EXCELLON

# Excellon Resources Inc.

Consolidated Financial Statements

December 31, 2016 and 2015
in thousands of U.S. dollars

EXCELLON

**Management's Responsibility for Financial Reporting**

The management of Excellon Resources Inc. is responsible for the integrity and fair presentation of the accompanying consolidated financial statements.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and reflect management's best estimates and judgements.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Management has developed and maintains a system of internal controls to obtain reasonable assurance that the Company's assets are safeguarded, transactions are authorized and financial information is reliable. Any system of internal control over financial reporting has inherent limitations, including the possibility of circumvention and overriding of controls, and therefore, can provide only reasonable assurance with respect to financial statement preparation and presentation. Management concludes that at December 31, 2016, the Company's internal control over financial reporting was effective. The Board of Directors oversees management's responsibility for financial reporting and internal control systems through an Audit Committee, which is composed entirely of independent directors. The Audit Committee of the Board of Directors has met with the Company's independent auditors to review the scope and results of the annual audit and to review the consolidated financial statements and related financial reporting matters prior to submitting the consolidated financial statements to the Board for approval. The Audit Committee also reviews the quarterly financial statements and recommends them for approval to the Board of Directors, reviews with management the Company's systems of internal control and approves the scope of the independent auditors audit and non-audit work.

The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, Chartered Professional Accountants, Licensed Public Accountants. Their report outlines the scope of their examination and opinion on the consolidated financial statements.

| | |
|---|---|
| (Signed) "*Brendan Cahill*" | (Signed) "*Rupy Dhadwar*" |
| President & Chief Executive Officer | Chief Financial Officer |

March 22, 2017

pwc

March 22, 2017

# Independent Auditor's Report

**To the Shareholders of**
**Excellon Resources Inc.**

We have audited the accompanying consolidated financial statements of Excellon Resources Inc., which comprise the consolidated statements of financial position as at December 31, 2016 and 2015 and the consolidated statements loss and comprehensive loss, statements of change in equity and statements of cash flow for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

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

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

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

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

*PricewaterhouseCoopers LLP*
*PwC Tower, 18 York Street, Suite 2600, Toronto, Ontario, Canada M5J 0B2*
*T: +1 416 863 1133, F: +1 416 365 8215*

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

**(Signed) "PricewaterhouseCoopers LLP"**

**Chartered Professional Accountants, Licensed Public Accountants**

# Excellon Resources Inc.

## Consolidated Statements of Financial Position

(in thousands of U.S. dollars)

| | *Notes* | December 31, 2016 $ | December 31, 2015 $ |
|---|---|---|---|
| **Assets** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | | 5,409 | 3,506 |
| Marketable securities | *5* | 1,521 | - |
| Trade receivables | | 738 | 464 |
| VAT receivables | *6* | 2,614 | 1,694 |
| Income taxes receivable | | 1,120 | 2,164 |
| Inventories | *7* | 2,151 | 1,404 |
| Other current assets | | 1,071 | 1,307 |
| Assets held for sale | *9* | - | 643 |
| | | 14,624 | 11,182 |
| **Non-current assets** | | | |
| Property, plant and equipment | *8* | 17,267 | 14,499 |
| Mineral rights | *9* | 3,119 | 3,438 |
| Deferred income tax assets | *17* | 9,789 | 8,902 |
| **Total assets** | | 44,799 | 38,021 |
| **Liabilities** | | | |
| **Current liabilities** | | | |
| Trade payables | *10* | 4,514 | 4,713 |
| VAT payables | *7* | 1,556 | 1,021 |
| | | 6,070 | 5,734 |
| **Non-current liabilities** | | | |
| Convertible Debt | *11* | 2,958 | 2,727 |
| Embedded Derivative Liability | *11* | 10,068 | 1,203 |
| Purchase Warrants | *11* | 1,673 | 189 |
| Provisions | *12* | 1,455 | 1,767 |
| **Total liabilities** | | 22,224 | 11,620 |
| **Equity** | | | |
| Share capital | *13* | 88,807 | 77,362 |
| Contributed surplus | | 14,719 | 12,159 |
| Accumulated other comprehensive income | | (16,044) | (12,284) |
| Deficit | | (64,907) | (50,836) |
| **Total equity** | | 22,575 | 26,401 |
| **Total liabilities and equity** | | 44,799 | 38,021 |

The accompanying notes are an integral part of these consolidated financial statements.

| **Approved by the Board** | **Director** | **Director** |
|---|---|---|
| | *"Timothy J. Ryan"* | *"Alan R. McFarland"* |

# Excellon Resources Inc.

## Consolidated Statements of Loss and Comprehensive Loss

## For the years ended December 31, 2016 and 2015

(in thousands of U.S. dollars, except per share data)

| | Notes | December 31, 2016 $ | December 31, 2015 $ |
|---|---|---|---|
| Revenues | *14* | 16,994 | 16,167 |
| Production Costs | | (13,906) | (15,611) |
| Depletion and amortization | | (2,435) | (3,080) |
| Cost of Sales | *15a* | (16,341) | (18,691) |
| **Gross profit (loss)** | | 653 | (2,524) |
| Administrative expenses | | (2,481) | (2,419) |
| Share based payments | *13* | (819) | (700) |
| Depletion and amortization | | (177) | (190) |
| General and administrative expenses | *15b* | (3,477) | (3,309) |
| Exploration | | (1,345) | (685) |
| Other income (expense) | *15c* | (971) | (354) |
| Impairment (reversal) on asset sold | *9* | 156 | (662) |
| Royalty Income | | - | 726 |
| Finance cost | *16* | (11,288) | (446) |
| **Loss before income tax** | | (16,272) | (7,254) |
| Income tax recovery | *18* | 2,201 | 2,214 |
| **Net loss** | | (14,071) | (5,040) |
| **Other comprehensive loss** | | | |
| Foreign currency translation differences | | (3,760) | (5,539) |
| **Total other comprehensive loss** | | (3,760) | (5,539) |
| **Total comprehensive loss** | | (17,831) | (10,579) |

| | | |
|---|---|---|
| **Loss per share** | | |
| Basic | $ (0.21) | $ (0.09) |
| Diluted | $ (0.20) | $ (0.09) |
| **Weighted average number of shares** | | |
| Basic | 65,657,827 | 54,957,682 |
| Diluted | 69,858,501 | 55,015,676 |

The accompanying notes are an integral part of these consolidated financial statements.

# Excellon Resources Inc.

Consolidated Statements of Changes in Equity

For the years ended December 31, 2016 and 2015

(in thousands of U.S. dollars, except per share data)

| | Share capital $ | Contributed surplus $ | Accumulated other comprehensive income (loss) $ | Deficit $ | Total equity $ |
|---|---|---|---|---|---|
| **Balance - January 1, 2015** | 77,323 | 11,504 | (6,745) | (45,796) | 36,286 |
| Net loss for the year | - | - | - | (5,040) | (5,040) |
| Total other comprehensive loss | - | - | (5,539) | - | (5,539) |
| Total comprehensive loss | - | - | (5,539) | (5,040) | (10,579) |
| Employee share options: | | | | | |
| Value of services recognized | - | 211 | - | - | 211 |
| Deferred and Restricted share units | | | | | |
| Value of units recognized | 73 | 393 | - | - | 466 |
| Broker Warrants | | | | | |
| Value of warrants recognized | - | 23 | | | 23 |
| Repurchased shares under normal course issuer bid | (34) | 28 | - | - | (6) |
| **Balance - December 31, 2015** | 77,362 | 12,159 | (12,284) | (50,836) | 26,401 |
| | | | | | |
| **Balance - January 1, 2016** | 77,362 | 12,159 | (12,284) | (50,836) | 26,401 |
| Net loss for the year | - | - | - | (14,071) | (14,071) |
| Total other comprehensive income | - | - | (3,760) | - | (3,760) |
| Total comprehensive loss | - | - | (3,760) | (14,071) | (17,831) |
| Employee share options: | | | | | |
| Value of services recognized | 31 | 59 | - | - | 90 |
| Proceeds on issuing shares | 51 | - | - | - | 51 |
| Deferred and Restricted share units | | | | | |
| Value of units recognized | - | 411 | - | - | 411 |
| Warrants | | | | | |
| Value of warrants issued in Private Placement | - | 454 | - | - | 454 |
| Value of warrants issued in Bought Deal | - | 1,669 | - | - | 1,669 |
| Proceeds on issuing shares | 268 | (33) | - | - | 235 |
| Value of share issued in Private Placement | 1,840 | - | - | - | 1,840 |
| Value of share issued in Bought Deal | 9,023 | - | - | - | 9,023 |
| Conversion of Convertible Debentures | 232 | - | - | - | 232 |
| **Balance - December 31, 2016** | 88,807 | 14,719 | (16,044) | (64,907) | 22,575 |

The accompanying notes are an integral part of these consolidated financial statements.

# Excellon Resources Inc.

## Consolidated Statements of Cash Flow

## For the years ended December 31, 2016 and 2015

(in thousands of U.S. dollars)

| | December 31, 2016 $ | December 31, 2015 $ |
|---|---|---|
| **Cash flow provided by (used in)** | | |
| **Operating activities** | | |
| Net loss for the year | (14,071) | (5,040) |
| Adjustments for: | | |
| Depletion and amortization | 2,612 | 3,270 |
| Deferred income tax | (2,460) | (1,167) |
| Share-based compensation | 501 | 700 |
| Post-employment benefits | - | (65) |
| Rehabilitation provision - accretion | 33 | 67 |
| Rehabilitation provision - change of estimate | (245) | 69 |
| Writedown of property, plant and equipment | 150 | - |
| Impairment (reversal) of assets held for sale | (156) | 662 |
| Convertible debentures - accretion | 324 | 24 |
| Unrealized loss on warrants liability | 1,530 | 62 |
| Unrealized loss on embedded derivative liability | 9,289 | 277 |
| Unrealized loss (gain) on marketable securities | (798) | - |
| Amortization of royalty income | - | (726) |
| Operating cash flows before changes in working capital | (3,291) | (1,867) |
| Changes in items of working capital: | | |
| Trade receivables | (274) | 125 |
| VAT receivable | (920) | (255) |
| Income taxes receivable | 1,044 | 392 |
| Inventories | (747) | 960 |
| Other current assets | 236 | 245 |
| Trade payables | (199) | 576 |
| VAT payable | 535 | (633) |
| **Net cash used in operating activities** | (3,616) | (457) |
| **Investing activities** | | |
| Purchase of property, plant and equipment | (8,193) | (1,626) |
| Purchase of mineral rights | - | (9) |
| **Net cash used in investing activities** | (8,193) | (1,635) |
| **Financing activities** | | |
| Proceeds on issuance of shares from private placement | 2,294 | - |
| Proceeds on issuance of shares from bought deal | 10,692 | - |
| Proceeds from options exercised | 51 | - |
| Proceeds from warrants exercised | 235 | - |
| Proceeds issued on convertible debentures | - | 3,763 |
| Proceeds from issuance of NSR royalty | - | 726 |
| Repurchased shares under normal course issuer bid | - | (6) |
| **Net cash provided by financing activities** | 13,272 | 4,483 |
| **Effect of exchange rate changes on cash and cash equivalents** | 440 | (2,352) |
| **Increase (decrease) in cash and cash equivalents** | 1,903 | 39 |
| **Cash and cash equivalents - Beginning of the year** | 3,506 | 3,467 |
| **Cash and cash equivalents - End of the year** | 5,409 | 3,506 |
| Interest | 190 | 17 |
| Cash paid for income tax | 131 | 219 |

The accompanying notes are an integral part of these consolidated financial statements.

## 1. GENERAL INFORMATION

Excellon Resources Inc. and its subsidiaries (together the Company or Excellon) are involved in the exploration, development and extraction of high-grade silver-lead-zinc metals in Mexico.

Excellon is domiciled in Canada and incorporated under the laws of the province of Ontario. The address of its registered office is 20 Victoria Street, Suite 900, Toronto, Ontario, M5C 2N8, Canada.

## 2. BASIS OF PRESENTATION

*a. Statement of compliance*

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC") which the Canadian Accounting Standards Board has approved for incorporation into Part 1 of the Chartered Professional Accountants of Canada. The consolidated financial statements have been prepared under the historical cost method, except for certain financial instruments measured at fair value. The Company has consistently applied the accounting policies used in preparation of these consolidated financial statements throughout all the periods presented. Critical accounting estimates and judgments used by management in the preparation of these consolidated financial statements are presented in note 4.

All financial information presented in United States dollars has been rounded to the nearest thousand unless otherwise stated.

These consolidated financial statements were approved by the Board of Directors for issue on March 22, 2017.

## 3. SIGNIFICANT ACCOUNTING POLICIES

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

*a. Consolidation*

i. Subsidiaries

Subsidiaries are entities controlled by the Company where control is achieved when the Company has the power to govern the financial and operating policies of the entity. The Company owns directly and indirectly 100% of all the subsidiaries. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Company.

ii. Transactions eliminated on consolidation

Intercompany transactions, balances, income and expenses are eliminated in preparing the consolidated financial statements.

b. *Segment reporting*

The Company has two reportable segments based on a geographical basis. During the year, the consolidated entity operated in Mexico and Canada.

The Mexican operation is principally engaged in the acquisition, exploration, evaluation, and development of mining properties. The Platosa property is in commercial production and is earning revenue through the sale of silver-lead concentrate and silver-zinc concentrate.

The Canadian operations are principally engaged in the acquisition, exploration and evaluation of mining properties in Quebec.

Non-current assets located at the corporate office in Canada are minor in relation to the total.

c. *Foreign currency transactions and translation*

i. Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statements of income. All foreign exchange gains and losses are presented in the statement of income within ‘other expenses’.

ii. Translation

The results and financial position of all the Company entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- Income and expenses for each statement of income and comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions);
- All resulting exchange differences have been recognized in other comprehensive income and accumulated as a separate component of equity in accumulated other comprehensive loss.

d. *Financial instruments*

Financial assets

The Company classifies its financial assets in the following categories: fair value through profit or loss, loans and receivables, and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of financial assets at recognition.

i. Financial assets at fair value through profit or loss

Held for trading ("HFT") financial instruments are financial assets initially recognized at fair value with changes in fair value recorded through income (loss) in the period when they arise. HFT assets are comprised of marketable securities.

ii. Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are classified as current assets or non-current assets based on their maturity date. Loans and receivables are initially recognized at fair value and subsequently carried at amortized cost less any impairment.

Loans and receivables are comprised of cash and cash equivalents and trade and other receivables.

iii. Available-for-sale financial assets

Available-for-sale ("AFS") financial assets are non-derivatives that are either designated as available-for-sale or not classified in any of the other financial asset categories. Available-for-sale assets are initially recorded at fair value plus transaction costs, and are subsequently carried at fair value. All unrealized gains and losses arising from changes in the fair value of assets classified as available-for-sale are recognized directly in other comprehensive income, except for unrealized foreign exchange gains or losses on monetary financial assets and impairment losses which are recognized in the statement of income. Any reversal of a previously recognized impairment loss on a non-monetary asset is recognized directly in other comprehensive income. Realized gains and losses from the derecognition of available-for-sale assets are recognized in the consolidated statement of loss in the period derecognized with any unrealized gains or losses being recycled from other comprehensive loss. The Company does not currently hold any of this type of financial asset.

Financial liabilities

Financial liabilities are classified either as financial liabilities at fair value through profit or loss, or other financial liabilities. The Company's financial liabilities include trade payables, convertible debt and derivative financial instruments.

Financial liabilities are measured at amortized cost using the effective interest method. Convertible debt is recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Financial liabilities at fair value through profit or loss include financial liabilities designated upon initial recognition at fair value through profit or loss and are carried at fair value with subsequent changes in fair value recognized in other expense in the consolidated statements of loss. The embedded derivative and equity settled warrants issued by the Company are classified as financial liabilities at fair value through profit or loss.

Financial assets and liabilities are offset and the net amount presented in the consolidated balance sheet when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

*e.* Cash and Cash equivalents

Cash and cash equivalents consist of cash on hand, bank deposits and highly liquid short-term investments with a maturity date of three months or less when acquired.

*f.* *Inventories*

Silver-lead and silver-zinc in concentrate and ore stockpiles are physically measured or estimated and valued at the lower of cost or net realizable value. Net realizable value is the estimated selling price, less estimated costs of completion and costs of selling final product.

Cost is determined by the weighted average method and comprises direct purchase costs and an appropriate portion of fixed and variable overhead costs, including amortization, incurred in converting materials into finished goods. The cost of production is allocated to joint products using a ratio of spot prices by volume at each month end. Separately identifiable costs of conversion of each metal are specifically allocated.

Materials and supplies are valued at the lower of cost or net realizable value. Any provision for obsolescence is determined by reference to specific items. A regular review is undertaken to determine the extent of any provision for obsolescence by comparing those item to their replacement costs.

When inventories have been written down to net realizable value, the Company makes a new assessment of net realizable value in each subsequent period. If the circumstances that caused the write-down no longer exist, the remaining amount of the write-down is reversed.

*g.* *Property, plant and equipment*

Property, plant and equipment are carried at cost less accumulated amortization and any impairment charges.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate assets (major components) of property, plant and equipment.

The cost of replacing a part of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

Amortization is recorded over the useful life of the asset, or over the remaining life of the mine, if shorter, as follows:

- Mining properties – on a units-of-production basis;
- Associated mining equipment – 3-10 years on a straight line basis;

- Buildings – 20 years on a straight line basis; and
- Processing equipment – 4-8 years on a straight line basis.

Amortization charges on a unit-of-production basis are based on measured and indicated mineral resources.

The method of amortization, estimates of residual values and useful lives are reassessed at least at each financial year-end, and any change in estimate is taken into account in the determination of future amortization charges.

h. *Exploration and evaluation expenditures*

Acquisitions of mineral rights are capitalized. Subsequent exploration and evaluation costs related to an area of interest are expensed as incurred on a project-by-project basis pending determination of indicated resources. Upon determination of indicated resources, further development costs are capitalized. When a licence is relinquished or a project is abandoned, the related costs are immediately recognized in profit or loss.

Exploration properties that contain estimated Proven and Probable Mineral Reserves, but for which a development decision has not yet been made, are subject to periodic review for impairment when events or changes in circumstances indicate the project's carrying value may not be recoverable.

Exploration and evaluation assets are reclassified to "Mine Properties - Mines under construction" when the technical feasibility and commercial viability of extracting the Mineral Resources or Mineral Reserves are demonstrable and construction has commenced or a decision to construct has been made. Exploration and evaluation assets are assessed for impairment before reclassification to "Mines under construction", and the impairment loss, if any, is recognized in profit or loss.

i. *Development expenditure*

Development expenditures incurred by or on behalf of the Company are accumulated separately for each area of interest in which an indicated resource has been identified. Such expenditures comprise costs directly attributable to the construction of a mine and the related infrastructure.

General and administrative costs are allocated to a development asset only to the extent that those costs can be related directly to development activities in the relevant area of interest.

Once a development decision has been taken, the development expenditure is classified under property, plant and equipment as ''development properties''.

A development property is reclassified as a "mining property'' at the end of the commissioning phase, when the mine is capable of operating in the manner intended by management.

No amortization is recognized in respect of development properties until they are reclassified as "mining properties''.

Each development property is tested for impairment in accordance with the policy in note *3 m ii Impairment*.

j. *Mining properties*

When further development expenditures are incurred in respect of a mining property after the commencement of production, such expenditures are carried forward as part of the mining property when it is probable that additional future economic benefits associated with the expenditure will flow to the consolidated entity. Otherwise such expenditures are classified as a cost of production.

Amortization is charged using the units-of-production method. The units-of-production basis results in an amortization charge proportional to the depletion of measured and indicated resources.

Mine properties are tested for impairment in accordance with the policy in note *3 m ii Impairment*.

k. *Decommissioning and site rehabilitation provision*

The Company records the present value of estimated costs of legal and constructive obligations required to restore operating locations in the period in which the obligation is incurred. The nature of these restoration activities includes dismantling and removing structures, rehabilitating mines and tailings dams, dismantling operating facilities, closure of plant and waste sites, and restoration, reclamation and re-vegetation of affected areas.

The obligation is attributable to development when the asset is installed or the environment is disturbed at the production location. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a discount rate that reflects the current market assessments of the time value of money. When the liability is initially recognized, the present value of the estimated cost is capitalised by increasing the carrying amount of the related mining asset.

The periodic unwinding of the discount applied in establishing the net present value of provisions due to the passage of time is recognized in the consolidated statement of income as a finance cost. Changes in the rehabilitation estimate attributable to development will be recognized as additions or charges to the corresponding assets and rehabilitation liability when they occur.

l. *Mineral Rights*

Mineral rights are carried at cost and amortized using a units-of-production method based on the resources that exist in the location that has access to such rights.

Methods of amortization and estimated useful lives are reassessed annually and any change in estimate is taken into account in the determination of future amortization charges.

m. *Impairment*

i. Financial assets

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

ii. Non-financial assets

The carrying amounts of the Company's non-financial assets, primarily property, plant and equipment and mineral rights, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset or CGU recoverable amount is estimated. Recoverability of assets or CGU (mine operation) to be held and used are measured by a comparison of the carrying value of the asset to the recoverable amount, which is the higher of value in use and fair value less costs to sell.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets.

An impairment loss is recognized if the carrying amount of an asset or the CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of the CGU are allocated to reduce the carrying amount of long-lived assets in the unit on a pro rata basis.

Non-financial assets that have been impaired in prior periods are tested for possible reversal of impairment whenever events or changes in circumstances indicate that the impairment has reversed. If the impairment has reversed, the carrying amount of the asset is increased to its recoverable amount but not beyond the carrying amount that would have been determined had no impairment loss been recognized for the asset in the prior periods. A reversal of an impairment loss is recognized into earnings immediately.

*n.* Future Termination Benefits

Employees of the Company's Mexican mines are entitled by local labor laws to employee leaving indemnities, generally based on each employee's length of service, employment category and remuneration.

The cost of these retirement benefits is determined using the projected unit credit method. Current service cost and any past service cost are recognized in the same line item in the statements of income as the related compensation cost. Changes in actuarial assumptions used to determine the accrued benefit obligation are recognized in full in the period in which they occur, in the statements of income.

The most significant assumptions used in accounting for post employment benefits are the discount rate, the mortality and the life of mine assumptions. The discount rate is used to determine the net present value of future liabilities. Each year, the unwinding of the discount on those liabilities is charged to the Company's income statement as the interest cost. The life of mine and mortality assumptions are used to project the future stream of benefit payments, which is then discounted to arrive at a net present value of liabilities. The values attributed to the liabilities are assessed in accordance with the advice of independent qualified actuaries.

*o. Current and deferred income tax*

The tax expense for the period comprises current and deferred tax. Tax is recognized in the statement of income and comprehensive income, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case the tax is also recognized in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws substantively enacted at the balance sheet date in the countries where the Company's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss. Deferred income tax is provided on temporary differences arising on investments in subsidiaries except in the case of a subsidiary where timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred income tax is determined on a non discount basis using tax rates (and laws) that have been substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The Company recognizes neither the deferred tax asset regarding the temporary difference on the rehabilitation liability, nor the corresponding deferred tax liability regarding the temporary difference on the rehabilitation asset.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

i. Royalties

Royalties, resource rent taxes and revenue-based taxes are accounted for under taxes when they have the characteristics of an income tax. This is considered to be the case when they are imposed under Government authority and the amount payable is based on taxable income – rather than based on quantity produced or as a percentage of revenue – after adjustment for temporary differences. For such arrangements, current and deferred tax is provided on the same basis as described above for other forms of taxation. Obligations arising from royalty arrangements that do not satisfy these criteria are recognized as current provisions and included in cost of sales. The 7.5% Mexican mining royalty is based on earnings before interest tax, depreciation and amortization (EBITDA), a non-gaap measure and an extraordinary mining royalty of 0.5% on precious metals revenue, is treated as an income tax in accordance with IFRS for financial reporting purpose, as it is based on a measure of revenue less certain specified costs.

*p. Share-based payments*

i. Share option plan

Employees (including directors and senior executives) of the Company receive a portion of their remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments (“equity-settled transactions”).

In situations where equity instruments are issued to non-employees and some or all of the goods or services received by the Company, as consideration cannot be specifically identified, they are measured at fair value of the share-based payment. Otherwise, share-based payments are measured at the fair value of goods or services received.

ii. Equity-settled transactions

The costs of equity-settled transactions with employees are measured by reference to the fair value at the date on which they are granted using the Black-Scholes option-pricing model.

The costs of equity-settled transactions are recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense is recognized for equity-settled transactions at each reporting date until the vesting date reflects the Company's best estimate of the number of equity instruments that will ultimately vest. The profit or loss charge or credit for a period represents the movement in cumulative expense recognized as at the beginning and end of that period and the corresponding amount is represented in contributed surplus. No expense is recognized for awards that do not ultimately vest.

Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

The dilutive effect of outstanding options is reflected as additional dilution in the computation of earnings per share.

iii. Cash-settled transactions

A Deferred Share Unit ("DSU") Plan was established for directors and certain employees in 2013. The cost of the DSUs is measured initially at fair value based on the closing price of the Company's common shares preceding the day the DSUs are granted. The cost of the DSUs is recognized as a liability under share based compensation plans in the consolidated statements of financial position and as a general and administrative expense in the consolidated statements of earnings. The liability is remeasured to fair value based on the market price of the Company's common shares at each reporting date up to and including the settlement date, with changes in fair value recognized in general and administrative expenses in the consolidated statements of earnings.

On April 29, 2014, the plan was amended and approved by the Company's shareholders allowing for DSUs to be paid in cash or in awards of common shares either from treasury or from market purchases. Accordingly, the expense is recorded in the consolidated statement of loss and comprehensive loss in share based payments and credited to equity under contributed surplus since the payment in cash or common shares is at the option of the Company.

A Restricted Share Unit ("RSU") Plan was established for directors, certain employees and eligible contractors of the Company. The RSUs vest equally over a three year period and are paid in cash based on the Market Price of the Company's publicly traded common shares on the entitlement date or dates. The cost of the RSUs is measured initially at fair value on the authorization date based on the market price of the Company's common shares preceding the day the RSUs are authorized by the Board of Directors. The cost of RSUs is recognized as a liability under share based compensation plans, with the current portion recognized in accounts payable and accrued liabilities, in the consolidated statements of financial position and as a general and administrative expense in the consolidated statements of earnings over the vesting period. The liability is remeasured to fair value based on the market price of the Company's common shares at each reporting date up to and including the settlement date, with changes in fair value recognized in general and administrative expenses.

On April 29, 2014, the plan was amended and approved by the Company's shareholders allowing for RSUs to be paid in cash or in awards of common shares either from treasury or from market purchases. Accordingly, the expense is recorded in the consolidated statement of loss and comprehensive loss in share based payments and credited to equity under contributed surplus since the payment in cash or common shares is at the option of the Company.

q. *Revenue recognition*

Company policy requires all production to be sold under contract. Revenue is only recognized on individual shipments when persuasive evidence exists that the following criteria are satisfied:

- The significant risks and rewards of ownership of the product have been transferred to the buyer;
- Neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold has been retained;
- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the sale will flow to the Company; and
- The costs incurred or to be incurred in respect of the sale can be measured reliably.

Satisfaction of these conditions depends on the terms of trade with individual customers. Generally, the risks and rewards are considered to have transferred to the customer when title and insurable risk of loss transfer.

Certain products are sold on a 'provisional pricing' basis where the sale price received by the group is subject to a final adjustment at the end of a period that may be up to 90 days after delivery to the customer. The final sale price is based on the market price on the quotational date in the contract of sale. Sales are initially recognized when the revenue recognition criteria have been satisfied, using market prices at that date. At each reporting date the provisionally priced shipment is marked to market based on the forward selling price for the quotational point specified in the contract until that point is reached. Revenue is only recognized on this basis where the forward selling price can be reliably measured.

Many of the Company's sales are subject to an adjustment based on inspection of the shipment by the customer. In such cases, revenue is recognized based on the group's best estimate of the grade at the time of shipment, and any subsequent adjustments are recorded against revenue when advised.

r. *Earnings per share*

Basic earnings per share ("EPS") is calculated by dividing the net income (loss) for the period attributable to equity owners of Excellon by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants and similar instruments is computed using the treasury stock method. Excellon's potentially dilutive common shares comprise stock options granted to employees and warrants.

s. *Accounting standards issued but not yet applied*

*IFRS 9, Financial instruments* ("IFRS 9") was issued by the IASB in November 2009 and will replace IAS 39, "Financial instruments: recognition and measurement" ("IAS 39"). IFRS 9 replaces the multiple rules in IAS 39 with a single approach to determine whether a financial asset is measured at amortized cost or fair value and a new mixed measurement model for debt instruments having only two categories: amortized cost and fair value. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

*IFRS 15, Revenue from contracts with Customers* ("IFRS 15") was issued by the IASB in May 2014. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized. IFRS 15 is effective for annual periods beginning on January 1, 2018. The Company is currently evaluating the impact this standard is expected to have on its consolidated financial statements.

*IFRS 16, Leases* ("IFRS 16") was issued on January 13, 2016. The new standard brings most leases onto the balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. The Company is currently evaluating the impact of IFRS 16 on its consolidated financial statements.

The Company plans to adopt these IFRS accounting standards when these standards become effective, if applicable.

## 4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The following areas involve a higher degree of judgement or are areas where assumptions and estimates are significant to the consolidated financial statements. Actual results may differ significantly from these estimates included in the consolidated financial statements.

i. Valuation of mining properties and other long lived assets

Mining properties and other long-lived assets are reviewed and evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Common indicators of impairment in the mining industry include:

- A significant deterioration in expected future commodity prices;
- A significant adverse movement in foreign exchange rates;
- A significant increase in production costs;
- A large cost overrun during the development and construction of a new mine;
- A significant increase in the expected cost of dismantling assets and restoring the site;
- A significant reduction in the mineral content of ore reserves/resources;

- Serious mine accidents;
- A significant increase in market interest rates; and
- Adverse changes in government regulations and environmental law, including a significant increase in the taxes payable by the mine.

Prior to December 31, 2015 the Company determined that there were indicators of impairment in carrying values for the DeSantis exploration properties in Canada that resulted in an impairment charge being recognized during the year (note 8).

ii. Useful economic life of property, plant and equipment

The cost less the residual value of each item of property, plant and equipment is amortized over its useful economic life. Amortization is charged to cost of production over the shorter of the estimated lives of the individual assets or the life of mine using the units-of-production method. Amortization commences when assets are available for use. Land is not amortized. The assets useful lives, expected units-of-production and methods of amortization are reviewed and adjusted if appropriate at each fiscal year end.

iii. Decommissioning and site rehabilitation provision

The Company records any decommissioning and site rehabilitation obligation as a long-term liability in the period in which the related environmental disturbance occurs, based on the net present value of the estimated future costs (note 9). This obligation is adjusted at the end of each fiscal period to reflect the passage of time and changes in the estimated future costs underlying the obligation. In determining this obligation, management must make a number of assumptions about the amount and timing of future cash flows and discount rate to be used.

The undiscounted estimate of the asset retirement obligation ("ARO") has been discounted to its present value at a risk free rate which represents the five year Government of Canada bond rate and an estimate of the Company's pricing in the market to obtain debt. Assuming that all other variables remain constant, a one percent change in the discount rate would result in the liability change of approximately $35. The estimate also assumes a long term inflation rate. Assuming all other variables remain constant, a one percent change in the long term inflation rate would result in the liability change of approximately $53. Assuming all other variables remain constant, a 10% change in the undiscounted estimate of the ARO would result in the liability change of approximately $97.

iv. Calculation of share-based compensation expense

The amount expensed for stock-based compensation is based on the application of a recognized option valuation formula, which is highly dependent on the expected volatility of the Company's registered shares and the expected life of the options. The Company uses an expected volatility rate for its shares based on past stock trading data, adjusted for future expectations, and actual volatility may be significantly different. While the estimate of stock-based compensation can have a material impact on the operating results reported by the Company, it is a non-cash charge and as such has no impact on the Company's cash position or future cash flows.

v. Determination of reserves and resources

The Company uses the services of experts to estimate the indicated and inferred resources of its mineral properties in Mexico. These experts express an opinion based on certain technological and legal information as prepared by management as being current, complete and accurate as of the date of their calculations and in compliance with National Instrument 43-101. These estimated resources are used in the evaluation of potential impairment of asset carrying values, the useful lives of assets, amortization rates and the timing of cash flows.

(in thousands of U.S. dollars, except share data)

vi. Deferred income taxes

Income taxes are calculated using the liability method of tax accounting. Under this method, current income taxes are recognized for the estimated income taxes payable for the current period. Deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and on unclaimed losses carried forward and are measured using the substantively enacted tax rates that are expected to be in effect when the differences are expected to reverse or losses are expected to be utilized. Deferred tax assets are recorded to recognize tax benefits only to the extent that, based on available evidence, including forecasts, it is probable that they will be realized.

vii. Income taxes

Uncertainties exist with respect to the interpretation of tax regulations. The Company establishes provisions for taxes, based on reasonable estimates, for liabilities to the tax authorities that are uncertain as to their amount and the probability of their occurrence. The amount of such provisions is based on various factors, such as experience with previous tax audits and differing legal interpretations by the taxable entity and the responsible tax authority. The final resolution of some of these items may give rise to a material change in the amount of the income tax expense recorded in consolidated statement of income (loss) and related tax payments

## 5. MARKETABLE SECURITIES

During Q2 2016, the Company completed the sale of the DeSantis Property to Osisko Mining Inc. (“Osisko”) for 837,000 ($843) common shares of Osisko net of commission fees. These securities have been classified as a HFT financial instrument during the year. An unrealized gain of $798 was recorded in income for the year ended December 31, 2016 in recognition of an increase in value as at December 31, 2016.

## 6. INVENTORIES

| | December 31, 2016 $ | December 31, 2015 $ |
|---|---|---|
| Ore | 54 | 50 |
| Concentrate | 465 | 41 |
| Production spares | 1,632 | 1,313 |
| | 2,151 | 1,404 |

(in thousands of U.S. dollars, except share data)

## 7. VAT RECEIVABLES

VAT (value added tax) receivables comprises of the total VAT credits recoverable by each of the Company's Mexican subsidiaries. In Mexico, VAT credits can only be applied to VAT payable specific to each entity and are non-transferable. The Company's VAT payable position is reflected separately on the balance sheet.

## 8. PROPERTY, PLANT AND EQUIPMENT

| | Mining properties $ | Mining equipment $ | Processing equipment $ | Assets under construction $ | Total $ |
|---|---|---|---|---|---|
| At January 1, 2015 | | | | | |
| Cost | 24,482 | 11,072 | 7,094 | 320 | 42,968 |
| Accumulated amortization | (14,097) | (6,004) | (4,483) | - | (24,584) |
| | 10,385 | 5,068 | 2,611 | 320 | 18,384 |
| **Year ended December 31, 2015** | | | | | |
| Opening net book value | 10,385 | 5,068 | 2,611 | 320 | 18,384 |
| Additions | 879 | 161 | - | 586 | 1,626 |
| Amortization | (1,284) | (1,005) | (661) | - | (2,950) |
| Exchange differences | (1,479) | (665) | (324) | (93) | (2,561) |
| Closing net book value | 8,501 | 3,559 | 1,626 | 813 | 14,499 |
| At December 31, 2015 | | | | | |
| Cost | 21,604 | 9,607 | 6,068 | 813 | 38,092 |
| Accumulated amortization | (13,103) | (6,048) | (4,442) | - | (23,593) |
| | 8,501 | 3,559 | 1,626 | 813 | 14,499 |
| **Year ended December 31, 2016** | | | | | |
| Opening net book value | 8,501 | 3,559 | 1,626 | 813 | 14,499 |
| Additions (1) | 1,283 | 1,779 | 114 | 5,017 | 8,193 |
| Reclassification | - | - | - | - | - |
| Disposals | 29 | (179) | - | - | (150) |
| Amortization | (1,220) | (713) | (396) | - | (2,329) |
| Write down | - | - | - | - | - |
| Exchange differences | (1,321) | (681) | (245) | (699) | (2,946) |
| Closing net book value | 7,272 | 3,765 | 1,099 | 5,131 | 17,267 |
| At December 31, 2016 | | | | | |
| Cost | 20,434 | 9,346 | 4,910 | 5,131 | 39,821 |
| Accumulated amortization | (13,162) | (5,581) | (3,811) | - | (22,554) |
| | 7,272 | 3,765 | 1,099 | 5,131 | 17,267 |

(in thousands of U.S. dollars, except share data)

During the year, the Company incurred capital expenditures **of $**4,800 towards an optimization plan (the "Optimization Plan") currently classified as assets under construction.

## 9. MINERAL RIGHTS

| | **Platosa (Mexico) $** | **Beschefer (Canada) $** | **DeSantis (Canada) $** | **Total $** |
|---|---|---|---|---|
| At January 1, 2015 | | | | |
| Cost | 4,534 | 1,723 | 1,292 | 7,549 |
| Accumulated amortization | (1,574) | - | - | (1,574) |
| | 2,960 | 1,723 | 1,292 | 5,975 |
| **Year ended December 31, 2015** | | | | |
| Opening net book value | 2,960 | 1,723 | 1,292 | 5,975 |
| Additions | 9 | - | - | 9 |
| Amortization | (320) | - | - | (320) |
| Impairments (1) | (219) | - | (443) | (662) |
| Reclassified as held for sale (1) | - | - | (643) | (643) |
| Exchange differences | (432) | (283) | (206) | (921) |
| Closing net book value | 1,998 | 1,440 | - | 3,438 |
| At December 31, 2015 | | | | |
| Cost | 3,847 | 1,440 | - | 5,287 |
| Accumulated amortization | (1,849) | - | - | (1,849) |
| | 1,998 | 1,440 | - | 3,438 |
| **Period ended December 31, 2016** | | | | |
| Opening net book value | 1,998 | 1,440 | - | 3,438 |
| Amortization | (283) | - | - | (283) |
| Exchange differences | (86) | 50 | - | (36) |
| Closing net book value | 1,629 | 1,490 | - | 3,119 |
| At December 31, 2016 | | | | |
| Cost | 3,564 | 1,490 | - | 5,054 |
| Accumulated amortization | (1,935) | - | - | (1,935) |
| | 1,629 | 1,490 | - | 3,119 |

(1) At December 31, 2015, the Company reclassified the DeSantis property ("DeSantis") to current assets on the balance sheet as an asset held for sale based on a letter of intent to sell DeSantis entered into in 2015 with Osisko. The Company wrote down the carrying value of DeSantis to an estimated fair value of $643, representing the consideration expected upon closing of the sale. During Q2 2016, the Company received a net total of 837,000 common shares of Osisko for a consideration value of $843 for DeSantis (refer to note 4). As such, the Company recorded a reversal of impairment into income during the year.

(in thousands of U.S. dollars, except share data)

## 10. TRADE PAYABLES

The Company's trade payable comprises of account payables and accruals as at December 31, 2016. Accounts payable account for $3,364 the balance of which $970 related to the acquisition of mining equipment and $687 related to the Optimization Plan. Accruals of $1,150 relate to operating costs, accounting, legal and statutory payroll withholding taxes.

## 11. DEBT

During Q4 2015, the Company completed a $4,766 (CAD$6,600) financing through the private placement of secured convertible debentures of the Company (the "Debentures") valued at $4,040 (CAD$5,610) and the sale of a net smelter return royalty (the "NSR") on the Platosa Project valued at $726 (CAD$990), collectively the "Debenture Financing".

The net proceeds from the Debenture Financing were budgeted for the Optimization Plan at the Platosa Mine and for general corporate purposes.

| | At inception date $ | Fair value adjustments $ | December 31, 2015 $ |
|---|---|---|---|
| **A - Proceeds from Convertible Debentures** | | | |
| Gross proceeds | 4,040 | 356 | 4,396 |
| Less transaction costs | (277) | - | (277) |
| Net proceeds | 3,763 | 356 | 4,119 |
| **B - Proceeds from NSR Royalty** | | | |
| Gross proceeds | 726 | - | 726 |
| Less transaction costs | - | - | - |
| Net proceeds | 726 | - | 726 |
| Total gross proceeds | 4,766 | 356 | 5,122 |
| Total transaction costs | (277) | - | (277) |
| **Total net proceeds** | **4,489** | **356** | **4,845** |

A - Convertible Debentures

The Debentures have a term of four years and are convertible into common shares ("Common Shares") of the Company prior to maturity at a conversion price of CAD$0.50 per Common Share. The Debentures bear interest at an annual rate of 3.75%, payable in cash semi-annually. Interest on the Debentures may alternatively be paid in Common Shares of the Company at the Company's option based on (i) the 10-day volume-weighted average price ("VWAP") of the Common Shares prior to the payment date and (ii) an effective rate of interest of 5% for the applicable period.

(in thousands of U.S. dollars, except share data)

The repayments of principal and interest are summarized as follows:

| | Within 1 year $ | 2-5 years (1) $ | Total $ |
|---|---|---|---|
| Convertible Debentures (principal & interest) | 157 | 4,263 | 4,420 |

(1) Assumes that the Debentures are not converted to Common Shares prior to Maturity.

On or after November 27, 2017, the second anniversary of the date of issue and prior to maturity, the Company may accelerate the conversion of the Debentures as follows: (i) 50% of the principal amount, provided that the 20-day VWAP of the Common Shares is CAD$1.10; and (ii) the remaining 50% principal amount provided that the 20-day VWAP of the Common Shares is CAD$1.40.

On May 27, 2017 or the “Put Date”, Debenture holders will have the option to request repayment in cash of the outstanding principal amount of the Debentures plus accrued interest by providing the Company with two months prior written notice and a one month period for repayment following the Put Date.

The Company also issued a total of 2,002,772 Common Share purchase warrants (“$0.50 Warrants“) to the purchasers of the Debentures in connection with the financing. Each $0.50 Warrant is exercisable at a price of CAD$0.50 for a period of four years from the date of issuance.

In connection with the Debenture Financing, the Company granted 480,000 broker warrants (the “Broker Warrants”) entitling the holder to purchase one Common Share at an exercise price of CAD$0.50 per Common Share for a period of three years from the closing of the Financing.

In accordance with IAS 39, Financial Instruments: Recognition and Measurement, the Debentures are considered to contain an embedded derivative relating to the conversion option. The conversion option was valued upon initial recognition at fair value using an option pricing model and was separated from the debt component of the Debentures. The debt component of the Debentures was measured upon initial recognition, based on the present value of the cash flows associated with the Debentures. Subsequent to initial recognition, the embedded derivative component is re-measured at fair value at each reporting date while the debt component is accreted to the face value of the Debentures using the effective interest rate through periodic charges to finance expense over the term of the Debentures. Accretion for the year ended December 31, 2016 was $324.

Fair value adjustment for the embedded derivative relating to the conversion option for the year ended December 31, 2016 was $9,211, which was recorded in finance cost.

Also in accordance with IAS 39, Financial Instruments: Recognition and Measurement, the $0.50 Warrants were detached from the convertible Debentures host contract and recognized as a separate financial liability. The $0.50 Warrants were fair valued using the Black-Scholes Model upon initial recognition based on the $0.50 Warrants terms. The fair value adjustment of the $0.50 Warrants for the year ended December 31, 2016 as $1,530, which was recorded in finance cost.

During the year ended December 31, 2016, the Company paid interest of $190 (CAD$242) on the Debentures.

During the year ended December 31, 2016, Debentures of $232 (CAD$307) was converted into 615,000 common shares. As at December 31, 2016, the value of the Debentures outstanding was CAD$5,303.

During the year, 631,726 of $0.50 Warrants were exercised for proceeds of $235 (CAD$316). As at

(in thousands of U.S. dollars, except share data)

December 31, 2016, there were 1,851,046 of $0.50 Warrants outstanding.

The components of the Debentures are summarized as follows:

| | January 1, 2016 | Accretion | Interest payments | Conversions | Fair value adjustments | Exchange adjustments | Dec 31, 2016 |
|---|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ | $ |
| **Convertible Debentures breakdown** | | | | | | | |
| Convertible Debt | 2,727 | 441 | (160) | (154) | - | 104 | 2,958 |
| Embedded Derivative Liability | 1,203 | - | - | (78) | 9,289 | (346) | 10,068 |
| $0.50 Purchase Warrants | 189 | - | - | - | 1,530 | (46) | 1,673 |
| **Total** | **4,119** | **441** | **(160)** | **(232)** | **10,819** | **(288)** | **14,699** |

The above components have been classified as non-current liabilities on the balance sheet.

B - Net Smelter Return Royalty

The NSR applies to the Platosa Project and bears a rate of either (a) 1.25% in respect of manto or mineralization other than skarn mineralization or (b) 0.50% in respect of skarn or “Source” mineralization. Payments are made in cash semi-annually. The NSR proceeds of $726 were amortized into income in 2015.

NSR royalty expensed for the year ended December 31, 2016 was $188.

(in thousands of U.S. dollars, except share data)

## 12. PROVISIONS

| | Post-retirement benefits (1) $ | Rehabilitation provision (2) $ | Total $ |
|---|---|---|---|
| **Year ended December 31, 2015** | | | |
| Opening balance | 669 | 1,315 | 1,984 |
| Change in estimate | (65) | 69 | 4 |
| Accretion for the year | - | 67 | 67 |
| Exchange differences | (92) | (196) | (288) |
| Closing Balance | 512 | 1,255 | 1,767 |
| **Period ended December 31, 2016** | | | |
| Opening balance | 512 | 1,255 | 1,767 |
| Change in estimate | - | (245) | (245) |
| Accretion for the period | - | 33 | 33 |
| Exchange differences | (86) | (14) | (100) |
| Closing Balance | 426 | 1,029 | 1,455 |

(1) Post-retirement benefits: The Company provides post retirement benefits supplements as well as leaving indemnities to employees at the Mexican operations. Under Mexican Labour Law, the Company provides statutorily mandated severance benefits to its employees terminated under certain circumstances. Such benefits consist of a one-time payment of three months wages plus 20 days wages for each year of service payable upon involuntary termination without just cause. Key financial assumptions used in the above estimate include an annual discount rate of 6.8% (December 31, 2015 – 6%) based on the yield curve from short and long term Mexican government bonds, annual salary and minimum wage increase rate of 3.75% (December 31, 2015 – 3.6%) and the life of mine of approximately five years.

(2) Rehabilitation provision: Key financial assumptions used in the above estimate include an annual discount rate of 4.5% (December 31, 2015 – 2.9%) based on the current risk-free borrowing rate, Mexican inflation rate and the life of mine of five years. The total undiscounted amount of estimated cash flows required to settle the Company's obligations is $1,279 of which $813 relates to the Platosa mine, and $466 relates to the Miguel Auza mine property. The present value of the total discounted obligation is $1,029 of which $654 relates to the Platosa mine and $375 relates to the Miguel Auza mine property.

(in thousands of U.S. dollars, except share data)

## 13. SHARE CAPITAL

| | Number of shares (000's) | $ |
|---|---|---|
| **Year ended December 31, 2015** | | |
| Opening balance | 54,904 | 77,323 |
| Shares issued on exercise of stock options | 153 | 73 |
| Shares purchased under normal course issuer bid | (32) | (34) |
| Balance at December 31, 2015 | 55,025 | 77,362 |
| **Period ended December 31, 2016** | | |
| Opening balance | 55,025 | 77,362 |
| Shares issued on exercise of stock options | 113 | 82 |
| Shares issued on exercise of warrants | 632 | 268 |
| Shares issued on conversion of convertible debenture | 615 | 232 |
| Shares issued from private placement (1) | 6,667 | 1,840 |
| Shares issued from bought deal (2) | 13,250 | 9,023 |
| Shares returned to treasury (3) | (323) | - |
| Balance at December 31, 2016 | 75,979 | 88,807 |

(1) On April 4, 2016, the Company completed a non-brokered equity private placement (the "Unit Financing") in the Company for gross proceeds of CAD$3,000 through the issuance of 6,666,667 units (each a "Unit") at a price of $0.45 per unit. Each Unit comprised one Common Share and one half warrant of the Company ("$0.65 Warrant"), with each whole $0.65 Warrant entitling the holder to purchase one additional Common Share of the Company at a price of CAD$0.65 per share for a period of 24 months from the closing date.

A finder's fee of CAD$60 was paid in respect of the Unit Financing.

The net proceeds of CAD$2,940 were allocated proportionally between the fair values of the common shares and the $0.65 Warrants issued in the Unit Financing.

(2) On July 26, 2016, the Company completed a bought deal public offering (the "Bought Deal") of 13,250,000 units ("Public Units") at a price of CAD$1.15 per Public Unit for gross proceeds of CAD$15,238 (the "Offering"). Each Public Unit comprises one Common Share and one half-warrant ("$1.75 Warrant") with each whole warrant entitling the holder to acquire a Common Share at a price of CAD$1.75 for a period of 24 months from the closing date.

A broker's fee of CAD$914 was paid in respect of the Bought Deal.

The net proceeds after transaction costs of CAD$13,953 were allocated proportionally between the fair values of the common shares and the warrants issued in the Bought Deal.

(3) During Q2 2016, the Company returned 322,887 Common Shares to treasury relating to the purchase of Destorbelle Mines Limited ("Destorbelle") in 2004. Under the terms of that transaction, each shareholder of Destorbelle was entitled to receive 3.25 Common Shares (pre-consolidation; 0.65 Common Shares post-consolidation) and $0.60 cash for each

(in thousands of U.S. dollars, except share data)

Destorbelle share. The Common Shares returned to treasury represent the entitlement of unexchanged Destorbelle shares as of 2016. The Company may issue Common Shares to any holders of unexchanged Destorbelle shares from time-to-time upon deposit of Destorbelle shares for exchange. As at December 31, 2016, 322,887 Common Shares remain potentially issuable upon exchange of Destorbelle shares.

*STOCK OPTION PLAN (EQUITY-SETTLED)*

The Company has a stock option plan that entitles directors, officers, employees and consultants to purchase Common Shares. Under the program, the Company may grant options to purchase Common Shares ("Options") for up to 10% of the Common Shares issued and outstanding. The exercise price of each Option may not be less than the market price of the Common Shares on the date of grant and each Option may have a maximum term is five years. Options may be granted by the board of directors at any time with varying vesting conditions.

*Disclosure of share option program*

The number and weighted average exercise prices of Options are as follows:

| | Weighted Average Exercise Price (CAD) | Options Outstanding |
|---|---|---|
| Outstanding at January 1, 2015 | $ 2.65 | 2,752,000 |
| Granted | $ 0.53 | 815,000 |
| Expired | $ 4.90 | (273,000) |
| Forfeited | $ 2.39 | (750,000) |
| Outstanding at December 31, 2015 | $ 1.80 | 2,544,000 |
| Exercisable at December 31, 2015 | $ 2.12 | 2,025,683 |

| | | |
|---|---|---|
| Outstanding at January 1, 2016 | $ 1.80 | 2,544,000 |
| Granted | $ 1.62 | 140,000 |
| Exercised | $ 0.58 | (113,335) |
| Expired | $ 4.40 | (40,000) |
| Forfeited | $ 1.68 | (100,000) |
| Cancelled (1) | $ 3.08 | (929,000) |
| Outstanding at December 31, 2016 | $ 1.03 | 1,501,665 |
| Exercisable at December 31, 2016 | $ 1.08 | 1,171,679 |

(1) The Company cancelled 929,000 Options, all of which were fully vested and had no financial impact upon cancellation.

(in thousands of U.S. dollars, except share data)

Options outstanding and exercisable were as follows:

| CAD | Stock Options Outstanding | Weighted Average Remaining Contractual Life (years) | Stock Options Exercisable | Weighted Average Exercise Price (CAD) |
|---|---|---|---|---|
| $0.00 to $0.49 | 136,666 | 4.00 | 86,673 | $ 0.31 |
| $0.50 to $0.99 | 459,999 | 3.26 | 273,340 | $ 0.57 |
| $1.14 to $1.49 | 635,000 | 2.00 | 635,000 | $ 1.17 |
| $1.50 to $1.99 | 170,000 | 4.32 | 76,666 | $ 1.74 |
| $2.00 to $2.50 | 100,000 | 0.82 | 100,000 | $ 2.10 |
| | 1,501,665 | 2.75 | 1,171,679 | $ 1.08 |

*Inputs for measurement of grant date fair values*

The grant date fair value of the Options were measured based on the Black-Scholes formula. Expected volatility is estimated by considering historic average share price volatility. The inputs used in the measurement of the fair values at grant date of the Options were the following:

| | 2016 | 2015 |
|---|---|---|
| Fair value at grant date | $0.98 | $0.32 |
| Share price at grant date | $1.56 | $0.53 |
| Exercise price | $1.56 | $0.53 |
| Risk free interest rate | 0.83% | 65.00% |
| Expected life of options in years | 5.00 | 5.00 |
| Expected volatility | 79.97% | 74.40% |
| Expected dividend yield | 0.00% | 0.00% |
| Estimated forfeiture rate | 5.04% | 5.04% |

*Share-based compensation expense*

Compensation expense is recognized over the vesting period of the grant with the corresponding equity impact recorded in contributed surplus. Share-based compensation expense is comprised of the following costs:

| | 2016 $ (CAD) | 2015 $ (CAD) |
|---|---|---|
| Share options granted in 2013 | - | 85 |
| Share options granted in 2014 | 4 | 19 |
| Share options granted in 2015 | 58 | 163 |
| Share options granted in 2016 | 57 | - |
| | 119 | 267 |

(in thousands of U.S. dollars, except share data)

*DEFERRED SHARE UNITS ("DSU")*

The Company has implemented a DSU plan, primarily in respect of director compensation, whereby DSUs granted may be paid in cash or in awards of Common Shares either from treasury or from market purchases based on the five-day volume weighted average price ("Market Price") of the Common Shares on settlement dates elected by the holder between the retirement date and December 15th of the calendar year subsequent to the year of the holder's retirement. All grants under the plan are fully vested upon credit to an eligible holder's' account. The value of the cash payout is determined by multiplying the number of DSUs vested at the payout date by the Market Price of Common Shares. The expense is recorded in the consolidated statement of loss and comprehensive loss in share based payments and credited to equity under contributed surplus as the payment in cash or Common Shares is at the option of the Company.

*Disclosure of DSU program*

DSUs outstanding are as follows:

| | **DSUs Outstanding** |
|---|---|
| Outstanding at January 1, 2015 | 371,426 |
| Granted | 1,403,265 |
| Settled | (153,282) |
| Outstanding at December 31, 2015 | 1,621,409 |
| Granted | 349,227 |
| Outstanding at December 31, 2016 | 1,970,636 |

During the year ended December 31, 2016, the Company granted 349,227 DSUs (2015 – 1,403,265 DSUs) with a market value of CAD$399 (2015 - CAD$561) at the date of grant to non-executive directors as compensation in lieu of cash director fees and other compensation.

During the year ended 2016, there were nil DSUs settled for common shares (2015 – 153,282 DSUs).

Total share based compensation expensed in the year ended December 31, 2016 related to vested DSUs was CAD$398 (2015 – CAD$561). As at December 31, 2016, 1,970,636 DSUs were outstanding.

*RESTRICTED SHARE UNITS ("RSU")*

The Company has implemented a RSU Plan whereby officers, employees and consultants may be entitled to either a cash payment or an award of common shares from treasury or from market purchases at the end of a term or performance period of up to three years following the date of the grant of applicable RSUs. The value of the cash payout is determined by multiplying the number of RSUs vested at the payout date by the Market Price of the Common Shares prior to a payout date with settlement in cash. The expense is recorded in the consolidated statement of loss and comprehensive loss in share based payments and credited to equity under contributed surplus as the payment in cash or Common Shares is at the option of the Company.

(in thousands of U.S. dollars, except share data)

*Disclosure of RSU program*

RSUs outstanding are as follows:

| | RSUs Outstanding |
|---|---|
| Outstanding at January 1, 2015 | 293,507 |
| Granted | 870,000 |
| Forfeited | (113,596) |
| Outstanding at December 31, 2015 | 1,049,911 |
| Granted | 410,000 |
| Settled | (214,911) |
| Outstanding at December 31, 2016 | 1,245,000 |

During the year ended December 31, 2016, the Company granted 230,000 RSUs subject to performance vesting conditions (2015– 875,000) with a market value of CAD$308 (2015 – CAD$380) at the date of grant to officers, employees and consultants.

During the year ended December 31, 2016, the Company granted 180,000 RSUs subject to time vesting conditions (2015 – nil) with a market value of CAD$332 at the date of grant to officers, employees and consultants.

During the year ended December 31, 2016, the Company settled 214,911 RSUs in cash for CAD$417 (2015 – nil).

Total share based compensation expensed in the year ended December 31, 2016 related to RSUs was CAD$343 (2015 – CAD$71). As at December 31, 2016, 1,245,000 RSUs were outstanding.

*WARRANTS*

*Disclosure of Common Share Purchases Warrants outstanding*

Common share purchase warrants (aggregating $0.50 Warrants, $0.65 Warrants and $1.75 Warrants) outstanding are as follows:

| | Weighted Average Exercise Price (CAD) | Warrants Outstanding |
|---|---|---|
| Outstanding at January 1, 2015 | $ - | - |
| Granted (1) | $ 0.50 | 2,482,772 |
| Outstanding at December 31, 2015 | $ 0.50 | 2,482,772 |
| | | |
| Outstanding at January 1, 2016 | $ 0.50 | 2,482,772 |
| Granted (2) | $ 1.38 | 9,958,333 |
| Exercised (3) | $ 0.50 | (631,726) |
| Outstanding at December 31, 2016 | $ 1.24 | 11,809,379 |

(in thousands of U.S. dollars, except share data)

(1) During Q4 2015, the Company issued a total of 2,002,772 $0.50 Warrants to purchasers of the Debentures in the Debenture Financing described in note 6. The $0.50 Warrants had a fair valued of $128 upon issuance and were recorded as a financial liability subject to fair value adjustments.

The Company also granted 480,000 Broker Warrants. The Broker Warrants had a fair value of $32 and were considered an equity share-based payment transaction that was accordingly recorded into equity.

(2) During the year ended December 31,2016, the Company completed the following transactions:
   *A.* the Unit Financing and issued 3,333,333 $0.65 Warrants.
   *B.* the Bought Deal and issued 6,625,000 $1.75 Warrants.

(3) During the year ended December 31, 2016, 631,726 $0.50 Warrants were exercised for CAD$316.

During the year ended December 31, 2016, the Company recognized a fair value adjustment of $1,530 on the Warrants related to the Debentures, which was recorded in finance cost (2015 - $62).

As at December 31, 2016, the following common share purchase warrants were outstanding:

| Exercise Price (CAD) | | Warrants Outstanding | Weighted Average Remaining Contractual Life (years) | Expiry Date |
|---|---|---|---|---|
| $ | 0.50 | 1,851,046 | 2.91 | November 27, 2019 |
| $ | 0.65 | 3,333,333 | 1.26 | April 4, 2018 |
| $ | 1.75 | 6,625,000 | 1.57 | July 26, 2018 |
| | | 11,809,379 | 1.69 | |

## 14. REVENUES

Under the terms of the Company's concentrate sales contracts, lead–silver and zinc-silver concentrates are sold on a provisional pricing basis whereby sales are recognized at prevailing metal prices when the revenue recognition criteria have been met, namely when title, and risks and rewards of ownership have transferred to the customer. Revenue is recorded net of treatment and refining charges. Final pricing of each delivery is not determined until one or two months post-delivery. The price recorded at the time of sale may differ from the actual final price received from the customer due to changes in market prices for metals. The price volatility is considered an embedded derivative in accounts receivable. The embedded derivative is recorded at fair value by mark-to market adjustments at each reporting period until settlement occurs, with the changes in fair value recorded to revenues. An amount of $503 is included in the trade receivables as at December 31, 2016 (as at December 31, 2015 – $205).

During the year ended December 31, 2016, the Company recognized positive adjustment to revenues of $265 primarily related to the reversal of the mark to market taken at the end of 2015 as receivables were ultimately settled at higher values in 2016 (2015 – positive adjustment of $136).

As at December 31, 2016, provisionally priced sales totalled $2,100, which are expected to settle at final prices during the first quarter of 2017. A 10% increase or decrease in the prices of silver, lead and zinc will result in a corresponding increase or decrease in revenues of $210 during the first quarter of 2017.

(in thousands of U.S. dollars, except share data)

## 15. EXPENSE BY NATURE

(a) Cost of sales comprises the following:

| | 2016 | 2015 |
|---|---|---|
| | $ | $ |
| Direct mining and milling costs (1) | 14,376 | 15,318 |
| Changes in inventories | (470) | 293 |
| Depletion, depreciation and amortization | 2,435 | 3,080 |
| **Cost of sales** | 16,341 | 18,691 |

(1) Direct mining and milling costs include personnel, general and administrative, fuel and electricity, maintenance and repair costs as well as operating supplies, external services, third party smelting, refining and transport fees.

(b) General and administrative expenses consist of the following:

| | 2016 | 2015 |
|---|---|---|
| | $ | $ |
| Office and overhead costs | 1,373 | 1,331 |
| Salaries and wages | 1,108 | 1,088 |
| Share based compensation | 819 | 700 |
| Depletion and amortization | 177 | 190 |
| **General and administrative expenses** | 3,477 | 3,309 |

(c) Other expense (income) consist of the following:

| | 2016 | 2015 |
|---|---|---|
| | $ | $ |
| Unrealized loss (gain) on marketable securities | (798) | - |
| Foreign exchange loss (gain) | 1,526 | 284 |
| Change in provision estimates | 243 | 70 |
| **Other expense (income)** | 971 | 354 |

(in thousands of U.S. dollars, except share data)

## 16. FINANCE COST

Finance expense comprises the following:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Interest Expense | 190 | 16 |
| Rehabilitation provision - accretion | 33 | 67 |
| Convertible debentures - accretion | 324 | 24 |
| Loss on change in fair value of purchase warrants | 1,530 | 62 |
| Loss on change in fair value of embedded derivative liability | 9,211 | 277 |
| **Finance Cost** | 11,288 | 446 |

## 17. RELATED PARTIES

The corporate secretary of the Company is a partner in a firm that provides legal services to the Company. During the year ended December 31, 2016, the Company incurred legal services of $134 (2015 - $157). As at December 31, 2016, the Company had an outstanding payable balance of $5 (December 31, 2015 – $154).

## 18. INCOME TAX

The Company's provision for (recovery of) income taxes differs from the amount computed by applying the combined Canadian federal and provincial income tax rates to income (loss) before income tax as a result of the following:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **Statutory tax rates** | **26.50%** | **26.50%** |
| Income taxes (recovery) computed at the statutory rates | (4,312) | (1,948) |
| Non-deductible (taxable) items | 2,390 | 2,559 |
| Change in tax benefit not recognized | 70 | (2,989) |
| Foreign tax differentials | (423) | (417) |
| Other | 204 | 881 |
| Special mining royalty | (130) | (300) |
| Provision for income taxes (recovery) | (2,201) | (2,214) |

The enacted or substantively enacted tax rates in Canada (26.5% in 2016) and Mexico (30% in 2016) where the Company operates are applied in the tax provision calculation.

The 7.5% mining royalty is treated as an income tax in accordance with IFRS for financial reporting purposes, as it is based on a measure of revenue less certain specified costs. On substantive enactment, a taxable temporary difference arises, as certain mining assets related to extractive activities have a book basis but no tax basis for purpose of the royalty. As at December 31, 2016, the Company has recognized a deferred tax liability of $290 (as at December 31, 2015 – $420) in respect of this special mining royalty. This deferred tax liability will be drawn down to $nil as a reduction to tax expense over the life of mine as the mine and its related assets are depleted or depreciated.

(in thousands of U.S. dollars, except share data)

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Current income taxes (recovery) | (1,313) | (1,047) |
| Deferred income taxes (recovery) | (888) | (1,167) |
| | (2,201) | (2,214) |

The following table reflects the Company's deferred income tax assets (liabilities):

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Non-capital losses carried forward | 10,246 | 8,646 |
| Resource related assets | 416 | 561 |
| Property, plant and equipment | (1,055) | (442) |
| Prepaid expenses, deposits and other | 487 | (103) |
| Deferred income tax assets | 10,094 | 8,662 |
| Deferred income and other | (15) | 659 |
| Accrued revenue | - | 1 |
| Special mining royalty | (290) | (420) |
| Net deferred income tax assets | 9,789 | 8,902 |

The Company recognized deferred tax assets of $10,246 in respect of tax losses as at December 31, 2016 (as at December 31, 2015 - $8,646) as projections of various sources of income support the conclusion that the realization of these deferred tax assets is probable.

The following temporary differences and non-capital losses have not been recognized in the consolidated financial statements.

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Non-capital losses carried forward | 17,243 | 18,622 |
| Capital losses | 4,951 | 4,977 |
| Resource related deductions | 19,013 | 17,701 |
| Share issuance costs | 248 | 306 |
| Property, plant and equipment | 168 | 224 |
| Prepaid expenses, deposits and other | 508 | 37 |
| | 42,131 | 41,867 |

As at December 31, 2016, the Company has non-capital losses to be carried forward and applied against taxable income of future years. The non-capital losses have expiry dates as follows:

(in thousands of U.S. dollars, except share data)

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| 2018 | 9,254 | 10,752 |
| 2019 | 220 | 255 |
| 2020 | - | - |
| 2021 and thereafter | 41,361 | 36,208 |
| | 50,835 | 47,215 |

As at December 31, 2016, the Company has Canadian capital losses of $10,397 (2015 - $10,054) that may be carried forward indefinitely and applied against capital gains of future years.

At December 31, 2016, $nil (2015 - $nil) was recognised as a deferred tax liability for taxes that would be payable on the unremitted earnings of certain of the Company's subsidiaries as the Company has determined that undistributed profits of its subsidiaries will not be distributed in the foreseeable future; and the investments are not held for resale and are expected to be recouped by continued use of these operations by the subsidiaries. The amount of temporary differences not booked for these unremitted earnings at December 31, 2016 is $6,817 (2015 - $9,860).

## 19. FINANCIAL INSTRUMENTS

*Fair Values of non-derivative financial instruments*

All financial assets and financial liabilities, other than derivatives, are initially recognized at the fair value of consideration paid or received, net of transaction costs as appropriate, and subsequently carried at fair value or amortized cost. The carrying values of cash and cash equivalents, trade receivables and other liabilities approximate their fair value. The methods and assumptions used in estimating the fair value of other financial assets and liabilities are as follows:

*Embedded derivatives*

Revenues from the sale of metals produced since the commencement of commercial production are based on provisional prices at the time of shipment. Variations between the price recorded at the time of sale and the actual final price received from the customer are caused by changes in market prices for metals sold and result in an embedded derivative in accounts receivable. The embedded derivative is recorded at fair value each reporting period until settlement occurs, with the changes in fair value recorded to revenues. For the year ended December 31, 2016, the Company recorded $2,100 (2015 - $1,704) in revenues from provisionally priced sales on the statement of loss and comprehensive loss, which are subject to adjustment pending final settlement subsequent to the year. As at December 31, 2016, the Company has recorded embedded derivatives in the amount of $553 (as at December 31, 2015 – $205) in trade receivables.

*Fair Value of derivative financial instruments*

The following is a summary of the amortized cost and fair value of the Company's Debentures and outstanding common share purchase warrants as at December 31, 2016:

(in thousands of U.S. dollars, except share data)

| | Amortized Cost $ | Fair Value $ |
|---|---|---|
| **Financial liabilities** | | |
| Convertible Debt | 2,958 | 14,179 |
| | 2,958 | 14,179 |

*Fair Value Hierarchy*

The Company values financial instruments carried at fair value using quoted market prices, where available. The three levels of the fair value hierarchy are as follows:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data

The financial liabilities are presented by class in the following table at their carrying values, which generally approximate to the fair values due to their short period to maturity:

| | Fair value hierarchy | Dec 31, 2016 $ | Dec 31, 2015 $ |
|---|---|---|---|
| **Financial assets** | | | |
| Fair value through profit and loss | | | |
| Marketable securities | Level 1 | 1,521 | - |
| **Financial liabilities** | | | |
| Fair value through profit and loss | | | |
| Embedded Derivative Liability | Level 3 | 10,068 | 1,203 |
| Purchase Warrants | Level 3 | 1,673 | 189 |
| | | 11,741 | 1,392 |

There were no transfers between levels 1, 2 or 3 during the year ended December 31, 2016.

***Risk management policies and hedging activities***

The Company is sensitive to changes in commodity prices, foreign exchange and interest rates. The Company's board of directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company addresses its price-related exposures through the use of options, futures, forwards and derivative contracts.

***Economic dependence***

The Company`s sole customer was Trafigura Mexico, S.A. de C.V. (a subsidiary within the Trafigura group of companies) ("Trafigura") accounting for 100% of sales of $16,994 (2015 – $16,167). An amount of $503 is included in the trade receivables from Trafigura as at December 31, 2016 (as at December 31, 2015 – $205). In late 2016, the Company negotiated offtake agreements for 2017 between two customers, Trafigura and MK Metal Trading Mexico, S.A. de C.V. ("MK Metals"). The Company believes that because of the availability of alternative processing and commercialization options for its concentrate, it would suffer no material adverse effect if it lost the services of Trafigura or MK Metals.

***Credit risk***

Credit risk is the risk of unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's credit risk is primarily attributable to cash and cash equivalents. Management believes the credit risk on cash and cash equivalents is very low since the Company's cash and cash equivalents balance are held at large international financial institutions with strong credit ratings.

The Company is exposed to credit risk from its customer, Trafigura. Accounts receivable are subject to normal industry credit risks and are considered low.

***Liquidity risk***

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to meet its liabilities when due. To the extent the Company does not believe it has sufficient liquidity to meet these obligations, management will consider securing additional funds through equity or debt transactions. Accounts payable excluding accrued liabilities are due within 90 days or less.

***Currency risk***

The Mexican peso (MXN) and the Canadian dollar are the functional currencies of the Company and as a result currency exposures arise from transactions and balance in currencies other than the functional currencies. The Company's potential currency exposures comprise:

- translational exposure in respect of non-functional currency monetary items
- transactional exposure in respect of non-functional currency expenditure and revenues;
- commodity price risk; and
- interest rate risk.

***Translational exposure in respect of non-functional currency monetary items***

Monetary items, including financial assets and liabilities, denominated in currencies other than the functional currency of an operation are periodically revalued to the functional currency equivalents as at that date, and the associated unrealized gain or loss is taken to the income statement to reflect this risk.

The principal non-functional currency to which the Company is exposed is the United States dollar (USD). Based on the Company's net financial assets and liabilities in USD as at December 31, 2016, a weakening of the USD against the MXN and CAD functional currencies by 1% with all other variables held constant, would increase/(decrease) net loss and equity by approximately $38.

***Transactional exposure in respect of non-functional currency expenditure and revenues***

Certain operating and capital expenditures are incurred by some operations in currencies other than their functional currency. To a lesser extent, certain sales revenue is earned in currencies other than the functional currency of operations, and certain exchange control restrictions may require that funds be maintained in currencies other than the functional currency of the operation.

At December 31, 2016, the Company has not entered into forward exchange contracts to manage short-term foreign currency cash flows relating to operating activities.

(in thousands of U.S. dollars, except share data)

***Commodity price risk***

The nature of the Company's operations results in exposure to fluctuations in commodity prices. Management continuously monitors commodity prices of silver, lead and zinc.

The Company is particularly exposed to the risk of movements in the price of silver. Declining market prices for silver could have a material effect on the Company's profitability, and the Company does not hedge its exposure to silver. The London Silver Spot price average, in USD per ounce, was $17 in 2016 (2015 – $16). The Company estimates that a 10% increase/decrease in commodity prices in 2016 with all other variables held constant would have resulted in an increase/decrease in net loss of approximately $1,142.

***Interest rate risk***

Cash and cash equivalents earn interest at floating rates dependent upon market conditions.

## 20. CAPITAL MANAGEMENT

The Company's objectives of capital management are intended to safeguard the entity's ability to continue as a going concern and to continue the exploration and extraction of ore from its mining properties.

The capital of the Company consists of the items included in shareholders' equity. Risk and capital management are monitored by the board of directors. The Company manages the capital structure and makes adjustments depending on economic conditions. Funds have been primarily secured through issuances of equity capital. The Company invests all capital that is surplus to its immediate needs in short-term, liquid and highly rated financial instruments, such as cash and other short-term deposits, all held with major financial institutions. Significant risks are monitored and actions are taken, when necessary, according to the Company's approved policies.

## 21. SEGMENT REPORTING

| | MEXICO | | CANADA | | TOTAL | |
|---|---|---|---|---|---|---|
| | Dec 31, 2016 $ | Dec 31, 2015 $ | Dec 31, 2016 $ | Dec 31, 2015 $ | Dec 31, 2016 $ | Dec 31, 2015 $ |
| Property, plant and equipment | 17,267 | 14,499 | - | - | 17,267 | 14,499 |
| Capital expenditures | (8,193) | (1,626) | - | - | (8,193) | (1,626) |
| Mineral rights | 1,629 | 1,998 | 1,490 | 1,440 | 3,119 | 3,438 |
| Total assets | 36,825 | 32,977 | 7,974 | 5,044 | 44,799 | 38,021 |

(in thousands of U.S. dollars, except share data)

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **MEXICO** | | |
| Revenue | 16,994 | 16,167 |
| Cost of sales | (16,341) | (18,691) |
| Exploration | (1,339) | (638) |
| Other expenses | (2,037) | 334 |
| Finance costs | (33) | (83) |
| Income tax | 2,201 | 2,214 |
| Net income (loss) | (555) | 29 |
| **CANADA** | | |
| Corporate administrative expenses | (3,477) | (3,309) |
| Exploration | (6) | (47) |
| Other expenses | 1,066 | (688) |
| Finance costs | (11,255) | (363) |
| Net loss | (13,516) | (5,069) |
| **Net loss** | **(14,071)** | **(5,040)** |

## 22. COMPARATIVE FIGURES

Certain comparative figures have been reclassified in order to conform with the presentation adopted in the current year.