# NEXTSOURCE MATERIALS INC.

**(An Exploration Stage Company)**

## Consolidated financial statements

### For the years ended June 30, 2017 and 2016

**(Expressed in US Dollars)**

## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of NextSource Materials Inc.

We have audited the accompanying consolidated balance sheets of NextSource Materials Inc. as of June 30, 2017 and 2016, and the related consolidated statements of operations and comprehensive loss, shareholders' equity (deficiency), and cash flows for the years then ended. NextSource Materials Inc.'s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. NextSource Materials Inc. is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of NextSource Materials Inc.'s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of NextSource Materials Inc. as of June 30, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 1, the Company has experienced negative cash flows from operations since inception and has accumulated a significant deficit which raises substantial doubt about its ability to continue as a going concern. Management's plans regarding these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

MNP LLP

Mississauga, Canada
September 27, 2017

Chartered Professional Accountants
Licensed Public Accountants

MNP LLP

**NextSource Materials Inc.**
**Consolidated Balance Sheets**
***(Expressed in US Dollars)***

| | June 30, 2017 | June 30, 2016 |
|---|---|---|
| **Assets** | | |
| **Current Assets:** | | |
| Cash and cash equivalents (note 12) | $ 1,964,948 | $ 544,813 |
| Amounts receivable | 39,441 | 13,955 |
| Prepaid expenses (note 6) | 39,096 | 11,545 |
| Total current assets | 2,043,485 | 570,313 |
| Equipment (note 4) | 27,805 | 21,911 |
| **Total Assets** | **$ 2,071,290** | **$ 592,224** |
| **Liabilities and Stockholders' Equity** | | |
| **Liabilities** | | |
| **Current Liabilities:** | | |
| Accounts payable (note 6) | $ 159,147 | $ 215,391 |
| Accrued liabilities | 68,241 | 24,743 |
| Contingency provision (note 13) | 182,883 | 182,742 |
| Warrant liability (note 10) | - | 111,049 |
| **Total Liabilities** | **$ 410,271** | **$ 533,925** |
| **Stockholders' Equity** | | |
| Common stock<br>650,000,000 shares authorized, $0.001 par value, 460,995,711 issued and outstanding (June 30, 2016: 364,931,425) (note 7) | 460,996 | 364,932 |
| Additional paid-in capital (note 7) | 99,160,128 | 93,654,114 |
| Accumulated deficit | (97,960,105) | (93,960,747) |
| **Total Stockholders' Equity** | **1,661,019** | **58,299** |
| **Total Liabilities and Stockholders' Equity** | **$ 2,071,290** | **$ 592,224** |

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

Nature of Operations and Going Concern (note 1)

Mineral Properties (note 5)

**NextSource Materials Inc.**
**Consolidated Statements of Operations and Comprehensive Loss**
***(Expressed in US Dollars)***

| | Year ended June 30, 2017 | Year ended June 30, 2016 |
|---|---|---|
| **Revenues** | **$ -** | **$ -** |
| **Expenses** | | |
| Mineral exploration expense (notes 5, 6 and 12) | 1,839,659 | 812,477 |
| Professional and consulting fees (note 6) | 770,397 | 811,704 |
| Stock-based compensation (note 6) | 794,864 | 331,491 |
| General and administrative (note 6) | 458,780 | 279,097 |
| Depreciation (note 4) | 21,911 | 56,602 |
| Interest | - | 11,371 |
| Foreign currency translation loss | 93,476 | 106,036 |
| **Total Expenses** | 3,979,087 | 2,408,778 |
| **Net Loss From Operations** | (3,979,087) | (2,408,778) |
| **Other Income (Expenses)** | | |
| Investment income | - | 623 |
| Gain on legal settlement | - | 59,556 |
| Loss on sale of marketable securities | - | (18,916) |
| Change in value of warrant liability (note 10) | 111,049 | 733,802 |
| Part XII.6 taxes (note 13) | (131,320) | - |
| **Net Loss** | (3,999,358) | (1,633,713) |
| Realized gain from marketable securities | - | 4,323 |
| **Comprehensive Loss** | $ (3,999,358) | $ (1,629,390) |
| Loss per share – basic and diluted | ($0.01) | ($0.00) |
| Weighted average shares outstanding – basic and diluted (note 11) | 448,187,140 | 343,243,652 |

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

**NextSource Materials Inc.**
**Consolidated Statements of Cash Flows**
***(Expressed in US Dollars)***

| | Year ended June 30, 2017 | Year ended June 30, 2016 |
|---|---|---|
| **Operating Activities** | | |
| **Net Loss** | **$ (3,999,358)** | **$ (1,633,713)** |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 21,911 | 56,602 |
| Change in value of warrant derivative liability | (111,049) | (733,802) |
| Stock-based compensation | 794,864 | 331,491 |
| Loss on sale of marketable securities | - | 8,068 |
| Change in non-cash working capital: | | |
| Amounts receivable and prepaid expenses | (53,037) | 40,016 |
| Accounts payable and accrued liabilities | (12,746) | (139,398) |
| Contingency provision | 141 | (7,345) |
| Net cash used in operating activities | (3,359,274) | (2,078,081) |
| **Investing Activities** | | |
| Loan to related party | - | 76,450 |
| Proceeds from sale of securities | - | 3,870 |
| Equipment Purchases | (27,805) | - |
| Net cash (used in) provided by investing activities | (27,805) | 80,320 |
| **Financing Activities** | | |
| Proceeds from issuance of common stock | 5,177,885 | 1,815,013 |
| Common stock issue costs | (370,671) | (51,557) |
| Net cash provided by financing activities | 4,807,214 | 1,763,456 |
| Net increase (decrease) in cash and cash equivalents | 1,420,135 | (234,305) |
| Cash and cash equivalents - beginning of year | 544,813 | 779,118 |
| Cash and cash equivalents - end of year | $ 1,964,948 | $ 544,813 |
| **Supplemental Disclosures:** | | |
| Interest Received | $ - | $ 11,371 |

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

**NextSource Materials Inc.**
**Consolidated Statement of Shareholder's Equity (Deficiency)**
***(Expressed in US Dollars)***

| | Shares # | Common Stock $ | Additional Paid-In Capital $ | Accumulated Comprehensive Income (Loss) $ | Accumulated Deficit $ | Total $ |
|---|---|---|---|---|---|---|
| **Balance - June 30, 2015** | **309,384,670** | **309,385** | **91,614,714** | **(4,323)** | **(92,327,034)** | **(407,258)** |
| Conversion of Special Warrants into common shares | 20,550,998 | 20,551 | (20,551) | - | - | - |
| Private placement of common shares subscribed | 14,200,000 | 14,200 | 516,473 | - | - | 530,673 |
| Private placement of common shares subscribed | 6,437,900 | 6,438 | 322,539 | - | - | 328,977 |
| Private placement of common shares subscribed | 3,207,857 | 3,208 | 169,425 | - | - | 172,633 |
| Private placement of common shares subscribed | 11,150,000 | 11,150 | 771,580 | - | - | 782,730 |
| Cost of issue of private placement of common shares subscribed | - | - | (51,557) | - | - | (51,557) |
| Stock-based compensation | - | - | 331,491 | - | - | 331,491 |
| Loss on marketable securities | - | - | - | (3,745) | - | (3,745) |
| Reclassified loss to profit or loss | - | - | - | 8,068 | - | 8,068 |
| Net loss for the year | - | - | - | - | (1,633,713) | (1,633,713) |
| **Balance - June 30, 2016** | **364,931,425** | **364,932** | **93,654,114** | **-** | **(93,960,747)** | **58,299** |
| Private placement of common shares subscribed | 96,064,286 | 96,064 | 5,081,821 | - | - | 5,177,885 |
| Cost of issue of private placement of common shares subscribed | - | - | (370,671) | - | - | (370,671) |
| Stock-based compensation | - | - | 794,864 | - | - | 794,864 |
| Net loss for the year | - | - | - | - | (3,999,358) | (3,999,358) |
| **Balance - June 30, 2017** | **460,995,711** | **460,996** | **99,160,128** | **-** | **(97,960,105)** | **1,661,019** |

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

## 1. Nature of Operations and Going Concern

NextSource Materials Inc. (f/k/a/ Energizer Resources, Inc.) (the "Company") is incorporated in the State of Minnesota, USA and has a fiscal year end of June 30. The Company's principal business is the acquisition, exploration and development of mineral resources. The Company has yet to generate revenue from mining operations or pay dividends and is unlikely to do so in the immediate or foreseeable future.

During fiscal 2008, the Company incorporated Energizer (Mauritius) Ltd. ("ERMAU"), a Mauritius subsidiary, and Energizer Madagascar Sarl. ("ERMAD"), a Madagascar subsidiary of ERMAU. During fiscal 2009, the Company incorporated THB Ventures Ltd. ("THB"), a Mauritius subsidiary of ERMAU, and Energizer Minerals Sarl. ("ERMIN"), a Madagascar subsidiary of THB, which holds the 100% ownership interest of the Green Giant Property in Madagascar (see note 5). During fiscal 2012, the Company incorporated Madagascar-ERG Joint Venture (Mauritius) Ltd. ("ERGJVM"), a Mauritius subsidiary of ERMAU, and ERG (Madagascar) Sarl. ("ERGMAD"), a Madagascar subsidiary of ERGJVM, which holds the Malagasy Joint Venture Ground (see note 5). During fiscal 2014, the Company incorporated 2391938 Ontario Inc., an Ontario, Canada subsidiary.

As of June 30, 2017, the Company had accumulated losses of $97,960,105 (June 30, 2016: $93,960,747), recurring loss and negative operating cash flows, and as such, there is substantial doubt regarding the Company's ability to continue as a going concern.

These consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will continue to realize its assets and discharge its liabilities in the normal course of business. The continuation of the Company as a going concern is dependent upon the continued financial support from its shareholders, the ability of the Company to obtain necessary equity or debt financing to continue operations, the Company's ability to attract joint venture partners and off-take contracts and the attainment of profitable operations. These consolidated financial statements do not include any adjustments to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

## 2. Significant Accounting Policies

**Principals of Consolidation and Basis of Presentation**

These consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). These consolidated financial statements include the accounts of NextSource Materials Inc. and its wholly-owned subsidiaries, Energizer (Mauritius) Ltd., THB Ventures Ltd., Energizer Madagascar Sarl, Energizer Minerals Sarl, Madagascar-ERG Joint Venture (Mauritius) Ltd., ERG (Madagascar) Sarl and 2391938 Ontario Inc.

All inter-company balances and transactions have been eliminated on consolidation.

**Use of Estimates**

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of these consolidated financial statements and the reported amounts of revenues and expenses during the year. On an ongoing basis, management evaluates its judgments and estimates in relation to assets, liabilities, revenue and expenses. Management uses past experience and other factors as the basis for its judgments and estimates. Actual results may differ from those estimates. The impacts of estimates are pervasive throughout these consolidated financial statements and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and the revision affects current and future periods. Areas where significant estimates and assumptions are used include: the binomial valuation of the warrant liability, the Black-Scholes valuation of warrants and stock options, the valuation recorded for future income taxes and the assumption that the Company will receive title to the properties after the Madagascar political situation stabilizes.

**Cash and Cash Equivalents**
Cash and cash equivalents include money market investments that are readily convertible to known amounts of cash and have an original maturity of less than or equal to 90 days. Included in cash and cash equivalents are term deposits and GICs that are held as security against the company's credit cards in the amount of $70,131.

**Marketable Securities**
The Company classifies and accounts for debt and equity securities in accordance with ASC Topic 320, "Accounting for Certain Investments in Debt and Equity Securities". The Company has classified all of its marketable securities as available for sale, thus securities are recorded at fair market value and any associated unrealized gain or loss, net of tax, are included as a separate component of stockholders' equity, titled accumulated comprehensive loss. When an unrealized loss is classified as being other than temporary, it is expensed within the consolidated statement of operations and comprehensive loss.

**Equipment**
Equipment is recorded at cost, less accumulated depreciation, and consists of exploration equipment. Depreciation is computed on a straight-line basis over 3 years, which coincides with its estimated useful life.

**Mineral Property Costs**
Mineral property acquisition and exploration costs are expensed as incurred. The Company has not yet realized any revenues from its mineral operations. When it has been determined that a mineral property can be economically developed as a result of establishing probable and proven reserves, the costs then incurred to develop such property will be capitalized. Such costs will be amortized using the units of production method over the estimated life of the probable reserve. If properties are abandoned or the carrying value is determined to be in excess of possible future recoverable amounts the Company will write off the appropriate amount.

## 2. Significant Accounting Policies (Continued)

**Warrant Liability**
The Company accounts for its derivative instruments not indexed to its stock as either assets or liabilities and carries them at fair value. Derivatives that are not defined as hedges must be adjusted to fair value through earnings. The Company has issued stock purchase warrants with exercise prices denominated in a currency other than its functional currency of U.S. dollars. As a result, these warrants were no longer considered to be solely indexed to the Company's common stock. Therefore, these warrants are classified as liabilities under the caption "warrant liability" and recorded at estimated fair value at each reporting date, computed using the Binomial valuation method. Changes in the liability from period to period are recorded in the statements of operations under the caption "change in value of warrant liability". The Company records the change in fair value of the warrant liability as a component of other income and expense on the statement of operations as it is believed the amounts recorded relate to financing activities and not as a result of our operations.

**Comprehensive Income / (Loss)**
ASC Topic 220, "Reporting Comprehensive Income", establishes standards for the reporting and display of comprehensive income, its components and accumulated balances.

**Foreign Currency Translation**
The Company's functional and reporting currency is United States Dollars. The functional and reporting currency of the Mauritius subsidiaries is United States Dollars. The functional and reporting currency of the Madagascar subsidiaries is Madagascar Ariary. Monetary assets and liabilities denominated in foreign currencies are translated in accordance with ASC Topic 830, "Foreign Currency Translation", using the exchange rate prevailing at the balance sheet date. Gains and losses arising on settlement of foreign currency denominated transactions or balances are included in the consolidated statements of operations and comprehensive loss.

**Long Lived Assets**
In accordance with ASC Topic 360, "Accounting for Impairment or Disposal of Long Lived Assets", the carrying value of intangible assets and other long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The Company recognizes impairment when the sum of the expected undiscounted future cash flows is less than the carrying amount of the asset. Impairment losses, if any, are measured as the excess of the carrying amount of the asset over its estimated fair value.

**Basic and Diluted Net Income / (Loss) Per Share**
The Company computes net earnings / (loss) per share in accordance with ASC Topic 260, "Earnings per Share". ASC Topic 260 requires presentation of basic and diluted earnings per share ("EPS") on the consolidated statement of operations and comprehensive loss. Basic EPS is computed by dividing net income / (loss) (numerator) by the weighted average number of shares outstanding (denominator) during the year. Diluted EPS gives effect to all dilutive potential common shares outstanding during the year using the treasury stock method and the "if converted" method for convertible instruments. In computing diluted EPS, the average stock price for the year is used in determining the number of shares assumed to be purchased from the exercise of stock options or warrants. Diluted EPS excludes all dilutive potential shares if their effect is anti-dilutive. Diluted EPS and the weighted average number of common shares exclude all dilutive potential shares since their effect is anti-dilutive.

**Stock-Based Compensation**
The Company has a Stock Option Plan (see Note 8). All stock based awards granted are accounted for using the fair value based method, using the more reliable measure of value of services and Black Scholes pricing model. The fair value of stock options granted is recognized as an expense within the consolidated statements of operations and comprehensive loss and a corresponding increase in additional paid in capital. Any consideration paid by eligible participants on the exercise of stock options is credited to common stock at the par value with the remaining included in additional paid-in capital. The additional paid in capital amount associated with stock options is transferred to common stock upon exercise.

## 2. Significant Accounting Policies (Continued)

**Income Taxes**
The Company has adopted Topic 740 "Accounting for Income Taxes" which is required to compute tax asset benefits for net operating losses carried forward. Deferred income taxes are recorded for temporary differences between financial statement carrying amounts and the tax basis of assets and liabilities. Deferred tax assets and liabilities reflect the tax rates expected to be in effect for the years in which the differences are expected to reverse. A valuation allowance is provided if it is more likely than not that some of all of the deferred tax asset will not be realized. Potential benefits of net operating losses have not been recognized in these consolidated financial statements as the Company cannot be assured it is more likely than not it will utilize the net operating losses carried forward in future years. Management does not believe unrecognized tax benefits will significantly change within one year of the balance sheet date. Interest and penalties related to income tax matters are recognized in income tax expense. As of June 30, 2017, there was no interest or penalties related to uncertain tax positions.

**Asset Retirement Obligations**
The operations of the Company are subject to regulations governing the environment, including future site restoration for mineral properties. The Company will recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred and when a reasonable estimate of fair value can be made. If a reasonable estimate of fair value cannot be made in the period the asset retirement is incurred, the liability is recognized when a reasonable estimate of fair value can be made. The Company has determined that there are no asset retirement obligations or any other environmental obligations currently existing with respect to its mineral properties and therefore no liability has been recognized.

**Financial Instruments**
The fair value of cash and cash equivalents, accounts payable and accrued liabilities were estimated to approximate their carrying values due to the immediate or short-term maturity of these financial instruments. The Company's exploration operations are in Madagascar and Canada, which result in exposure to market risks from changes in foreign currency rates. Financial risk is the risk to the Company's operations that arise from movements in foreign exchange rates and the degree of volatility of these rates.

**Fair Value of Financial Instruments Hierarchy**
ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Cash and cash equivalents and marketable securities were in Level 1 within the fair value hierarchy. The three levels are as follows:

- Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 includes marketable securities such as listed equities and U.S. government treasury securities.
- Level 2 - Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using industry standard models or other valuation methodologies. These models consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, current market and contractual prices for the underlying instruments as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category include the warrant liability.
- Level 3 - Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value from the perspective of a market participant. Level 3 instruments include those that may be more structured or otherwise tailored to customers' needs. At each balance sheet date, the Company performs an analysis of all instruments subject to ASC Topic 820 and includes in Level 3 all of those whose fair value is based on significant unobservable inputs.

## 3. Recent Accounting Pronouncements Potentially Affecting The Company

The following are recent FASB accounting pronouncements, which may have an impact on the Company's future consolidated financial statements.

- "Presentation of Financial Statements Going Concern (ASC Topic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15") was issued during August 2014. FASB issued guidance on how to account for and disclose going concern risks. This guidance is effective for annual periods beginning after December 15, 2016.
- "Leases" (ASU 2016-02) was issued during February 2016. This update will require organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The new guidance will also require additional disclosure about the amount, timing and uncertainty of cash flows arising from leases. This guidance is effective for annual and interim periods beginning after December 15, 2018.
- "Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" (ASU 2016-09) was issued in March 2016. This new standard provided guidance for the simplification of several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This standard is effective for annual periods beginning after December 15, 2016.
- "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15") was issued in August 2016. This update addresses several specific cash flow issues with the objective of reducing the existing diversity in practice.
- "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting" (ASU 2017-09) was issued in May 2017. This update will provide clarity and reduce both diversity in practice and cost and complexity when applying the guidance in Topic 718, Compensation – Stock Compensation, to a change to the terms or conditions of a share-based payment award. This standard is effective for annual periods beginning after December 15, 2017.

The Company continues to evaluate the impact of ASU 2014-15, ASU 2016-02, ASU 2016-09, ASU 2016-15, and ASU 2017-09 on its consolidated financial statements.

***(Expressed in US Dollars)***

## 4. Equipment

For the year ended June 30, 2017, the Company incurred depreciation expenses totaling $21,911 (June 30, 2016: $56,602) resulting in the full depreciation of the underlying equipment and its derecognition since no future economic benefits are expected from use or disposal.

During the year ended June 30, 2017, the Company acquired metallurgical testing equipment in Madagascar valued at $27,805 (March 31, 2016: $nil) which has not yet been put into use.

| | **Equipment Cost $** | **Less: Accumulated Depreciation $** | **Net Book Value $** |
|---|---|---|---|
| **Balance June 30, 2015** | **195,561** | **117,048** | **78,513** |
| Depreciation expense | - | 56,602 | (56,602) |
| **Balance June 30, 2016** | **195,561** | **173,650** | **21,911** |
| Depreciation expense | - | 21,911 | (21,911) |
| Derecognition of equipment | (195,561) | (195,561) | - |
| Acquisition of metallurgical equipment | 27,805 | - | 27,805 |
| **Balance June 30, 2017** | **27,805** | **-** | **27,805** |

## 5. Mineral Properties

**Molo Graphite Property, Southern Madagascar Region, Madagascar**

On December 14, 2011, the Company entered into a Definitive Joint Venture Agreement ("JVA") with Malagasy Minerals Limited ("Malagasy"), a public company listed on the Australian Stock Exchange, to acquire a 75% interest in a property package for the exploration and development of industrial minerals, including graphite, vanadium and 25 other minerals. The land position consists of 2,119 permits covering 827.7 square kilometers and is mostly adjacent towards the south and east with the Company's 100% owned Green Giant Property. Pursuant to the JVA, the Company paid $2,261,690 and issued 7,500,000 common shares that were valued at $1,350,000.

On April 16, 2014, the Company signed a Sale and Purchase Agreement and a Mineral Rights Agreement (together “the Agreements”) with Malagasy to acquire the remaining 25% interest. Pursuant to the Agreements, the Company paid $364,480 (CAD$400,000), issued 2,500,000 common shares subject to a 12-month voluntary vesting period that were valued at $325,000 and issued 3,500,000 common share purchase warrants, which were valued at $320,950 using Black-Scholes, with an exercise price of $0.14 and an expiry date of April 15, 2019. On May 20, 2015 and upon completion of a bankable feasibility study (“BFS”) for the Molo Graphite Property, the Company paid $546,000 (CAD$700,000) and issued 1,000,000 common shares, which were valued at $100,000.

Malagasy retains a 1.5% net smelter return royalty ("NSR") on the property. A further cash payment of approximately $720,900 (CAD$1,000,000) will be due within five days of the commencement of commercial production.

The Company also acquired a 100% interest in the industrial mineral rights additional claim blocks covering 10,811 hectares adjoining the east side of the Molo Graphite Property.

The Molo Graphite Project is located within Exploration Permit #3432 ( “PR 3432”) as issued by the Bureau de Cadastre Minier de Madagascar (“BCMM”) pursuant to the Mining Code 1999 (as amended) and its implementing decrees.

The Molo Graphite Project exploration permit PR 3432 is currently held under the name of one of our Madagascar subsidiary ERG Madagascar SARLU. Our Madagascar subsidiaries have paid all taxes and administrative fees to the Madagascar government and its mining ministry with respect to all the mining permits held in country. These taxes and administrative fee payments have been acknowledged and accepted by the Madagascar government.

We have applied to the BCMM to have the Molo Graphite Project exploration permit converted into an exploitation permit. The exploitation permit is required to advance the Molo Project into the developmental stage.

The Company cannot provide any assurance as to the timing of the receipt of the required permits and licenses.

**Green Giant Property, Southern Madagascar Region, Madagascar**

In 2007, the Company entered into a joint venture agreement with Madagascar Minerals and Resources Sarl ("MMR") to acquire a 75% interest in the Green Giant Property. Pursuant to the agreement, the Company paid $765,000 in cash, issued 2,500,000 common shares and issued 1,000,000 common share purchase warrants, which have now expired.

On July 9, 2009, the Company acquired the remaining 25% interest by paying $100,000. MMR retains a 2% NSR. The first 1% NSR can be acquired at the Company's option by paying $500,000 in cash or common shares and the second 1% NSR can be acquired at the Company's option by paying $1,000,000 in cash or common shares.

On April 16, 2014, the Company signed a Joint Venture Agreement with Malagasy, whereby Malagasy acquired a 75% interest in non-industrial minerals on the Company's 100% owned Green Giant Property. On May 21, 2015, Malagasy terminated the Joint Venture Agreement, which as a result, the Company reverted to its original 100% interest in all minerals on the property.

**Sagar Property, Labrador Trough Region, Quebec, Canada**

In 2006, the Company purchased from Virginia Mines Inc. ("Virginia") a 100% interest in 369 claims located in northern Quebec, Canada. Virginia retains a 2% net smelter return royalty ("NSR") on certain claims within the property. Other unrelated parties also retain a 1% NSR and a 0.5% NSR on certain claims within the property, of which half of the 1% NSR can be acquired by the Company by paying $200,000 and half of the 0.5% NSR can be acquired by the Company by paying $100,000.

On February 28, 2014, the Company signed an agreement to sell a 35% interest in the Sagar property to Honey Badger Exploration Inc. ("Honey Badger"), a public company that is a related party through common management. The terms of the agreement were subsequently amended on July 31, 2014 and again on May 8, 2015. To earn the 35% interest, Honey Badger was required to complete a payment of $36,045 (CAD$50,000) by December 31, 2015, incur exploration expenditures of $360,450 (CAD$500,000) by December 31, 2016 and issue 20,000,000 common shares to the Company by December 31, 2015. Honey Badger did not complete the earn-in requirements by December 31, 2015 resulting in the termination of the option agreement.

## 6. Related Party Transactions and Balances

The Company had related party transactions during the period. Parties are related if one party has the direct or indirect ability to control or exercise significant influence over the other party in making operating and financial decisions. Parties are also related if they are subject to common control or common significant influence. Related parties include corporate entities, members of the Board of Directors and certain key management as well as companies controlled by these individuals.

A transaction is considered to be a related party transaction when there is a transfer of economic resources or financial obligations between related parties. Related party transactions that are in the normal course of business and have commercial substance are measured at the fair value.

The following related party transactions occurred during the year ended June 30, 2017:

a) The Company incurred $639,190 in mineral exploration expense and professional and consulting fees incurred directly to directors and officers or companies under their control (June 30, 2016: $556,982).
b) The Company incurred $nil in severance costs paid or accrued directly to former officers (June 30, 2016: $125,047).
c) The Company incurred $nil in general and administrative costs (June 30, 2016: $68,293) from a public company related by common management, Red Pine Exploration Inc. (TSX.V: "RPX").
d) The Company granted 18,100,000 stock options to directors and officers of the Company (June 30, 2016: 7,900,000 common stock purchase options issued to directors and officers). These stock options were valued at $680,560 using the Black-Scholes option pricing model and are included in stock-based compensation (June 30, 2016: $308,092).

The following related party transactions balances existed as of June 30, 2017:

a) The accounts payable balance for payroll, management and consulting fees owed to directors and officers or companies under their control was $16,400 at the end of the year (June 30, 2016: $42,000).
b) The prepaid payroll balance for payroll expenditures paid to officers was $29,746 at the end of the year (June 30, 2016: $nil).

## 7. Common Stock and Additional Paid-in Capital

The authorized share capital of the Company is 650,000,000 shares with a $0.001 par value. As of June 30, 2017, the Company had 460,995,711 common shares issued and outstanding (June 30, 2016: 364,931,425).

The Company issued the following common shares during the year ended June 30, 2017:

(a) On August 18, 2016, the Company closed a non-brokered private placement offering of 96,064,286 common shares at a price of $0.05 (CAD$0.07) for aggregate gross proceeds of $5,177,885 (CAD$6,724,500). The share issue costs totaled $370,671 for this issuance.

The Company issued the following common shares during the year ended June 30, 2016:

(a) On July 31, 2015, a total of 20,550,998 special common share purchase warrants with no exercise price were converted into one common share and one half one common share purchase warrants with an exercise price of $0.14 and an expiry date of May 4, 2018 (see also note 9). As a result, a total of 20,550,998 common shares and 10,275,499 common share purchase warrants were issued.

(b) On October 7, 2015, the Company closed a private placement offering of 14,200,000 units (the "Units") at a price of $0.04 (CAD$0.05) per unit, representing aggregate gross proceeds of $530,673 (CAD$710,000). Each Unit consisted of one common share of the Company and one half of one common share purchase warrant (each whole common share purchase warrant, a "Warrant"). Each Warrant entitles the holder to purchase one common share at a price of $0.07 per common share until October 6, 2017.

(c) On February 4, 2016, the Company closed a private placement offering of 6,437,900 units (the "Units") at a price of $0.05 (CAD$0.07) per unit, representing aggregate gross proceeds of $328,977 (CAD$450,653). Each Unit consisted of one common share of the Company and one common share purchase warrant (a "Warrant"). Each Warrant entitles the holder to purchase one common share at a price of $0.11 per common share until February 4, 2018.

(d) On April 11, 2016, the Company closed a private placement offering of 3,207,857 units (the "Units") at a price of $0.05 (CAD$0.07) per unit, representing aggregate gross proceeds of $172,633 (CAD$224,550). Each Unit consisted of one common share of the Company and one common share purchase warrant (a "Warrant"). Each Warrant entitles the holder to purchase one common share at a price of $0.11 per common share until April 11, 2018.

(e) On May 17, 2016, the Company closed a private placement offering of 11,150,000 common shares at a price of $0.07 (CAD$0.09) for aggregate gross proceeds of $782,730 (CAD$1,003,500).

***(Expressed in US Dollars)***

## 8. Stock Options

The Company's stock option plan is restricted to a maximum of 46,000,000 stock options.

As of June 30, 2017, there were 44,470,000 options outstanding (June 30, 2016: 41,965,000) with a weighted average exercise price of $0.11 and an expiration of 3.5 years. All the stock options vested on their grant date.

The following is a schedule of the Company's outstanding common stock purchase options for the year ending June 30, 2017:

| Grant Date | Expiration Date | Exercise Price | Balance Outstanding June 30, 2016 | Balance Outstanding June 30, 2017 |
|---|---|---|---|---|
| July 1, 2011 | July 1, 2016 | $0.30 | 3,300,000 | - |
| July 12, 2012 | July 13, 2016 | $0.29 | 1,650,000 | - |
| October 24, 2011 | October 24, 2016 | $0.20 | 1,640,000 | - |
| December 1, 2011 | December 1, 2016 | $0.21 | 1,785,000 | - |
| March 7, 2012 | March 4, 2017 | $0.28 | 4,900,000 | - |
| May 23, 2012 | May 23, 2017 | $0.23 | 180,000 | - |
| February 27, 2013 | February 27, 2018 | $0.21 | 4,900,000 | 3,725,000 |
| July 9, 2013 | July 9, 2018 | $0.11 | 1,080,000 | 880,000 |
| September 19, 2013 | July 19, 2018 | $0.15 | 675,000 | 450,000 |
| October 9, 2013 | October 9, 2018 | $0.13 | 250,000 | - |
| January 10, 2014 | January 10, 2019 | $0.18 | 4,400,000 | 3,775,000 |
| July 3, 2014 | July 3, 2019 | $0.15 | 4,275,000 | 2,750,000 |
| February 26, 2015 | February 26, 2020 | $0.20 | 4,430,000 | 4,100,000 |
| December 22, 2015 | December 22, 2020 | $0.06 | 8,500,000 | 7,650,000 |
| June 9, 2017 | June 9, 2022 | $0.07 | - | 21,140,000 |
| Total Outstanding | | | 41,965,000 | 44,470,000 |

The following is a continuity schedule of the Company's outstanding common stock purchase options from prior years:

| | Weighted-Average Exercise Price ($) | Number of Stock Options |
|---|---|---|
| Outstanding as of June 30, 2015 | 0.22 | 35,365,000 |
| Granted | 0.06 | 8,500,000 |
| Exercised | - | - |
| Expired | 0.23 | (1,900,000) |
| Outstanding as of June 30, 2016 | 0.18 | 41,965,000 |
| Granted | 0.07 | 21,140,000 |
| Exercised | - | - |
| Expired | 0.23 | (18,635,000) |
| Outstanding as of June 30, 2017 | 0.11 | 44,470,000 |

The Company granted the following stock options during the year ended June 30, 2017:

(a) On June 9, 2017, the Company issued 21,140,000 stock options at an exercise price of $0.07 and an expiry date of June 9, 2022. The stock options were valued at $794,864 using the Black-Scholes pricing model with the following assumptions: risk free rate – 1.11%; expected volatility – 82%; dividend yield – NIL; and expected life – 5 years. These stock options vested on the grant date.

The Company granted the following stock options during the year ended June 30, 2016:

(b) On December 22, 2015, the Company issued 8,500,000 stock options at an exercise price of $0.06 and an expiry date of December 22, 2020. The stock options were valued at $331,491 using the Black-Scholes pricing model with the following assumptions: risk free rate – 0.74%; expected volatility – 91%; dividend yield – NIL; and expected life – 5 years. These stock options vested on the grant date.

***(Expressed in US Dollars)***

## 9. Warrants

As of June 30, 2017, there were 30,521,256 common share purchase warrants outstanding with a weighted average exercise price of $0.11 and an expiration of 0.8 years.

The following is a schedule of the Company's outstanding common stock purchase warrants for the year ending on June 30, 2017:

| Issued Date | Expiration Date | Exercise Price | | Balance Outstanding June 30, 2016 | Balance Outstanding June 30, 2017 |
|---|---|---|---|---|---|
| September 26, 2014 | September 26, 2016 | $0.14 | | 1,928,571 | - |
| November 15, 2012 | November 15, 2016 | $0.18 | | 2,903,571 | - |
| December 30, 2014 | December 30, 2016 | $0.12 | | 147,000 | - |
| January 14, 2014 | January 14, 2017 | $0.14 | (a) | 29,152,033 | - |
| January 31, 2014 | January 31, 2017 | $0.14 | (a) | 590,000 | - |
| October 7, 2015 | October 6, 2017 | $0.07 | (b) | 7,100,000 | 7,100,000 |
| July 31, 2015 | May 4, 2018 | $0.14 | (c) | 10,275,499 | 10,275,499 |
| February 4, 2016 | February 4, 2018 | $0.11 | (d) | 6,437,900 | 6,437,900 |
| April 11, 2016 | April 11, 2018 | $0.11 | (e) | 3,207,857 | 3,207,857 |
| June 23, 2014 | April 15, 2019 | $0.14 | | 3,500,000 | 3,500,000 |
| Total Outstanding | | | | 65,242,431 | 30,521,256 |

(a) These warrants were issued at a $0.18 CAD exercise price (see Note 10).

The following is the continuity schedule of the Company's common share purchase warrants from prior years:

| | Weighted-Average Exercise Price ($) | | Number of Warrants |
|---|---|---|---|
| Outstanding as of June 30, 2015 | 0.10 | * | 63,618,917 |
| Issued | 0.11 | | 27,021,256 |
| Exercised | - | | (20,550,998) |
| Expired | 0.12 | * | (4,846,744) |
| Outstanding as of June 30, 2016 | 0.13 | * | 65,242,431 |
| Issued | - | | - |
| Exercised | - | | - |
| Expired | 0.14 | * | (34,721,175) |
| Outstanding as of June 30, 2017 | 0.11 | | 30,521,256 |

* Amount represents the converted USD exercise price

The Company did not issue any common share purchase warrants during the year ended June 30, 2017.

The Company issued the following common share purchase warrants during the year ended June 30, 2016:

(b) These warrants were issued on October 7, 2015 as part of a private placement (see note 8).
(c) These warrants were issued on July 31, 2015 as part of the conversion of special common share purchase warrants (see note 8).
(d) These warrants were issued on February 4, 2016 as part of a private placement (see note 8).
(e) These warrants were issued on April 11, 2016 as part of a private placement (see note 8).

***(Expressed in US Dollars)***

## 10. Warrant Liability

The warrants that expired in January 2017 were issued in a currency other than the Company's functional currency and therefore, in accordance with ASC 815 *Derivatives and Hedging*, are considered a derivative instrument and recorded on the balance sheet as a warrant liability. The fair value of the warrant liability was estimated on the date of issue and is re-measured at each reporting period using a binomial model until expiration or exercise of the underlying warrants.

For the year ended June 30, 2017, the Company recorded a gain in the fair value of the derivative warrant liability of $111,049 (June 30, 2016: gain of $733,802).

The fair value of the warrant liability was estimated using the following model inputs on the following valuation dates:

| | **Year-Ended June 30, 2017** | **Year-Ended June 30, 2016** |
|---|---|---|
| Exercise price | Nil | $0.14 |
| Risk free rate | Nil | 0.50% |
| Expected volatility | Nil | 88% |
| Expected dividend yield | Nil | Nil |
| Expected life (in years) | Nil | 0.55 |
| Opening balance, derivative warrant liability | $ **111,049** | **$ 844,851** |
| Gain on change in fair value of derivative warrant liability | (111,049) | (733,802) |
| **Ending balance, derivative warrant liability** | **$ -** | **$ 111,049** |

## 11. Loss Per Share

Basic and diluted loss per share is computed using the weighted average number of common shares outstanding during the reporting period. Diluted loss per share and the weighted average number of shares of common stock excludes all potentially dilutive shares since their effect is anti-dilutive.

As of June 30, 2017, there was a total of 74,991,256 potentially dilutive warrants and stock options outstanding (June 30, 2016: 107,207,431).

***(Expressed in US Dollars)***

## 12. Segmented Reporting

The Company operates one operating segment, which is the acquisition, exploration and development of mineral resources in Madagascar. No revenue has been generated by any mineral resource properties. Limited amounts of cash and equipment are currently held in Madagascar. Substantially all of the remaining assets are held in Canada. The Company's President and Chief Executive Officer and Chief Financial Officer are the operating decision-makers and direct the allocation of resources to its geographic segments.

The following is the segmented information by geographic region:

| **Mineral Exploration Expense** | **Madagascar**<br>**$** | **Canada**<br>**$** | **Total**<br>**$** |
|---|---:|---:|---:|
| Year ended June 30, 2017 | 1,763,223 | 76,436 | 1,839,659 |
| Year ended June 30, 2016 | 747,315 | 65,162 | 812,477 |

| **Cash and Equivalents** | **Madagascar**<br>**$** | **Canada**<br>**$** | **Total**<br>**$** |
|---|---:|---:|---:|
| As of June 30, 2017 | 44,085 | 1,920,863 | 1,964,948 |
| As of June 30, 2016 | 29,239 | 515,574 | 544,813 |

## 13. Contingency Provision and Legal Settlement

(a) During fiscal 2014, the Company issued 17,889,215 flow-through shares to eligible Canadian taxpayer subscribers with contractual commitments for the Company to incur $3,812,642 in eligible Canadian Exploration Expenditures ("CEEs") by December 31, 2014 as per the provision of the Income Tax Act of Canada. The CEEs were renounced as a tax credit to the flow-through share subscribers on December 31, 2013. As at December 31, 2014, the Company had unfulfilled CEE obligations. During the year ended June 30, 2015, the Company recorded a contingent provision for the Part XII.6 taxes and related penalties for the indemnification liability to subscribers for taxes and penalties related to the CEE renunciation shortfall. During the year ended June 30, 2017, the Company paid $131,320 (2015: $nil) in Part XII.6 taxes related to a revised estimate of the CEE renunciation shortfall and maintained the existing contingent provision amount for the indemnification liability to subscribers for taxes and penalties. During the year ended June 30, 2017, the contingent provision was adjusted due to foreign exchange fluctuations to $182,883 (June 30, 2016: $182,742).

(b) On July 30, 2016, the Company concluded a legal settlement with the Company's former Chief Financial Officer, whereby a severance of $34,457 (CAD$44,750) was awarded and paid in full.

***(Expressed in US Dollars)***

## 14. Income Taxes

Below is a reconciliation of the United States income tax provision at the statutory rate of 35% to the actual provision:

| | **June 30, 2017** | **June 30, 2016** |
|---|---:|---:|
| Net Loss | (3,999,358) | (1,633,713) |
| Statutory rate | 35.00% | 35.00% |
| | | |
| Expected income tax recovery | (1,399,775) | (571,800) |
| Tax rate changes and other adjustments | (147,580) | (703,720) |
| Stock based compensation | 278,200 | 116,020 |
| Change in tax benefits not recognized | 1,260,325 | 1,415,360 |
| Non-deductible expenses | 8,830 | (255,860) |
| Income tax recovery | - | - |

***Deferred Tax***

The Company's future income tax assets and liabilities as at June 30, 2017 and 2016 are as follows:

| | **June 30, 2017** | **June 30, 2016** |
|---|---:|---:|
| Property, plant and equipment | 31,780 | 29,230 |
| Non-capital losses – United States | 7,041,230 | 7,562,070 |
| Exploration expenditures | 13,046,610 | 11,259,980 |
| Other deductible temporary differences | 6,890 | 6,890 |
| Deferred tax assets | 20,126,511 | 18,858,170 |
| Less: valuation allowance | (20,126,511) | (18,858,170) |
| Net deferred tax liabilities | - | - |

***(Expressed in US Dollars)***

## 14. Income Taxes (Continued)

The United States net operating loss carry forwards expire as noted in the table below. The remaining deductible temporary differences may be carried forward indefinitely. Deferred tax assets have not been recognized in respect of these items because it is not probable that future taxable profit will be available against which the group can utilize the benefits there from.

The Company's United States net operating losses expire as follows:

| **Expiration Year** | **Tax Loss** <br> **$** |
|---|---:|
| 2025 | 4,130 |
| 2026 | 29,460 |
| 2027 | 283,870 |
| 2028 | 909,180 |
| 2029 | 341,250 |
| 2030 | 3,435,600 |
| 2031 | 3,998,670 |
| 2032 | 5,264,970 |
| 2033 | 4,956,930 |
| 2034 | 3,642,800 |
| 2035 | 4,880,240 |
| 2036 | 4,549,970 |
| 2037 | 4,978,979 |
| Operating loss carry forwards | 37,276,037 |