

Condensed Interim Financial Statements

Quest Rare Minerals Ltd.

(An Exploration & Development Stage Corporation)

For the three and nine-month periods ended July 31, 2017

(Unaudited)

INDEX

Interim Statements of Financial Position	1
Interim Statements of Comprehensive Loss	2
Interim Statements of Changes in Equity	3
Interim Statements of Cash Flows	4
Notes to Condensed Interim Financial Statements	5 – 26

NOTICE TO READER

Management has compiled the unaudited condensed interim financial statements of Quest Rare Minerals Ltd. as at July 31, 2017 and for the three and nine-month periods then ended. These condensed interim financial statements have not been audited or reviewed by the Corporation's independent auditors.

Quest Rare Minerals Ltd.

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

As at	July 31, 2017 \$	October 31, 2016 \$
	<u> </u>	<u> </u>
ASSETS		
Current assets		
Cash [notes 1 and 13]	208,676	58,026
Investments [note 13]	1,350	750
Prepaid expenses and deposits	251,253	220,938
Commodity taxes and other receivables	48,487	82,979
Tax credits receivable	164,440	2,199,468
	<u>674,206</u>	<u>2,562,161</u>
Non-current assets		
Other non-current assets [note 7]	927,957	719,680
Government grants receivable [note 9]	73,264	66,247
Total assets	<u>1,675,427</u>	<u>3,348,088</u>
DEFICIENCY AND LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities [note 12]	4,131,242	3,140,511
Loans payable [note 8]	148,974	112,911
Deferred government grants [note 9]	354,418	417,580
Convertible debentures [notes 10 and 13]	383,616	2,270,296
Total current liabilities	<u>5,018,250</u>	<u>5,941,298</u>
Non-Current liabilities		
Accounts payable and accrued liabilities [note 12]	27,309	49,653
Total non-current liabilities	<u>27,309</u>	<u>49,653</u>
Deficiency		
Share capital [note 11(a)]	82,534,123	81,740,738
Warrants reserve [note 11(c)]	584,545	927,890
Equity component of convertible debentures [note 10]	—	229,873
Contributed surplus [notes 10 and 11]	22,902,067	21,782,149
Deficit	(109,390,867)	(107,323,513)
Total deficiency	<u>(3,370,132)</u>	<u>(2,642,863)</u>
Total deficiency and liabilities	<u>1,675,427</u>	<u>3,348,088</u>
Going concern uncertainty [note 1]		
See accompanying notes		

Quest Rare Minerals Ltd.

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

	Three-month periods ended		Nine-month periods ended	
	July 31		July 31	
	2017	2016	2017	2016
	\$	\$	\$	\$
REVENUES	—	—	—	—
EXPENSES				
Exploration and evaluation expenditures <i>[note 5]</i>	145,498	(94,142)	862,164	690,591
Administration expenses <i>[notes 6 and 12]</i>	195,766	147,658	653,666	594,125
Investor relations <i>[notes 6 and 12]</i>	30,718	40,010	184,258	135,968
Professional fees <i>[note 12]</i>	24,062	48,439	164,447	231,205
	396,044	141,965	1,864,535	1,651,889
Operating loss	(396,044)	(141,965)	(1,864,535)	(1,651,889)
Finance income	283	3,772	1,150	16,740
Finance expenses <i>[notes 6, 8 and 10]</i>	(53,215)	(147,421)	(204,569)	(465,724)
Unrealized gain on investments held for trading	(500)	(200)	600	150
	(53,432)	(143,849)	(202,819)	(448,834)
Net loss and comprehensive loss for the period	(449,476)	(285,814)	(2,067,354)	(2,100,723)
Net loss per share				
Basic and fully diluted	(0.00)	(0.00)	(0.02)	(0.02)
Weighted average number of outstanding shares				
Basic and fully diluted	94,629,011	86,429,011	90,142,198	85,894,575

Going concern uncertainty *[note 1]*

See accompanying notes

Quest Rare Minerals Ltd.

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

	Share capital		Warrants reserve		Equity component of convertible debentures	Contributed surplus	Deficit	Total
	#	\$	#	\$	\$	\$	\$	\$
Balance – November 1, 2015	85,034,011	81,543,188	18,105,300	927,890	232,957	21,808,066	(104,813,781)	(301,680)
Issuance of shares <i>[note 11]</i>	1,000,000	60,000	—	—	—	—	—	60,000
Settlement of RSUs <i>[note 11]</i>	255,000	69,825	—	—	—	(69,825)	—	—
Settlement of DSUs <i>[note 11]</i>	140,000	67,725	—	—	—	(67,725)	—	—
Redemption of convertible debentures <i>[note 10]</i>	—	—	—	—	(3,084)	—	—	(3,084)
Share-based compensation <i>[note 11(e)]</i>	—	—	—	—	—	95,031	—	95,031
Net loss and comprehensive loss for the period	—	—	—	—	—	—	(1,814,909)	(1,814,909)
Balance – July 31, 2016	86,429,011	81,740,738	18,105,300	927,890	229,873	21,765,547	(106,628,690)	(1,964,642)
Balance – November 1, 2016	86,429,011	81,740,738	18,105,300	927,890	229,873	21,782,149	(107,323,513)	(2,642,863)
Redemption of convertible debentures <i>[note 10]</i>	—	—	—	—	(229,873)	229,873	—	—
Issuance of convertible debentures <i>[note 10]</i>	—	—	550,000	73,241	—	—	—	73,241
Issue costs - convertible debentures <i>[note 10]</i>	—	—	—	(7,146)	—	—	—	(7,146)
Issuance of shares and warrants <i>[note 11]</i>	8,100,000	1,057,200	8,100,000	562,800	—	—	—	1,620,000
Issue costs - shares and warrants <i>[note 11]</i>	—	(237,850)	—	(126,615)	—	—	—	(364,465)
Issue costs - options issued to brokers <i>[note 11]</i>	—	(36,952)	—	(19,670)	—	56,622	—	—
Exercise of stock options <i>[note 11]</i>	100,000	10,987	—	—	—	(4,487)	—	6,500
Expiry of warrants <i>[note 11]</i>	—	—	(11,025,485)	(825,955)	—	825,955	—	—
Share-based compensation <i>[note 11(e)]</i>	—	—	—	—	—	11,955	—	11,955
Net loss and comprehensive loss for the period	—	—	—	—	—	—	(2,067,354)	(2,067,354)
Balance – July 31, 2017	94,629,011	82,534,123	15,729,815	584,545	—	22,902,067	(109,390,867)	(3,370,132)

Going concern uncertainty *[note 1]*

See accompanying notes

Quest Rare Minerals Ltd.

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

Nine-month periods ended July 31,

	2017	2016
	\$	\$
OPERATING ACTIVITIES		
Net loss	(2,067,354)	(2,100,723)
Items not impacting cash:		
Accretion of convertible debentures <i>[note 10]</i>	118,460	309,653
Excess of redemption of convertible debentures <i>[notes 6 and 10]</i>	21,976	20,178
Unrealized (gain) on investments held for trading	(600)	(150)
Other non-cash expenses	17,153	—
Share-based compensation <i>[note 11(e)]</i>	11,955	101,175
	(1,898,410)	(1,669,867)
Net change in non-cash working capital items	2,627,860	2,511,307
Net cash flows from (used in) operating activities	729,450	841,440
INVESTING ACTIVITIES		
Increase in non-current assets <i>[note 7]</i>	—	(10,650)
Net cash flows (used in) investing activities	—	(10,650)
FINANCING ACTIVITIES		
Increase in loans payable <i>[note 8]</i>	25,000	105,000
Proceeds from issuance of shares and warrants <i>[note 11]</i>	1,626,500	60,000
Proceeds from issuance of convertible debentures <i>[note 10]</i>	25,678	—
Redemption of convertible debentures <i>[note 10]</i>	(2,071,941)	(158,000)
Share and warrant issue costs <i>[note 11]</i>	(142,065)	(3,712)
Convertible debenture issue costs <i>[note 10]</i>	(41,972)	—
Net cash flows (used in) from financing activities	(578,800)	3,288
Net increase (decrease) in cash	150,650	834,078
Cash, beginning of year	58,026	208,925
Cash, end of year	208,676	1,043,003

Going concern uncertainty *[note 1]*

See accompanying notes

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 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 1200 McGill College Avenue Suite 1100, Montreal, Québec, H3B 4G7. Quest was a publicly-listed corporation and its shares were listed on the Toronto Stock Exchange under the symbol "QRM". On August 11, 2017, the Toronto Stock Exchange delisted the Corporation's securities, which as at September 11, 2017 remain suspended from trading.

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.

Notice of Intention to make a proposal under the Bankruptcy and Insolvency Act

On July 5, 2017 the Corporation filed a Notice of Intention to Make a Proposal ["Notice of Intention"] pursuant to the provisions of Part III of the Bankruptcy and Insolvency Act (Canada) [the "BIA"].

Pursuant to the Notice of Intention, PricewaterhouseCoopers Inc. ["PwC"] has been appointed as the trustee in the Corporation's proposal proceedings and will assist the Corporation in its restructuring efforts.

This filing follows the Corporation's strategic review of its options pursuant to the decision of a major industrial conglomerate with interests in construction, mining and hydrocarbons not to follow through with an investment in the Quest project, as contemplated in the Memorandum of Understanding signed on November 2, 2016. The filing of the Notice of Intention has the effect of imposing an automatic 30-day stay of proceedings that will protect the Corporation and its assets from the claims of creditors while the Corporation pursues its restructuring efforts. This 30-day period may be extended with the authorization of the Superior Court of Québec.

On August 4, 2017 the Superior Court of Québec granted Quest's motion for an extension of the delay to file a proposal pursuant to the provisions of Part III of the Bankruptcy and Insolvency Act, thereby extending the delay to file such proposal by an additional 45 days, up to and including September 18, 2017.

The Corporation believes that the action it has taken will be beneficial to all stakeholders by giving the Corporation the time and resources needed to find other sources of funding or to merge with or be acquired by another company although there is no guarantee that these efforts will be successful.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

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

Going Concern Uncertainty

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

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

The Corporation's current committed cash resources are insufficient to cover expected expenditures for the next 12 months and its planned Pre-feasibility study on Strange Lake. The Corporation is currently delisted from the Toronto Stock Exchange and has filed a Notice of Intention under the BIA. 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 and the successful completion of its restructuring activities. There can be no guarantee that the Corporation will be successful in securing financing or achieving its restructuring objectives. Failure by the Corporation to achieve its financing and restructuring goals will likely result in the Company becoming bankrupt.

The Corporation reported a net loss and total comprehensive loss in the nine-month period ended July 31, 2017 and the year ended October 31, 2016 of \$2,067,354 and \$2,509,732, respectively. As at July 31, 2017, the Corporation's current liabilities exceeded its current assets by \$4,344,044 [October 31, 2016 – \$3,379,137]. These recurring losses, the need for continued financing to continue operations, the delisting from the Toronto Stock Exchange and the filing of a Notice of Intention under the BIA indicate the existence of a material uncertainty that casts 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)

July 31, 2017

2. BASIS OF PREPARATION

Statement of Compliance

The condensed interim financial statements of the Corporation for the three and nine-months ended July 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 consolidated financial statements for the year ended October 31, 2016 which have been prepared in accordance with IFRS.

The Board of Directors approved these condensed interim financial statements effective September 11, 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)**

July 31, 2017

4. INCOME TAXES

A reconciliation of income tax charge applicable to the accounting loss before income tax at the weighted average statutory income tax rate to the income tax charge at the Corporation's effective income tax rate for the three and nine-month periods ended July 31 is as follows:

	Three-month periods ended July 31		Nine-month periods ended July 31	
	2017	2016	2017	2016
	\$	\$	\$	\$
Loss before income tax	(449,476)	(285,814)	(2,067,354)	(2,100,723)
Income tax recovery at the combined Federal and Provincial tax rate 26.80% [2016 – 26.98%]	(120,481)	(76,809)	(554,151)	(564,547)
Stock based compensation	(4,877)	1,651	3,205	27,190
Other non-deductible expenses	(13,029)	(82,267)	(133,117)	45,270
Changes in valuation allowance	138,387	157,425	684,063	492,087
Tax charge at effective income tax rate	—	—	—	—

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

	July 31, 2017	October 31, 2016
	\$	\$
Future income tax assets		
Exploration and evaluation expenditures	16,024,050	15,782,431
Non-capital loss carry-forwards	6,364,811	5,989,543
Share issue costs	217,842	196,182
Investments	5,582	5,663
	22,612,285	21,973,819
Future income tax liabilities		
Convertible debentures	(9,144)	(54,741)
Net future income tax assets	22,603,141	21,919,078
Unrecognized deferred tax assets	(22,603,141)	(21,919,078)
Net future income tax liabilities	—	—

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 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 nine-month period ended July 31:

	Three-month periods ended July 31,		Nine-month periods ended July 31,	
	2017	2016	2017	2016
	\$	\$	\$	\$
Strange Lake (Québec)	145,498	(95,259)	858,519	683,945
Alterra – Strange Lake (Newfoundland & Labrador)	—	—	1,500	—
Strange Lake (Newfoundland & Labrador)	—	—	2,145	—
Total exploration and evaluation expenditures before stock-based compensation	145,498	(95,259)	862,164	683,945
Stock-based compensation [note 11[e]]	—	1,117	—	6,646
Total expenditures incurred	145,498	(94,142)	862,164	690,591

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)**

July 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:

	Nine-month period ended July 31, 2017	Nine-month period ended July 31, 2016	From Inception
	\$	\$	\$
Acquisition costs	26,059	—	227,193
Geochemical Surveys	—	—	42,027
Geophysical Surveys	—	—	288,651
Geological Surveys	—	53,125	13,037,117
Drilling	21,875	28,125	15,126,292
Prospecting	—	—	264,174
Prefeasibility Studies	260,667	245,392	32,175,674
Feasibility Studies	—	—	5,110,525
Metallurgical Work	—	—	2,851,112
Environmental & Permitting	161,936	221,261	2,944,019
Project Management & Support	529,602	767,818	2,906,440
Other	—	—	2,425,206
Government Tax Credits	(71,441)	(81,837)	(14,879,509)
Government Grants <i>[note 9]</i>	(70,179)	(549,939)	(732,648)
Total expenditures incurred	858,519	683,945	61,786,273

Other, (Newfoundland & Labrador)

On March 14, 2016, Quest staked an additional 33 contiguous claims (825 ha) in Newfoundland & Labrador. This covers available claim blocks immediately north and east of the Main Zone REE Deposit, historically referred to as the A Zone by the Iron Ore Mining Company of Canada (IOCC). This new license is adjacent to Quest's existing Mineral License, also known as the Alterra Property. Quest's Alterra property in Newfoundland & Labrador consists of 30 claims.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

6. EXPENSES BY NATURE

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

	Three-month period ended July 31		Nine-month period ended July 31	
	2017	2016	2017	2016
Administration expenses:				
Office expenses:				
Salaries and other employee benefits	33,151	40,676	125,647	141,728
Directors' fees	53,750	57,500	167,500	180,000
Directors' and officers' insurance	8,517	11,264	29,782	54,885
Rent	11,844	14,203	39,216	42,592
Telephone and internet	5,038	3,925	15,001	13,063
Travel costs	2,589	3,000	7,989	22,021
IT services	3,283	4,765	12,743	18,716
Equipment lease/rental	1,738	2,673	7,695	7,951
Other office expenses	2,498	3,029	8,899	8,367
Bank charges	208	1,254	2,203	4,339
Foreign exchange loss	(1,434)	342	(8,981)	1,359
Stock-based compensation [note 11[e]]	(18,193)	5,027	11,955	94,529
Restructuring expenses:				
Separation and termination benefits	61,891	—	202,659	3,141
Trustee	19,016	—	19,016	—
Other	11,870	—	12,342	1,434
Total	195,766	147,658	653,666	594,125

As at July 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 \$198,460 and \$57,101 respectively [July 31, 2016 – \$115,594 and \$119,004].

Quest Rare Minerals Ltd.

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

July 31, 2017

6. EXPENSES BY NATURE [Cont'd]

	Three-month periods ended July 31		Nine-month periods ended July 31	
	2017	2016	2017	2016
Investor relations:				
Advertising	5,208	3,902	13,003	11,701
Conferences	—	—	2,277	—
Investor relations fees	3,800	3,825	22,800	10,500
Listing and stock transfer fees	14,046	7,421	49,829	46,564
Meetings	6,102	22,463	41,745	54,416
Printing and filing	1,562	2,140	10,256	3,536
Travel related costs	—	—	44,348	8,486
Other	—	259	—	765
Total	30,718	40,010	184,258	135,968
Finance expense:				
Interest on loans payable <i>[note 8]</i>	4,006	2,334	11,063	5,526
Interest on convertible debentures <i>[note 10]</i>	14,271	41,322	53,070	130,368
Accretion of convertible debentures <i>[note 10]</i>	34,938	103,765	118,460	309,652
Excess of redemption of convertible debentures <i>[note 10]</i>	—	—	21,976	20,178
Total	53,215	147,421	204,569	465,724

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

7. OTHER NON-CURRENT ASSETS

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

	July 31, 2017	October 31, 2016
	\$	\$
SPIP Agreement – lease payments	547,932	446,652
Fraenkel Agreement – option payments	380,025	273,028
Total	927,957	719,680

8. LOANS PAYABLE

On December 15, 2015, the Corporation entered into loan agreements with a number of Directors, Officers or their related parties and others (collectively “the Lenders”) under which the Lenders agreed to loan to the Corporation a total of \$105,000 (“Tranche 1 Loan”) for the purposes of providing working capital. The Tranche 1 Loan amounts are repayable at the earlier of receipt of certain commodity taxes receivables, future private placements, future government grants, or one year from the date of the loan and bear interest at a rate of 8.5% per annum, compounded monthly, for the first twelve months and 12% per annum thereafter, compounded annually. The Corporation provided security to each Lender by way of a hypothec, in the amount 120% of the principal loan amount, over all input tax credits or input tax refunds, due from the Government of Québec, present or future, including those related to its three-month period ended July 31, 2017.

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

During the three and nine-month periods ended July 31, 2017, interest expense pursuant to these loans amounted to \$4,006 and \$11,063 respectively [July 31, 2016 – \$2,334 and \$5,526 respectively] [note 6].

9. GOVERNMENT GRANTS

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

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

9. GOVERNMENT GRANTS [Cont'd]

As at July 31, 2017, the program is on-hold pending resolution of the Corporations restructuring activities. It remains the goal of the Corporation to complete the project goals..

A breakdown of government grants receivable representing the holdback amount and deferred government grants as at July 31, 2017 and October 31, 2016 and the respective changes during the nine-month period and the year then ended are summarized as follows:

	Government grants receivable \$	Deferred government grants \$
Outstanding, October 31, 2015	—	—
Received during the year	—	(1,013,802)
Earned during the year	66,247	596,222
Outstanding, October 31, 2016	66,247	(417,580)
Earned during the period [note 5]	7,017	63,162
Outstanding, July 31, 2017	73,264	(354,418)
Current – July 31, 2017	—	(354,418)
Non-current – July 31, 2017	73,264	—

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.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

10. CONVERTIBLE DEBENTURES [Cont'd]

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 nine-month period ended July 31, 2017, as part of finance expenses *[note 6]*.

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

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

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

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

10. CONVERTIBLE DEBENTURES [Cont'd]

As at July 31, 2017, issue costs incurred pertaining to the Ekagrata debentures and the 2017 Debenture, that were unpaid and included in accounts payable and accrued liabilities, amounted to \$50,976 and \$11,689 respectively [October 31, 2016 - \$50,976 and nil respectively]. These amounts have been excluded from the statements of cash flows. In addition, other transactions related to the convertible debentures were excluded from the statement of cash flows as they did not consist of cash inflows or outflows for the Corporation.

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

On July 17, 2017, the Corporation completed a partial redemption of its 2017 Debenture in the amount of \$115,360. The excess of this partial redemption amount over the carrying value of the host debt and equity components, was estimated to be nil and so the entire redemption amount was allocated to reduce the carrying value of the host debt component.

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

	Host debt component \$	Common share purchase warrants \$	Equity component of convertible debentures \$	Total \$
Balance, November 1, 2015	1,987,238	172,036	232,957	2,392,231
Accretion	417,796	—	—	417,796
Redemptions during the year	(134,738)	—	(3,084)	(137,822)
Balance, October 31, 2016	2,270,296	172,036	229,873	2,672,205
Accretion	118,460	—	—	118,460
Redemptions during the period	(2,435,385)	—	—	(2,435,385)
Transferred to contributed surplus	—	—	(229,873)	(229,873)
Debentures issued during the period	476,759	73,241	—	550,000
Issue costs	(46,514)	(7,146)	—	(53,660)
Balance, July 31, 2017	383,616	238,131	—	621,747

Quest Rare Minerals Ltd.

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

July 31, 2017

11. SHARE CAPITAL

Authorized

Common

An unlimited number of no par value shares.

Preferred

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

[a] Common shares

Issuances during the three and nine-month periods ended July 31, 2017

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

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

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

As at July 31, 2017, none of the broker options issued had been exercised.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

11. SHARE CAPITAL [Cont'd]

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

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

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

As at July 31, 2017 a total of \$187,657 of issue costs were unpaid and included in accounts payable and accrued liabilities. These amounts have been excluded from the statements of cash flows.

- [ii] During the nine-month period ended July 31, 2017, the Corporation issued 100,000 common shares at an average exercise price of \$0.065 per share for a total cash amount of \$6,500 for stock options exercised, and an amount of \$4,487 related to exercised stock options was transferred from contributed surplus to capital stock.

Issuances during the three and nine-month periods ended July 31, 2016

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

Quest Rare Minerals Ltd.

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

July 31, 2017

11. SHARE CAPITAL [Cont'd]

[b] Stock Options

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

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

The following options, excluding broker options and units, are outstanding and exercisable as at July 31, 2017:

Options outstanding					
Range of exercise price \$	Number outstanding #	Weighted average remaining contractual life (in years)	Weighted average exercise price \$	Number exercisable #	Weighted average exercise price \$
0.01 to 0.749	3,956,000	2.81	0.16	3,622,666	0.17
1.50 to 2.249	150,000	4.19	2.24	150,000	2.24
2.25 to 2.999	595,000	3.48	2.73	595,000	2.73
3.75 to 4.499	1,240,000	3.26	4.43	1,240,000	4.43
4.50 to 5.249	350,000	3.22	4.69	350,000	4.69
5.25 to 5.999	250,000	3.44	5.72	250,000	5.72
0.00 to 5.999	6,541,000	3.04	1.71	6,207,666	1.79

Quest Rare Minerals Ltd.

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

July 31, 2017

11. SHARE CAPITAL [Cont'd]

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

Assumption	Three-month period ended July 31, 2016	Nine-month period ended July 31, 2016
Risk-free interest rate	—	0.72%
Expected volatility	—	6.44%
Dividend yield	—	90%
Expected life [in years]	—	Nil
Share Price	—	5
Fair value at grant date	—	\$0.05

[c] Warrants

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

	Nine-month period ended July 31, 2017		Year ended October 31, 2016	
	Number of warrants #	Weighted average exercise price \$	Number of warrants #	Weighted average exercise price \$
Outstanding balance, beginning of year	18,105,300	0.30	18,105,300	0.30
Granted	8,650,000	0.27	—	—
Exercised	—	—	—	—
Expired	(11,025,485)	(0.40)	—	—
Outstanding balance, end of year	15,729,815	0.22	18,105,300	0.30

As at July 31, 2017, the warrants outstanding had a weighted average life of 2.17 years [October 31, 2016 – 1.39 years]. All warrants are exercisable.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

11. SHARE CAPITAL [Cont'd]

[d] Restricted and Deferred Share Unit Plans

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

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

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

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

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

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

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

11. SHARE CAPITAL [Cont'd]

	Deferred Share Units			
	Number of units #	Fair value at grant date \$	Number of units #	Fair value at grant date \$
	Nine-month period ended July 31, 2017		Year ended October 31, 2016	
Outstanding, beginning of period	480,000	0.48	620,000	0.48
Exercised	—	—	(140,000)	(0.48)
Outstanding, end of period	480,000	0.48	480,000	0.48
Units exercisable	100,000	—	—	—

[e] Stock-based compensation

For the three-month period ended July 31, 2017, the amount of stock-based compensation expenditures from all sources, included in administration expenses and exploration and evaluation expenditures in the statements of comprehensive loss, were (\$18,193) and nil respectively [2016 – \$5,027 and \$1,117]. For the nine-month period ended July 31, 2017, the amount of stock-based compensation expenditures from all sources, included in administration expenses and exploration and evaluation expenditures in the statements of comprehensive loss, were \$11,955 and nil respectively [2016 – \$94,529 and \$6,646].

12. RELATED PARTY TRANSACTIONS

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

- [a] During the three and nine-month periods ended July 31, 2017, the Corporation incurred fees to a law firm in which a director of the Corporation is a partner. For the three-month period ended July 31, 2017, the total amount for such services provided was \$3,216, of which \$3,055 was recorded in professional fees, nil was recorded in issue costs and \$161 in annual meetings [2016 – \$1,253 \$1,713, and \$828 respectively]. For the nine-month period ended July 31, 2017, the total amount for such services provided was \$215,366, of which \$30,796 was recorded in professional fees, \$169,376 was recorded in issue costs and \$15,194 was recorded in annual meetings [2016 – \$43,525, \$1,713, and \$9,695 respectively]. As at July 31, 2017, an amount of \$400,178 [October 31, 2016 – \$193,093] owing to this law firm was included in accounts payable and accrued liabilities in respect of these fees.

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

12. RELATED PARTY TRANSACTIONS [Cont'd]

[b] During the three and nine-month periods ended July 31, 2017, the Corporation incurred fees to a private investment firm of which a director of the Corporation has a related party association. For the three and nine-month periods ended July 31, 2017, the total amounts for such services provided was nil and \$42,581 respectively, which were recorded in professional fees [2016 – \$30,000 and \$90,000 respectively]. As at July 31, 2017, an amount of \$186,481 [October 31, 2016 – \$143,900] owing to this firm was included in accounts payable and accrued liabilities in respect of these fees.

[c] During the three and nine-month periods ended July 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 July 31, 2017, the total amount for such services provided was \$80,500, of which \$12,500 was recorded in directors fees and \$68,000 was recorded in exploration and evaluation expenditures [2016 – \$12,500 and \$72,000 respectively]. For the nine-month period ended July 31, 2017, the total amount for such services provided was \$249,500, of which \$37,500 was recorded in directors fees and \$212,000 was recorded in exploration and evaluation expenditures [2016 – \$37,500 and \$219,016 respectively]. As at July 31, 2017, an amount of \$447,957 [October 31, 2016 – \$233,125] owing to these firms was included in accounts payable and accrued liabilities in respect of these fees.

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

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

	Three-month period ended July 31		Nine-month period ended July 31	
	2017	2016	2017	2016
	\$	\$	\$	\$
Salaries and employee benefits	71,571	73,606	199,145	224,336
Directors' fees	41,250	45,000	130,000	142,500
Stock compensation	730	2,480	2,922	49,700
Total	113,551	121,086	332,067	416,536

Quest Rare Minerals Ltd.

NOTES TO CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

July 31, 2017

13. FINANCIAL INSTRUMENTS

Principles of risk management

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

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

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

The Corporation's investments are classified as follows:

Classification	Fair value level	July 31, 2017		October 31, 2016		
		Carrying value \$	Fair Value \$	Carrying value \$	Fair value \$	
Financial assets						
Investments – Canadian stocks	Held-for-trading	I	1,350	1,350	750	750
Financial liabilities						
Convertible debentures	Other liabilities	I	383,616	402,666	2,270,296	2,351,023

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

Quest Rare Minerals Ltd.

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

July 31, 2017

13. FINANCIAL INSTRUMENTS [Cont'd]

Credit risk

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

The Corporation is not exposed to any significant credit risk as at July 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 July 31, 2017, the Corporation had a total of \$208,676 in cash and cash equivalents. The Corporation manages liquidity risk through the management of its capital structure. Accounts payable and accrued liabilities have contractual maturities of 30 – 90 days or less and are subject to normal trade terms, and amounts due to related parties are due on demand

Market risk analysis

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

Interest rate risk

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