,911                     |
| Deferred government grants <i>[note 9]</i>                  | 357,671                     | 417,580                     |
| Convertible debentures <i>[note 10]</i>                     | 434,838                     | 2,270,296                   |
| <b>Total current liabilities</b>                            | <u>4,836,119</u>            | <u>5,941,298</u>            |
| <b>Non-Current liabilities</b>                              |                             |                             |
| Accounts payable and accrued liabilities <i>[note 12]</i>   | 42,205                      | 49,653                      |
| <b>Total non-current liabilities</b>                        | <u>42,205</u>               | <u>49,653</u>               |
| <br><b>Deficiency</b>                                       |                             |                             |
| Share capital <i>[note 11(a)]</i>                           | 81,740,738                  | 81,740,738                  |
| Warrants reserve <i>[note 11(c)]</i>                        | 993,985                     | 927,890                     |
| Equity component of convertible debentures <i>[note 10]</i> | —                           | 229,873                     |
| Contributed surplus <i>[notes 10 and 11]</i>                | 22,037,196                  | 21,782,149                  |
| Deficit   | (108,154,284)               | (107,323,513)               |
| <b>Total deficiency</b>                                     | <u>(3,382,365)</u>          | <u>(2,642,863)</u>          |
| <br><b>Total deficiency and liabilities</b>                 | <u>1,495,959</u>            | <u>3,348,088</u>            |
| <br>Going concern uncertainty <i>[note 1]</i>               |                             |                             |
| Subsequent events <i>[note 14]</i>                          |                             |                             |
| See accompanying notes                                      |                             |                             |

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**Quest Rare Minerals Ltd.**

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

| Three-month periods ended January 31,                   | <b>2017</b>              | <b>2016</b>        |
|---|--------------------------|--------------------|
|   | \$                       | \$                 |
| <b>REVENUES</b>   | <u>—</u>                 | <u>—</u>           |
| <b>EXPENSES</b>   |                          |                    |
| Exploration and evaluation expenditures <i>[note 5]</i> | <b>280,801</b>           | 461,356            |
| Administration expenses <i>[notes 6 and 12]</i>         | <b>319,306</b>           | 256,394            |
| Investor relations <i>[notes 6 and 12]</i>              | <b>54,438</b>            | 36,643             |
| Professional fees <i>[note 12]</i>                      | <b>71,911</b>            | 112,262            |
|   | <u><b>726,456</b></u>    | <u>866,655</u>     |
| <b>Operating loss</b>                                   | <u><b>(726,456)</b></u>  | <u>(866,655)</u>   |
| Finance income  | <b>520</b>               | 470                |
| Finance expenses <i>[notes 6, 8 and 10]</i>             | <b>(104,885)</b>         | (149,678)          |
| Unrealized gain on investments held for trading         | <b>50</b>                | 150                |
|   | <u><b>(104,315)</b></u>  | <u>(149,058)</u>   |
| <b>Net loss and comprehensive loss for the period</b>   | <u><b>(830,771)</b></u>  | <u>(1,015,713)</u> |
| <b>Net loss per share</b>                               |                          |                    |
| Basic and fully diluted                                 | <u><b>(0.01)</b></u>     | <u>(0.01)</u>      |
| <b>Weighted average number of outstanding shares</b>    |                          |                    |
| Basic and fully diluted                                 | <u><b>86,429,011</b></u> | <u>85,064,500</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              |
|---|-------------------|-------------------|-------------------|----------------|--|---------------------|----------------------|
|   | #                 | \$                | #                 | \$             | \$   | \$                  | \$                   |
| <b>Balance – November 1, 2015</b>                     | 85,034,011        | 81,543,188        | 18,105,300        | 927,890        | 232,957                                    | 21,808,066          | (104,813,781)        |
| Settlement of RSUs                                    | 255,000           | 69,825            | —                 | —              | —  | (69,825)            | —                    |
| Share-based compensation <i>[note 11(e)]</i>          | —                 | —                 | —                 | —              | —  | 71,970              | —                    |
| Net loss and comprehensive loss for the period        | —                 | —                 | —                 | —              | —  | —                   | (1,015,713)          |
| <b>Balance – January 31, 2016</b>                     | <b>85,289,011</b> | <b>81,613,013</b> | <b>18,105,300</b> | <b>927,890</b> | <b>232,957</b>                             | <b>21,810,211</b>   | <b>(105,829,494)</b> |
| <b>Balance – November 1, 2016</b>                     | <b>86,429,011</b> | <b>81,740,738</b> | <b>18,105,300</b> | <b>927,890</b> | <b>229,873</b>                             | <b>21,782,149</b>   | <b>(107,323,513)</b> |
| Redemption of convertible debentures <i>[note 10]</i> | —                 | —                 | —                 | —              | (229,873)                                  | 229,873             | —                    |
| Issuance of convertible debentures <i>[note 10]</i>   | —                 | —                 | 550,000           | 73,241         | —  | —                   | —                    |
| Issue costs - convertible debentures <i>[note 10]</i> | —                 | —                 | —                 | (7,146)        | —  | —                   | —                    |
| Share-based compensation <i>[note 11(e)]</i>          | —                 | —                 | —                 | —              | —  | 25,174              | —                    |
| Net loss and comprehensive loss for the period        | —                 | —                 | —                 | —              | —  | —                   | (830,771)            |
| <b>Balance – January 31, 2017</b>                     | <b>86,429,011</b> | <b>81,740,738</b> | <b>18,655,300</b> | <b>993,985</b> | <b>—</b>                                   | <b>22,037,196</b>   | <b>(108,154,284)</b> |

Going concern uncertainty *[note 1]*

See accompanying notes

**Quest Rare Minerals Ltd.**

**INTERIM STATEMENTS OF CASH FLOWS  
(UNAUDITED)**

Three-month periods ended January 31,

|  | <b>2017</b>               | <b>2016</b>             |
|--|---------------------------|-------------------------|
|  | \$                        | \$                      |
| <b>OPERATING ACTIVITIES</b>  |                           |                         |
| Net loss   | (830,771)                 | (1,015,713)             |
| Items not impacting cash:  |                           |                         |
| Accretion of convertible debentures <i>[note 10]</i>                           | 54,321                    | 104,614                 |
| Excess of redemption of convertible debentures <i>[notes 6 and 10]</i>         | 21,976                    | —                       |
| Interest payable <i>[notes 6, 7 and 10]</i>                                    | 28,588                    | 45,064                  |
| Unrealized (gain) on investments held for trading                              | (50)                      | (150)                   |
| Other non-cash expenses  | 17,153                    | —                       |
| Share-based compensation <i>[note 11(e)]</i>                                   | 25,174                    | 71,970                  |
|  | <u>(683,609)</u>          | <u>(794,215)</u>        |
| Net change in non-cash working capital items                                   | 2,534,556                 | 637,580                 |
| <b>Net cash flows from (used in) operating activities</b>                      | <u><b>1,850,947</b></u>   | <u><b>(156,635)</b></u> |
| <b>INVESTING ACTIVITIES</b>  |                           |                         |
| Increase in non-current assets <i>[note 7]</i>                                 | —                         | (10,715)                |
| <b>Net cash flows from (used in) investing activities</b>                      | <u>—</u>                  | <u>(10,715)</u>         |
| <b>FINANCING ACTIVITIES</b>  |                           |                         |
| Increase in loans payable <i>[note 8]</i>                                      | 25,000                    | 105,000                 |
| Proceeds from issuance of convertible debentures and warrants <i>[note 10]</i> | 25,678                    | —                       |
| Redemption of convertible debentures <i>[note 10]</i>                          | (1,956,580)               | —                       |
| Share issue costs <i>[note 11]</i>   | —                         | (3,712)                 |
| <b>Net cash flows (used in) from financing activities</b>                      | <u><b>(1,905,902)</b></u> | <u><b>101,288</b></u>   |
| <b>Net decrease in cash</b>  | <b>(54,955)</b>           | <b>(66,062)</b>         |
| Cash, beginning of year  | <u><b>58,026</b></u>      | <u><b>208,925</b></u>   |
| <b>Cash, end of year</b>   | <u><b>3,071</b></u>       | <u><b>142,863</b></u>   |

Going concern uncertainty *[note 1]*

*See accompanying notes*

## **Quest Rare Minerals Ltd.**

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

**January 31, 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 Robert Bourassa Blvd, 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 twelve months and its planned pilot plant and 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 comprehensive loss in the three-month period ended January 31, 2017 and the year ended October 31, 2016 of \$830,771 and \$2,509,732, respectively. As at January 31, 2017, the Corporation’s current liabilities exceeded its current assets by \$4,202,169 [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.

**Quest Rare Minerals Ltd.**

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

**January 31, 2017**

**2. BASIS OF PREPARATION**

**Statement of Compliance**

The condensed interim financial statements of the Corporation for the three-month period ended January 31, 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 financial statements for the year ended October 31, 2016 which have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

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

**Quest Rare Minerals Ltd.**

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

**January 31, 2017**

**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-month periods ended January 31 is as follows:

|   | <b>2017</b>      | <b>2016</b>        |
|---|------------------|--------------------|
|   | \$               | \$                 |
| Loss before income tax  | <u>(830,771)</u> | <u>(1,015,713)</u> |
| Income tax recovery at the combined Federal and<br>Provincial tax rate 26.80% [2016 – 26.87%] | (222,687)        | (272,962)          |
| Share-based compensation  | 6,748            | 19,341             |
| Other non-deductible expenses or non-taxable revenues   | (26,498)         | (13,902)           |
| Changes in valuation allowance  | 242,437          | 267,523            |
| Tax recovery at the effective income tax rate   | <u>—</u>         | <u>—</u>           |

The deferred tax assets and liabilities of the Corporation consist of the following:

|   | <b>January 31,<br/>2017</b> | <b>October 31,<br/>2016</b> |
|---|-----------------------------|-----------------------------|
|   | \$                          | \$                          |
| <b>Future income tax assets</b>         |                             |                             |
| Exploration and evaluation expenditures | 15,859,589                  | 15,782,431                  |
| Non-capital loss carry-forwards         | 6,135,764                   | 5,989,543                   |
| Share issue costs                       | 179,385                     | 196,182                     |
| Investments                             | 5,656                       | 5,663                       |
|   | <u>22,180,394</u>           | <u>21,973,819</u>           |
| <b>Future income tax liabilities</b>    |                             |                             |
| Convertible debentures                  | (18,879)                    | (54,741)                    |
| Net future income tax assets            | <u>22,161,515</u>           | <u>21,919,078</u>           |
| Unrecognized deferred tax assets        | (22,161,515)                | (21,919,078)                |
| <b>Net future income tax</b>            | <u>—</u>                    | <u>—</u>                    |



**Quest Rare Minerals Ltd.**

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

**January 31, 2017**

**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 three-month periods ended January 31:

|   | <b>2017</b>    | <b>2016</b> |
|---|----------------|-------------|
|   | \$             | \$          |
| Strange Lake (Québec)   | <b>280,801</b> | 458,056     |
| Total exploration and evaluation expenditures before share-based compensation | <b>280,801</b> | 458,056     |
| Share-based compensation <i>[note 11[e]]</i>                                  | —              | 3,300       |
| <b>Total expenditures incurred</b>  | <b>280,801</b> | 461,356     |

**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.

**Quest Rare Minerals Ltd.**

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

January 31, 2017

**5. EXPLORATION AND EVALUATION EXPENDITURES [Cont'd]**

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

|                                    | <b>Three-month<br/>period ended<br/>January 31,<br/>2017<br/>\$</b> | <b>Three-month<br/>period ended<br/>January 31,<br/>2016<br/>\$</b> | <b>From<br/>Inception<br/>\$</b> |
|------------------------------------|---|---|----------------------------------|
| Acquisition costs                  | <b>12,948</b>   | —   | 214,083                          |
| Geochemical surveys                | —   | —   | 42,027                           |
| Geophysical surveys                | —   | —   | 288,651                          |
| Geological surveys                 | —   | 18,750  | 13,037,117                       |
| Drilling                           | <b>9,375</b>  | 9,375   | 15,113,792                       |
| Prospecting                        | —   | —   | 264,174                          |
| Prefeasibility studies             | <b>67,151</b>   | 105,694   | 31,982,159                       |
| Feasibility studies                | —   | —   | 5,110,525                        |
| Metallurgical work                 | —   | —   | 2,851,112                        |
| Environmental and permitting       | <b>66,517</b>   | 118,427   | 2,848,599                        |
| Project management and support     | <b>214,874</b>  | 260,310   | 2,591,712                        |
| Other                              | —   | —   | 2,425,205                        |
| Government tax credits             | <b>(23,500)</b>   | (54,500)  | (14,831,568)                     |
| Government grants <i>[note 9]</i>  | <b>(66,564)</b>   | —   | (729,033)                        |
| <b>Total expenditures incurred</b> | <b>280,801</b>  | 458,056   | 61,208,555                       |

## Quest Rare Minerals Ltd.

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

January 31, 2017

#### 6. EXPENSES BY NATURE

The following is a breakdown of the nature of expenses included in administration, investor relations and finance expenses for the three-month periods ended January 31:

|  | 2017           | 2016           |
|--|----------------|----------------|
|  | \$             | \$             |
| <b>Administration expenses:</b>        |                |                |
| Office expenses:                       |                |                |
| Salaries and other employee benefits   | 46,416         | 48,748         |
| Directors' fees                        | 60,000         | 61,250         |
| Directors' and officers' insurance     | 11,264         | 26,226         |
| Rent                                   | 14,603         | 14,045         |
| Travel costs                           | 3,000          | 12,636         |
| Telephone and internet                 | 5,083          | 4,206          |
| IT services                            | 4,557          | 6,984          |
| Equipment lease and rental             | 2,508          | —              |
| Other office expenses                  | 2,548          | 12,338         |
| Bank charges                           | 1,300          | 1,612          |
| Foreign exchange gain                  | (8,206)        | (321)          |
| Share-based compensation [note 11 (e)] | 25,174         | 68,670         |
| Restructuring expenses:                |                |                |
| Separation and termination benefits    | 151,059        | —              |
| <b>Total</b>                           | <b>319,306</b> | <b>256,394</b> |
|  |                |                |
|  | 2017           | 2016           |
|  | \$             | \$             |
| <b>Investor relations expenses:</b>    |                |                |
| Advertising                            | 3,902          | 3,902          |
| Conferences                            | 2,016          | —              |
| Dues and subscriptions                 | —              | 255            |
| Investor relations fees                | 13,900         | 4,575          |
| Listing and stock transfer fees        | 25,040         | 26,920         |
| Meetings                               | 1,998          | —              |
| Printing and filing                    | 3,223          | 564            |
| Travel related costs                   | 4,359          | 427            |
| <b>Total</b>                           | <b>54,438</b>  | <b>36,643</b>  |

## Quest Rare Minerals Ltd.

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

January 31, 2017

#### 6. EXPENSES BY NATURE [Cont'd]

|  | 2017           | 2016           |
|--|----------------|----------------|
|  | \$             | \$             |
| <b>Finance expenses:</b>                                 |                |                |
| Interest on loans payable [note 8]                       | 3,199          | 955            |
| Interest on convertible debentures [note 10]             | 25,389         | 44,109         |
| Accretion of convertible debentures [note 10]            | 54,321         | 104,614        |
| Excess of redemption of convertible debentures [note 10] | 21,976         | —              |
| <b>Total</b>   | <b>104,885</b> | <b>149,678</b> |

As at January 31, 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 \$251,145 and \$71,997 respectively [January 31, 2016 – \$153,828 and \$98,243].

#### 7. OTHER NON-CURRENT ASSETS

A breakdown of other non-current assets as at January 31, 2017 and October 31, 2016 are as follows:

|                                      | January 31,<br>2017 | October 31,<br>2016 |
|--------------------------------------|---------------------|---------------------|
|                                      | \$                  | \$                  |
| SPIP Agreement – lease payments      | 478,506             | 446,652             |
| Fraenkel Agreement – option payments | 310,600             | 273,028             |
| <b>Total</b>                         | <b>789,106</b>      | <b>719,680</b>      |

#### 8. 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 (“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, present or future, including those related to its three-month period ended January 31, 2017.

## Quest Rare Minerals Ltd.

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

January 31, 2017

#### 8. LOANS PAYABLE [Cont'd]

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-month period ended January 31, 2017, interest expense pursuant to these loans amounted to \$3,199 [January 31, 2016 – \$955].

#### 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.

As at January 31, 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 January 31, 2017 and the respective changes during the three-month period then ended are summarized as follows:

|                                   | <b>Government grants<br/>receivable</b> | <b>Deferred government<br/>grants</b> |
|-----------------------------------|---|---------------------------------------|
|                                   | \$                                      | \$                                    |
| Outstanding, October 31, 2016     | <b>66,247</b>                           | <b>(417,580)</b>                      |
| Earned during the period [note 5] | <b>6,656</b>                            | <b>59,908</b>                         |
| Outstanding, January 31, 2017     | <b>72,903</b>                           | <b>(357,671)</b>                      |
| <b>Current</b>                    | —                                       | <b>(357,671)</b>                      |
| <b>Non-current</b>                | <b>72,903</b>                           | —                                     |

## **Quest Rare Minerals Ltd.**

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

**January 31, 2017**

#### **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 three-month period ended January 31, 2017, as part of finance expenses.

On January 18, 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)

January 31, 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 18, 2017 | feature issued<br>January 18, 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.

As at January 31, 2017 a total of \$69,891 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.

## Quest Rare Minerals Ltd.

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

January 31, 2017

#### 10. CONVERTIBLE DEBENTURES [Cont'd]

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 January 31, 2017 and October 31, 2016 are as follows:

|                                     | Host debt<br>component<br>\$ | Common share<br>purchase<br>warrants<br>\$ | Equity<br>component of<br>convertible<br>debentures<br>\$ | Total<br>\$      |
|-------------------------------------|------------------------------|--|---|------------------|
| <b>Balance, November 1, 2015</b>    | 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)        |
| <b>Balance, October 31, 2016</b>    | <b>2,270,296</b>             | <b>172,036</b>                             | <b>229,873</b>  | <b>2,672,205</b> |
| Accretion                           | 54,321                       | —  | —   | 54,321           |
| 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)         |
| <b>Balance, January 31, 2017</b>    | <b>434,838</b>               | <b>238,131</b>                             | <b>—</b>  | <b>672,969</b>   |

#### 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-month period ended January 31, 2017

[i] There were no issuances of common shares during the three-month period ended January 31, 2017.

##### Issuances during the three-month period ended January 31, 2016

[ii] On January 20, 2016, the Corporation issued 255,000 common shares in relation to the exercise of 255,000 RSUs [note 11 [d]].



**Quest Rare Minerals Ltd.**

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

January 31, 2017

**11. SHARE CAPITAL [Cont'd]**

**[b] Stock options**

The outstanding options as at January 31, 2017 and October 31, 2016 and the respective changes during the three-month period and the year then ended are summarized as follows:

|                                     | Three-month period ended<br>January 31, 2017 |   | Year ended<br>October 31, 2016 |   |
|-------------------------------------|--|---|--------------------------------|---|
|                                     | Number of<br>options<br>#                    | Weighted<br>average<br>exercise price<br>\$ | Number of<br>options<br>#      | Weighted<br>average<br>exercise price<br>\$ |
| Outstanding, beginning of<br>period | <b>6,821,000</b>                             | <b>1.66</b>                                 | 5,301,000                      | 2.42  |
| Granted                             | —  | —   | 1,920,000                      | 0.07  |
| Exercised                           | —  | —   | (400,000)                      | (4.09)                                      |
| Outstanding, end of<br>period       | <b>6,821,000</b>                             | <b>1.66</b>                                 | 6,821,000                      | 1.66  |

The following options are outstanding and exercisable as at January 31, 2017.

| Options outstanding              |                            |   |   |                            |   |
|----------------------------------|----------------------------|---|---|----------------------------|---|
| Range of<br>exercise price<br>\$ | Number<br>outstanding<br># | Weighted<br>average<br>remaining<br>contractual<br>life<br>(in years) | Weighted<br>average<br>exercise price<br>\$ | Number<br>exercisable<br># | Weighted<br>average<br>exercise price<br>\$ |
| 0.01 to 0.749                    | 4,181,000                  | 3.30  | 0.16  | 3,847,666                  | 0.17  |
| 1.50 to 2.249                    | 205,000                    | 3.53  | 2.11  | 205,000                    | 2.11  |
| 2.25 to 2.999                    | 595,000                    | 3.98  | 2.73  | 595,000                    | 2.73  |
| 3.75 to 4.499                    | 1,240,000                  | 3.76  | 4.43  | 1,240,000                  | 4.43  |
| 4.50 to 5.249                    | 350,000                    | 3.72  | 4.69  | 350,000                    | 4.69  |
| 5.25 to 5.999                    | 250,000                    | 3.93  | 5.72  | 250,000                    | 5.72  |
| <b>0.00 to 5.999</b>             | <b>6,821,000</b>           | <b>3.49</b>   | <b>1.66</b>                                 | <b>6,487,666</b>           | <b>1.74</b>                                 |

**Quest Rare Minerals Ltd.**

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

January 31, 2017

**11. SHARE CAPITAL [Cont'd]**

The fair value of stock options granted during the three-month period ended January 31, 2016 were estimated at their respective grant dates using the Black Scholes option pricing model, using the following weighted average assumptions.

|                                 |               |
|---------------------------------|---------------|
|                                 | <b>2016</b>   |
| Risk-free interest rate         | 0.72%         |
| Forfeiture rate                 | 6.44%         |
| Expected volatility             | 90%           |
| Dividend yield                  | Nil           |
| Expected life [in years]        | 5             |
| <b>Fair value at grant date</b> | <b>\$0.05</b> |

**[c] Warrants**

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

|   | <b>Three-month period ended<br/>January 31, 2017</b> |   | <b>Year ended October<br/>31, 2016</b> |   |
|---|--|---|--|---|
|   | <b>Number of<br/>warrants<br/>#</b>                  | <b>Weighted<br/>average exercise<br/>price<br/>\$</b> | <b>Number of<br/>warrants<br/>#</b>    | <b>Weighted<br/>average exercise<br/>price<br/>\$</b> |
| <b>Outstanding balance,<br/>beginning of year</b> | <b>18,105,300</b>                                    | <b>0.30</b>   | 18,105,300                             | 0.30  |
| Granted   | <b>550,000</b>                                       | <b>0.18</b>   | —                                      | —   |
| <b>Outstanding balance,<br/>end of year</b>       | <b>18,655,300</b>                                    | <b>0.30</b>   | 18,105,300                             | 0.30  |

**[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.

**Quest Rare Minerals Ltd.**

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

**January 31, 2017**

**11. SHARE CAPITAL [Cont'd]**

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.

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 January 31, 2017 and October 31, 2016 and the respective changes during the three-month period and the year then ended are summarized as follows:

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

|                                  | <b>Deferred Share Units</b>     |                                 |                         |                                 |
|----------------------------------|---------------------------------|---------------------------------|-------------------------|---------------------------------|
|                                  | <b>Number of units</b>          | <b>Fair value at grant date</b> | <b>Number of units</b>  | <b>Fair value at grant date</b> |
|                                  | #                               | \$                              | #                       | \$                              |
|                                  | <b>Three-month period ended</b> |                                 | <b>Year ended</b>       |                                 |
|                                  | <b>January 31, 2017</b>         |                                 | <b>October 31, 2016</b> |                                 |
| Outstanding, beginning of period | 480,000                         | 0.48                            | 620,000                 | 0.48                            |
| Exercised                        | —                               | —                               | (140,000)               | (0.48)                          |
| Outstanding, end of period       | <b>480,000</b>                  | <b>0.48</b>                     | <b>480,000</b>          | <b>0.48</b>                     |
| Units exercisable                | —                               | —                               | —                       | —                               |

## **Quest Rare Minerals Ltd.**

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

**January 31, 2017**

#### **11. SHARE CAPITAL [Cont'd]**

##### **[e] Share-based compensation**

For the three-month period ended January 31, 2017, the amount of share-based compensation expenditures from all sources, included in administration expenses and exploration and evaluation expenditures in the statements of comprehensive loss, were \$25,174 and nil respectively [2016 – \$68,670 and \$3,300].

#### **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-month period ended January 31, 2017, the Corporation incurred fees to a law firm in which a director of the Corporation is a partner. During the three-month period ended January 31, 2017, the total amount for such services provided was \$114,714, of which \$8,205 was recorded in professional fees, \$1,998 was recorded in investor relations, \$44,482 was recorded in convertible debenture issue costs and \$60,029 was recorded in prepayments [2016 – \$33,551, nil, nil, and nil]. As at January 31, 2017 an amount of \$285,681 [October 31, 2016 – \$193,093] owing to this law firm was included in accounts payable and accrued liabilities in respect of these fees.
- [b] During the three-month period ended January 31, 2017, the Corporation incurred fees to a private investment firm of which a director of the Corporation has a related party association. During the three-month period ended January 31, 2017, the total amount recorded in professional fees for such services provided was \$30,000 [2016 – \$30,000]. As at January 31, 2017, an amount of \$173,900 [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-month period ended January 31, 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 January 31, 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 \$75,017 respectively]. As at January 31, 2017, an amount of \$369,574 [October 31, 2016 – \$233,125] owing to these firms was included in accounts payable and accrued liabilities in respect of these fees.

## Quest Rare Minerals Ltd.

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

January 31, 2017

#### 12. RELATED PARTY TRANSACTIONS [Cont'd]

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

Excluding the amounts reported above, during the three-month periods ended January 31, 2017 and 2016, the Corporation recorded the following compensation for key management personnel and the Board of Directors:

|   | 2017           | 2016           |
|---|----------------|----------------|
|   | \$             | \$             |
| Salaries, employee benefits   | 75,637         | 74,685         |
| Directors' fees   | 47,500         | 61,250         |
| Stock compensation  | 1,461          | 44,341         |
| Total compensation paid to key management personnel<br>and Board of Directors | <u>124,598</u> | <u>180,276</u> |

#### 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 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 10*) 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.

The Corporation's financial instruments consist of cash, investments, accounts payable and accrued liabilities and loans payable.

## Quest Rare Minerals Ltd.

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

January 31, 2017

#### 13. FINANCIAL INSTRUMENTS [Cont'd]

The Corporation's investments are classified as follows:

| Classification                   | Fair value level  | January 31, 2017     |                  | October 31, 2016     |                  |           |
|----------------------------------|-------------------|----------------------|------------------|----------------------|------------------|-----------|
|                                  |                   | Carrying value<br>\$ | Fair value<br>\$ | Carrying value<br>\$ | Fair value<br>\$ |           |
| <b>Financial assets</b>          |                   |                      |                  |                      |                  |           |
| Investments –<br>Canadian stocks | Held-for-trading  | I                    | 800              | 800                  | 750              | 750       |
| <b>Financial liabilities</b>     |                   |                      |                  |                      |                  |           |
| Convertible<br>debentures        | Other liabilities | I                    | 434,838          | 481,678              | 2,270,296        | 2,351,023 |

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 January 31, 2017. The Corporation's cash is deposited with a major Canadian chartered bank and is 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. All of the Corporation's financial liabilities are due within one year.

As at January 31, 2017, the Corporation had a total of \$3,071 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 primary market exposures are to interest rate risk

## **Quest Rare Minerals Ltd.**

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

**January 31, 2017**

#### **13. FINANCIAL INSTRUMENTS [Cont'd]**

##### **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 interest rate exposure on its cash balances.

#### **14. SUBSEQUENT EVENTS**

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.

Each of the Special Warrants may be exchanged, for no additional consideration, for one Quest common share and one common share purchase warrant ("Warrant") of the Corporation. Each of the Warrants will entitle its holder to purchase one common share at a price of \$0.275 for a period of three years from the closing date of the private placement.

The Corporation is in the process of filing a prospectus in those provinces in which Special Warrants were sold in order to qualify for distribution the Shares and Warrants issuable upon the exchange of the Special Warrants. The Special Warrants will be deemed to be exercised without payment of additional consideration or further action on the third business day following the day upon which the Corporation obtains a receipt for the final prospectus. In the event that the Corporation does not obtain a receipt for the final prospectus from the applicable Canadian securities authorities by March 24, 2017, each Special Warrant will be exchanged, at no additional cost, for 1.25 common shares and 0.75 Warrants (instead of one common share and one Warrant). In that event, each Warrant will entitle its holder to purchase one common share at a price of \$0.275 for a period of four years.

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.