Mountain Province

DIAMONDS

# Management's Discussion and Analysis

**For the Year Ended December 31, 2016**

**TSX: MPVD |NASDAQ: MPVD**

**MOUNTAIN PROVINCE DIAMONDS INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE YEAR ENDED DECEMBER 31, 2016

**TABLE OF CONTENTS** Page


| | |
|---|---|
| Fourth Quarter 2016 Highlights | 3 |
| Company Overview | 4 |
| Gahcho Kué Diamond Mine | 5 |
| Financing Transactions | 10 |
| Results of Operations | 13 |
| Financial Review | 14 |
| Summary of Quarterly Results | 15 |
| Costs and Expenses | 16 |
| Income and Resource Taxes | 17 |
| Financial Position and Liquidity | 17 |
| Off-Balance Sheet Arrangements | 19 |
| Financial Instruments Risks | 19 |
| Significant Accounting Judgments, Estimates and Assumptions | 21 |
| Standards and Amendments to Existing Standards | 22 |
| Related Party Transactions | 23 |
| Contractual Obligations | 25 |
| Subsequent Events | 25 |
| Other MD&A Analysis Requirements | 26 |
| Disclosure of Outstanding Share Data | 27 |
| Controls and Procedures | 27 |
| Cautionary Note Regarding Forward-Looking Statements | 28 |


This Management's Discussion and Analysis ("MD&A") of March 28, 2017 provides a review of the financial performance of Mountain Province Diamonds Inc. (the "Company" or "Mountain Province" or "MPV") and should be read in conjunction with the audited consolidated financial statements and the notes thereto as at December 31, 2016 and 2015 and for the years ended December 31, 2016 and 2015.

The audited consolidated financial statements of the Company were prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

All amounts are expressed in Canadian dollars unless otherwise stated.

Technical information included in this MD&A regarding the Company's mineral property has been reviewed by Carl Verley, a Director of the Company and a Qualified Person as defined by National Instrument 43-101 - Standards of Disclosure for Mineral Properties ("NI 43-101").

Additional information, related to the Company is available on SEDAR at http://sedar.com/ and on EDGAR at http://www.sec.gov/edgar.shtml.

## HIGHLIGHTS FOR 2016 AND TO DATE

- Ramp up to commercial production commenced on August 1, 2016. The Gahcho Kué Diamond Mine ("GK Mine") declared commercial production (defined below) subsequent to year end on March 1, 2017.

- Mining of overburden, waste rock and ore in the 5034 open pit for the twelve months ended December 31, 2016 was approximately 23.7 million tonnes, with approximately 66,000 tonnes of ore stockpiled at year end on a 100% basis.

- From August 1 to December 31, 2016, the GK Mine on a 100 percent basis processed approximately 565,000 tonnes of ore through the process plant and recovered approximately 949,000 carats for an average grade of approximately 1.68 carats/tonne.

- Approximately 1,361,223 carats were produced prior to declaring commercial production, of which approximately 668,449 carats or 49% are the Company's share.

- From the commencement of ramp up on August 1, 2016 to December 31, 2016, three splits of the diamond production took place at the Diavik Diamond Mines Inc. ('DDMI') sorting facility based in Yellowknife.

- Under the terms of the Gahcho Kué Joint Venture Agreement, the Company and De Beers Canada Inc. ("De Beers"), (collectively, the "Participants") each bid for all Fancies and Special Diamonds. Fancies are diamonds of a fancy or unusual colour and Specials are diamonds weighing 10.8 carats or more.

- As at March 28, 2017, the Company has conducted two diamond sales through its diamond broker based in Antwerp, Belgium and a third diamond sale is currently underway and scheduled to be completed on March 29, 2017. The results of the Company's first quarter diamond sales will be announced with the 2017 first quarter financial results.

- The Work in Progress ('WIP') inventory on hand prior to declaring commercial production was approximately 257,637 tonnes, estimated at a cost of approximately $8.5 million. The Company expects to sell approximately 201,000 carats based on the expected grade, being its 49% share of the WIP inventory. It is expected that due to the timing of production and sales, the Company will only reflect revenue during the second quarter of 2017.

- At December 31, 2016, the Company had drawn US$332 million from the Loan Facility and drawn an additional US$25 million as at March 28, 2017. Commencing on March 31, 2017, the Company is subject to maintaining a cash call reserve account balance based upon certain budgeted amounts which will vary over the term of the Loan Facility. Approximately US$27.9 million was originally required to be deposited in the cash call reserve account on March 31, 2017. On March 27, 2017, the Company received a waiver deferring the requirement to fund the cash call reserve account to May 31, 2017. As conditions of the waiver, certain information must be furnished to the lenders by May 31, 2017 including: an updated financial model and life of mine plan; a diamond pricing valuation comparison between production to date and historic samples from April 2011 to be prepared by the lender's independent diamond consultant; and a reconciliation of cumulative diamond production including a statistical comparison of total diamond carats, size and quality. The failure to comply with any of the requirements of the waiver constitutes an event of default. Management expects the Company will seek additional waivers or amendments from the lenders as to the timing and amount of all of these funding requirements. There are no assurances the lenders will accommodate further waivers or amendments the Company will seek. If the Company is unable to fully fund the required reserve accounts, or is unable to comply with other financial covenants, and is not successful in obtaining suitable waivers or amendments, it would result in

an event of default, and the Loan Facility outstanding balance would become payable on demand. Further, management may seek alternative sources of financing. These conditions indicate the existence of a material uncertainty that results in substantial doubt as to the Company's ability to continue as a going concern. The financial statements do not include the adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern. These adjustments may be material.

The following table summarizes key operating and financial highlights for the year ended December 31, 2016.

| | | **Year ended December 31, 2016** |
|---|---|---|
| **GK Operating data** | | |
| *Mining* | | |
| *Ore tonnes mined [1] | kilo tonnes | 624 |
| *Ore tonnes processed | kilo tonnes | 565 |
| *Waste tonnes mined [2] | kilo tonnes | 23,700 |
| *Total tonnes mined | kilo tonnes | 24,324 |
| *Ore in stockpile | number of days | 7 |
| *Processing* | | |
| *Average plant throughput | tonnes per day | 3,693 |
| *Average diamond recovery | carats per tonne | 1.68 |
| *Production and sales* | | |
| *Diamonds produced [3] | carats | 949,000 |
| Approximate diamonds produced - Mountain Province | carats | 465,010 |
| **Financial data** | | |
| Cash | $ | 6,843,704 |
| Restricted cash | $ | 83,878,089 |
| Working capital | $ | (30,386,834) |
| Total debt | $ | 425,903,138 |
| Total assets | $ | 783,761,882 |
| Total liabilities | $ | 469,331,328 |

1. Ore mined since commencement of ramp-up on August 1, 2016
2. Waste tonnes mined since January 1, 2016
3. Diamonds produced on 100% basis as per operator, but before cleaning and splitting

* at 100%

## COMPANY OVERVIEW

Mountain Province is a Canadian-based resource company listed on the Toronto Stock Exchange and NASDAQ under the symbol 'MPVD'. The Company's registered office and its principal place of business is 161 Bay Street, Suite 1410, P.O. Box 216, Toronto, ON, Canada, M5J 2S1. The Company through its wholly owned subsidiaries 2435572 Ontario Inc. and 2435386 Ontario Inc., holds a 49% interest in the GK Mine, located in the Northwest Territories of Canada. De Beers Canada Inc. ("De Beers") holds the remaining 51% interest. The Joint Arrangement between the Company and De Beers is governed by the 2009 amended and restated Joint Venture Agreement. The Company's primary asset is its 49% interest in the GK Mine.

The first blast in the quarry at the GK Mine occurred on December 13, 2013 and on September 25, 2014, the GK Mine received approval of a Type A Land Use Permit, allowing the GK Mine to commence full scale construction.

Physical construction of the GK Mine was substantially completed at June 30, 2016 and the commissioning of the plant took place during July 2016. Ramp-up to commercial production commenced on August 1, 2016 and commercial production was declared on March 1, 2017 after the GK mine achieved approximately 70% of nameplate capacity of 8,333 tonnes/day over a 30-day period.

Under the Gahcho Kué Joint Venture Agreement discussed below, commercial production for sunk cost repayment purposes is based on the first day after 30 days (excluding maintenance days) of achieving and maintaining 70% of designed production capacity. The $10 million sunk cost repayment on reaching commercial production is due March 31, 2017. For royalty purposes for the Government of the Northwest Territories, commercial production is based on the first day after 90 days of achieving 60% of designed production capacity.

The Company's strategy is to mine and sell its 49% share of rough diamonds at the highest price on the day. Mountain Province's long term view of the rough diamond market remains positive, based on the outlook for a tightening rough diamond supply and growing demand, particularly in developing markets such as China and India, resulting in real, long term price growth.

The Company held its first sales of pre-commercial production diamonds subsequent to the year end during January and February 2017 and will be holding sales approximately every five weeks thereafter.

## GAHCHO KUÉ DIAMOND MINE

### Gahcho Kué Joint Venture Agreement

The GK Mine is located in the Northwest Territories, about 300 kilometers northeast of Yellowknife. The mine covers approximately 10,353 acres, and encompasses four mining leases (numbers 4341, 4199, 4200, and 4201) held in trust by the Operator, De Beers. The Project hosts four primary kimberlite bodies – 5034, Hearne, Tuzo and Tesla. The four main kimberlite bodies are within two kilometers of each other.

The GK Mine is an unincorporated Joint Arrangement between De Beers (51%) and Mountain Province (49%) through its wholly owned subsidiaries. On October 2, 2014, Mountain Province assigned its 49% interest to its wholly-owned subsidiary 2435386 Ontario Inc. to the same extent as if 2435386 Ontario Inc. had been the original party to the Joint Venture Agreement. The Company accounts for the mine as a joint operation in accordance with International Financial Reporting Standard 11, Joint Arrangements. Mountain Province through its subsidiaries holds an undivided 49% ownership interest in the assets, liabilities and expenses of the GK Mine.

Provisions of the Joint Arrangement include the following:

(a) The Participants' continuing interests in the GK Mine will be Mountain Province 49% and De Beers 51%, except for normal dilution provisions which are applicable to both Participants;
(b) Each Participant markets their own proportionate share of diamond production in accordance with their participating interest;
(c) Each Participant has contributed their proportionate share to the development costs and will contribute their proportionate share of operating costs;
(d) Material strategic and operating decisions, including plans and budgets, will be made by consensus of the Participants as long as each Participant has a participating interest of 40% or more;
(e) The Participants have agreed that the sunk historic costs to the period ended on December 31, 2008 will be limited to $120 million;

(f) The 2009 Agreement's provision for consensus decision-making for material strategic and operating decisions provides the Company with joint control of the Project with De Beers;

(g) The Company will repay De Beers $59 million (representing 49% of the agreed sum of $120 million) plus interest compounded on the outstanding amounts in settlement of the Company's share of the agreed historic sunk costs. At December 31, 2016, the following amounts remain to be settled and will be accrued on declaration of commercial production which occurred on March 1, 2017:

- $10 million within 90 days following the commencement of commercial production This amount will be paid from the US$370 million Loan Facility during March, 2017; and
- The balance of approximately $24.4 million plus accumulated interest of approximately $25.8 million within 18 months following commencement of commercial production. At December 31, 2016, accumulated interest is approximately $22.0 million. Accumulated interest is calculated at the prevailing LIBOR rate plus 5%. The remaining $24.4 million plus the accumulated interest of $25.8 million will be paid out of future cash flows.

2435386 Ontario Inc. has agreed that the Company's marketing rights under the 2009 Agreement may be diluted if the Company defaults on the remaining repayments described above, if and when such payments become due.

The GK Mine has been successfully constructed and commissioned, and the Company has funded its 49% share of these costs. The underlying value and recoverability of the amounts shown in the consolidated financial statements for the Company's Mineral Properties is dependent upon having access to necessary working capital and future profitable production.

Between 2014 and 2016, the Company and De Beers signed agreements allowing the Operator to utilize De Beers' credit facilities to issue reclamation and restoration security deposits to the federal and territorial governments. In accordance with these agreements, the Company agreed to a 3% fee for the share of the security deposits issued. As at December 31, 2016, the Company's share of the security deposits issued were $23,419,125 (2015 - $14,378,228).

## Gahcho Kué Capital Program

The budgeted capital cost to construct the GK Mine as per the 2014 Feasibility Study NI 43-101 Technical Report was $1,019 million, excluding a management fee of 3% payable to De Beers who are both a Participant and also the Operator of the mine.

For the year ended December 31, 2016, approximately $404.6 million (excluding management fee) was required by the Operator. Included in the $404.6 million is $263.8 million relating to the capital budget of $1,019 million, $37.5 million relating to additional estimated costs to complete the construction of the GK Mine, $14.4 million relating to the remaining minor out-of-scope purchases and movements in foreign exchange, commissioning and ramp-up operating costs of $69.0 million, $1.7 million for sustaining capital and advanced working capital of $18.2 million.

The Company contributed approximately $204.2 million, which included a management fee of approximately $5.9 million. Of the $204.2 million an amount of $178.9 million was funded from the Loan Facility and the remaining amount of approximately $25.3 million from the Cost Overrun Reserve Account.

For the period, January 1, 2017 to February 28, 2017, funding of approximately $24.4 million (excluding management fee) was required by the Operator. Included in this amount are ramp-up operating costs of $21.9 million, $1.2 million for working capital and the remaining $1.3 million for original capital related costs. The Company will fund approximately $12.0 million representing its proportionate share.

Table 1 below compares the original budget against the forecast to completion and commercial production.

**Table 1**

**Capital Forecast by Work Breakdown Structure (WBS) (Presented on a 100% basis)**

| WBS | Description | CAD (M) ORIGINAL BUDGET | CAD (M) ACTUAL |
|---|---|---|---|
| 1000 | Mine Operations | 197.3 | **240.1** |
| 2000 | Site Development & Roadworks | 10.6 | **15.0** |
| 3000 | Process Facilities | 140.1 | **170.3** |
| 4000 | Utilities | 50.2 | **53.9** |
| 5000 | Ancillary Buildings | 53.1 | **66.7** |
| 6000 | Waste & Water Management | 6.3 | **5.1** |
| 7000 | Off-site Facilities | 0.4 | **0.6** |
| **Subtotal - Direct Costs =** | | **458.0** | **551.7** |
| 8000 | *Owner's Management Costs* | 104.2 | **89.1** |
| 9000 | *Indirect Costs* | 375.7 | **414.0** |
| **Subtotal – Owners + Indirect Costs =** | | **479.9** | **503.1** |
| 9900 | Contingency | 81.1 | **1.8** |
| **Total - Projects** | | **1,019.0** | **1,056.6** |
| **Management Reserve** | Out-of-scope and foreign exchange | – | **37.0** |
| **Total – Projects and Management Reserve** | | **1,019.0** | **1,093.6** |

### Gahcho Kué Production Forecast

Management expects that the GK mine will produce approximately 4.4 million carats for the year ended December 2017 and the Company expects to receive approximately 2.2 million carats, being its 49% share of production.

During 2017, the Company expects to sell approximately 2 million carats of diamonds, including pre-commercial production sales.

An update to 2017 production is expected to be completed by mid-year.

### Gahcho Kué Mineral Reserve

On April 2, 2014, Mountain Province announced a Mineral Reserve estimate for the GK Mine. The Mineral Reserve is the Indicated Resource contained in the open pit mine that can be mined and processed profitably and is scheduled for treatment in the feasibility study life of mine plan. The Gahcho Kué Mineral Reserve Summary estimate as of December 31, 2016 is summarized in Table 2 below.

**Table 2**

**Gahcho Kué Mineral Reserves (as of December 31, 2016) (presented on a 100% basis)**

| Kimberlite Deposit | Classification | Tonnes | Carats | Grade |
|---|---|---|---|---|
| | | **Mt** | **Mct** | **Cpht** |
| 5034 | Probable Reserve | 12.8 | 22.3 | 174 |
| Hearne | Probable Reserve | 5.6 | 11.7 | 207 |
| Tuzo | Probable Reserve | 16.4 | 20.6 | 125 |
| Summary | Probable Reserves | 34.8 | 54.6 | 157 |

Notes:

(1) Mineral Reserves/Resources are reported at a bottom cut-off of 1.0 mm.
(2) Mineral Resources are not Mineral Reserves and do not have demonstrated economic viability.
(3) Tonnes and carats are rounded to the nearest 100,000.
(4) Tuzo tonnes exclude 0.6 Mt of a granite raft and CRX_BX.
(5) Probable Reserves for 5034 are net of production that occurred in 2016.
(6) Mt = Metric tonnes, Mct = Million carats, Cpht = Carats per hundred tonnes.

## Diamond Outlook

The Global Diamond Report 2016 published by Bain & Company Inc., reported that restocking by midstream buyers of rough diamonds, following their inventory sell-off in late 2015, produced growth of around 20% in rough-diamond sales during the first half of 2016. However, continued strong rough-diamond sales in 2016 may again lead to overstocked midstream inventories if retail demand does not strengthen proportionately. Declining sales at major jewelry retailers in the first half of 2016 indicate a possible demand slowdown in the U.S. and China.

Also, the global diamond industry is facing disruption that could stretch through the first half of 2017, as a result of the Indian government's radical move to abolish most of the nation's bank notes overnight.

In the western Indian city of Surat craftsmen cut and polish approximately 80 percent of the world's diamonds, a business dependent on cash and the demonetization of the high-value banknotes from November 8, 2016 has prevented most of the manufacturing industry from operating. Thousands of diamond brokers in the area are also doing little business which had negatively impacted the demand and price for rough diamonds.

## Gahcho Kué Diamond Mine Update

### Procurement Progress

As at December 31, 2016, procurement for the construction of the mine was 100% complete with only ongoing field purchasing remaining (costs to be incurred during ramp up to commercial production). During the quarter ended December 31, 2016, with the various equipment and construction material at site, the focus was on the close-out of the various procurement packages, which is expected to be completed by April 2017.

Since commencing construction in December 2013 to December 31, 2016, materials, equipment and services totaling $1,049 million of the revised $1,093.6 million forecast have been ordered and received at site, which represents approximately 96.0% of the total material, equipment and services costs for the construction of the Mine. The balance will be spent in Q1 2017 during the ramp up to commercial production as discussed above.

### Mining

For the year ended December 31, 2016, on a 100% basis, a total of 23.7 million tonnes of overburden, waste rock and ore had been extracted from the 5034 open pit, compared to a plan of approximately 23.2 million tonnes (102% of plan). A total of 624,000 tonnes of ore have been delivered to the stockpile compared to a plan of 626,000 tonnes (99%). From August 1 to December 31, 2016, 565,000 tonnes of kimberlite ore was processed with 949,000 carats (100% basis) being recovered at a grade of 1.68 carats per tonne.

At December 31, 2016, there was approximately 66,000 tonnes (100% basis) of stockpiled ore. Sufficient ore is available in the 5034 pit to meet the planned process throughput rate. The stockpiling of ore was limited due to mining strategies related to minimizing loader tramming distances and reduced ore re-handle. Moving into 2017, the Operator will continue to build the stockpile as planned.

At December 31, 2016, the Company had 95,986 carats in available for sale inventory, of which the Company sold 49,420 carats in January 2017. The remaining 46,566 carats were sold in February 2017.

### Gahcho Kué Capital Cost Summary

At December 31, 2016, the Operator of the GK Mine issued purchase orders of $1,055 million of the approved $1,056.5 million budget. As mentioned above, approximately $1,049.4 million of materials, equipment and services had been received leaving a balance of approximately $7.1 million to be received or incurred during the ramp up to commercial production. Based on the approved forecast, approximately $1.5 million remains uncommitted before out of scope and foreign exchange. These orders will be placed from January 2017 to completion. The above amounts exclude commitments for ramp-up costs, working capital and minor out-of-scope purchases and movements in foreign exchange.

## FINANCING TRANSACTIONS

### Loan Facility

On April 2, 2015, the Company through its subsidiary, 2435572 Ontario Inc. entered into a Loan Facility of US$370 million with a syndicate of lenders led by Natixis S.A., Scotiabank and Nedbank Ltd. and including ING Capital LLC, Export Development Canada and the Bank of Montreal. On April 29, 2015, Société Générale joined the lender syndicate. The lenders hold security over the Company's 49% interest in the GK Mine held through the Company's subsidiaries. The term of the Loan Facility is seven years and the interest rate is U.S. dollar LIBOR plus 5.5 percent. The Loan Facility drawdown schedule commenced on April 7, 2015 and ends on September 30, 2017 to correspond with the projected construction period and the required interest payments under the Loan Facility up to September 30, 2017. At March 31, 2017, the Company is subject to maintaining a cash call reserve account balance in the amount of approximately US$27.9 million. On March 27, 2017, the lenders have provided a waiver indicating the amount is now to be funded by May 31, 2017. At September 30, 2017, certain financial covenants related to servicing the debt, as defined by the Loan Facility agreement, become effective.

The table below describes the initial funding of minimum reserve balance requirements by quarter:

| | | March 31, 2017 | June 30, 2017 | September 30, 2017 | December 31, 2017 | March 31, 2018 | Total |
|---|---|---|---|---|---|---|---|
| Cash call reserve account* | US $ | 27,900,000 | $ - | $ - | $ - | $ - | $ 27,900,000 |
| Sunk cost reserve account** | | - | - | 43,000,000 | - | - | 43,000,000 |
| Debt service reserve account | | - | - | 57,100,000 | 32,700,000 | - | 89,800,000 |
| Environment reclamation reserve account | | - | - | - | 18,200,000 | 14,400,000 | 32,600,000 |
| | US $ | 27,900,000 | $ - | $ 100,100,000 | $ 50,900,000 | $ 14,400,000 | $ 193,300,000 |

* As of March 27, 2017, the lenders have provided a waiver indicating the amount is now to be funded by May 31, 2017

** The sunk cost reserve account is to be funded by September 1, 2017

Cash call reserve account minimum balance represents the cash calls expected to be paid to the Operator in the next three months.

Sunk cost reserve account minimum balance represents the total expected sunk cost payments to the operator as described in note 7 of the financial statements.

Debt service reserve account minimum balance represents the principal and interest payments on the loan facility expected to be paid to the lenders in the next nine months.

Environment reclamation reserve account minimum balance represents the Company's share of all letters of credit issued and expected to be issued in the next nine months to any Government agency pursuant to any environmental or social permit.

As mentioned above, at March 31, 2017, the Company is subject to maintaining a cash call reserve account balance in the amount of approximately US$27.9 million. As of March 27, 2017, the Company has received a waiver from the lenders on the amounts due to be funded by March 31, 2017 until May 31, 2017. The Company does not expect to be able to comply with the other reserve account funding requirements at September 30, 2017 and accordingly, the Company expects to seek additional waivers or amendments from the lenders as to the timing and amount of all of these funding requirements. There are no assurances the lenders will accommodate further waivers or amendments the Company will seek.

Being able to comply with the covenants, and/or maintain sufficient liquidity, is dependent upon a number of factors including, realized diamond prices, exchange rates, operating costs and production levels. Adverse changes in one or more of these factors negatively impact the Company's ability to comply with the covenants and/or maintain sufficient liquidity.

At March 1, 2017, on declaring commercial production, the Company had funded its 49% share of the development of the GK Mine. Drawdowns under the Loan Facility were subject to certain conditions, including approval of a quarterly cost-to-complete report prepared by an independent technical consultant. In addition to the Loan Facility, the Company funded a cost overrun reserve account as discussed below, which was restricted to fund potential cost overruns of the Project up to September 30, 2017, and use of this account must be approved by the lenders. At September 30, 2017, the Company can use the remaining balance available in the restricted cost overrun account to fund a portion of the above reserve accounts.

The Loan Facility required the Company to arrange a US$75 million cost overrun facility or $93,345,000, which was deposited into a restricted cost overrun account in 2435572 Ontario Inc. At December 31, 2016, $23,785,818 had been used to fund minor out-of-scope items and foreign exchange variances approved by the Joint Venture Management Committee and the lenders. For the year ended December 31, 2016, interest totaling $675,921 (2015 - $627,435) had been earned in the restricted cost overrun account. At December 31, 2016, the restricted cost overrun account balance was $70,862,538.

The Loan Facility was used to fund the Company's share of the remaining construction cost of the GK Mine, associated fees, operating costs during the build-up to commercial production, general and administrative costs, interest costs and repayment of $10 million of sunk costs, which became payable to De Beers after achievement of commercial production as defined in the Gahcho Kué Joint Venture Agreement as discussed above.

At March 28, 2017, the Company had drawn US$357 million against the US$370 million Loan Facility. The remaining US$13 million of the Loan Facility will be used to fund the interest, interest rate swap and the commitment fee payments due on June 30, 2017 and September 30, 2017, respectively. Included in the US$370 million is an amount of US$5 million drawn and held in a restricted bid reserve account for the bidding of Fancies and Specials.

The Company has entered into U.S. dollar interest rate swaps ("IRS") to manage interest rate risk associated with the U.S. dollar variable rate Loan Facility and into foreign currency forward strip contracts to mitigate the risk that a devaluation of the U.S. dollar against the Canadian dollar would reduce the Canadian dollar equivalent to the U.S. dollar Loan Facility and the Company would not have sufficient Canadian dollar funds to develop the GK Mine. On July 10, 2015, the Company entered into additional foreign currency forward strip contracts from August 4, 2015 to February 1, 2017. The interest rate swaps and forward strip contracts are secured on an equal basis with the Loan Facility and documented in the form of International Swaps Derivatives Association Master agreements.

These derivatives have been classified as "non-hedge derivatives". Changes in the fair value of the IRS and foreign currency forward strip contracts are recognized in the income (loss) as gains or losses on derivatives.

***Interest Rate Swap Contracts***

On April 7, 2015, the Company entered into U.S. dollar floating-to-fixed interest rate swaps intended to economically fix the interest rate on 75% of the outstanding principal of the balance of the Loan Facility based on the forecast loan drawdown schedule up to a maximum of US$277 million. The interest rate swaps terminate on March 31, 2020. The Company will pay a fixed rate of 1.827% and will receive a variable rate based on the 3 month LIBOR forward curve, reset quarterly. Payments are settled on a quarterly basis in March, June, September, and December of each year.

The table below provides a summary of the interest rate swap contracts outstanding as at December 31, 2016:

| Period of Interest Rate Contracts | | Notional Amount (USD) |
|---|---|---|
| January 1, 2017 to December 1, 2017 | $ | 277,500,000 |
| January 1, 2018 to December 31, 2018 | | 161,932,194 |
| January 1, 2019 to December 31, 2019 | | 41,995,998 |
| January 1, 2020 to March 31, 2020 | | 5,877,827 |

***Foreign Currency Forward Strip***

On April 7, 2015, the Company executed foreign currency forward strip contracts to buy Canadian dollars and sell U.S. dollars for the period from April 7, 2015 to February 1, 2017 for notional amounts of $219,125,894 or US$175,666,949, with a weighted average price of $1.2474/US$1 and on July 10, 2015, the Company executed foreign currency forward strip contracts to buy Canadian dollars and sell U.S. dollars for the period from August 4, 2015 to February 1, 2017 for notional amounts of $54,832,365 or US$43,130,678, with a weighted average price of $1.27131/US$1.

The table below provides a summary of currency contracts outstanding as at December 31, 2016:

| Period of Currency Contracts | | Notional Amount (CAD) | | Weighted Average Price (USD) | | Notional Amount (USD) |
|---|---|---|---|---|---|---|
| January 1, 2017 to February 1, 2017 | $ | 10,547,404 | $ | 1.2447 | $ | 8,473,594 |

At December 31, 2016, US$332 million ($445.8 million Canadian) was outstanding under the Loan Facility using an exchange rate of $1.3427/US$1. The loan is carried at amortized cost on the consolidated balance sheet.

As at December 31, 2016, financing costs totaling $31,802,974 consisting primarily of fees payable to the lenders, legal and financial advisory fees, other financing related expenses and commitment fees relating to the Loan Facility were incurred. The loan has been reduced by a pro-rata portion of the deferred financing costs relative to what has been drawn to date, which is being amortized over the life of the Loan Facility using the effective interest method. The resulting balance of financing costs as at December 31, 2016 is $1,902,344 (2015 - $13,891,403) and will be allocated to future drawdowns and amortized over the life of the Loan Facility using the effective interest rate method. Unamortized deferred financing costs as at December 31, 2016 of $19,873,262 is netted against the Loan Facility.

Of the US$332 million drawn at December 31, 2016, approximately US$268.6 million was used for capital related costs, US$59.4 million for costs listed below and the remainder of approximately US$4.0 million for funds held in restricted accounts discussed below.

- US$13.7 million paid to the lenders for fees and various agency roles;
- US$6.4 million used to fund various legal, advisory fees and other financing and related expenses incurred to arrange the Loan Facility and other marketing related activity;
- US$6.0 million used to fund general and administration costs;
- US$28.3 million of interest and commitment fees; and
- US$5.0 million set aside in a restricted account for the bidding on Fancy and Special diamonds;

At December 31, 2016, the Company had US$3,451,329 in the restricted U.S. dollar proceeds account and $952,667 or US$709,516 equivalent in the restricted Canadian dollar proceeds account. These amounts are restricted to the mine and related expenditure and may only be released on completion of utilization requests approved by the Facility Agent.

The following table shows the repayment schedule for the gross amount of the Loan Facility:

| Year | |
|---|---|
| 2017 | **US $ 24,791,085** |
| 2018 | **93,845,271** |
| 2019 | **100,948,191** |
| 2020 | **46,778,076** |
| 2021 | **63,039,904** |
| 2022 | **40,597,473** |
| **Total** | **US $ 370,000,000** |

## RESULTS OF OPERATIONS

The expenditures directly attributable to the development of the GK Mine are capitalized. The total budgeted cost to construct the mine was $1,019 million (excluding exchange rate movements, out-of-scope purchases and adjustments resulting from the QRA as discussed above). The revised forecast is $1,093.6 million as discussed above.

The Company has funded its share of the remaining costs, associated fees, operating costs during the build-up to commercial production, which was declared on March 1, 2017. The Company, as discussed above, has held two sales of diamonds in January and February 2017, respectively and expects to conduct sales approximately every five weeks generating cash by selling its 49% share of the diamonds produced at the GK Mine.

## SELECTED ANNUAL INFORMATION

| | December 31, 2016 | December 31, 2015 | December 31, 2014 |
|---|---|---|---|
| Interest income | $ 976,039 | $ 1,130,419 | $ 458,659 |
| Management fees | 90,000 | 90,000 | 90,000 |
| Operating expenses | (6,277,175) | (6,316,576) | (4,726,839) |
| Other income (expenses) | 11,570,474 | (38,072,814) | (215,899) |
| Net income (loss) for the period | 4,797,834 | (43,168,971) | (4,394,079) |
| Basic and diluted earnings (loss) per share | 0.03 | (0.28) | (0.04) |
| Cash flow from operating activities | (18,011,528) | (4,243,550) | (8,858,684) |
| Cash, end of year | 6,843,704 | 9,081,791 | 3,779,907 |
| Total assets | 783,761,882 | 582,848,108 | 300,994,512 |
| Long-term liabilities | 417,016,374 | 230,226,813 | 7,996,825 |
| Dividend declared | Nil | Nil | Nil |

## FINANCIAL REVIEW

*Three months and year ended December 31, 2016 compared to the three months and year ended December 31, 2015*

For the three months ended December 31, 2016, the Company recorded a net loss of $8,305,428 or $0.05 loss per share compared to $10,247,682 net loss or $0.06 loss per share for the same period in 2015. For the year ended December 31, 2016, the Company recorded net income of $4,797,834 or $0.03 earnings per share compared to a $43,168,971 net loss or $0.28 loss per share for the same period in 2015. The main reason for the significant change was a foreign exchange gain of $4,835,228 in 2016 compared to a $18,224,300 loss for the same period in 2015. Another contributing factor was the reduction in stock based compensation from $2,268,263 for the year ended December 31, 2015 compared to $468,573 for the same period in 2016.

Quarterly financial information for the past eight quarters is shown in Table 1.

## SUMMARY OF QUARTERLY RESULTS

**Table 1 - Quarterly Financial Data**

| | Three months ended | | | |
|---|---|---|---|---|
| | **December 31 2016** | **September 30 2016** | **June 30 2016** | **March 31 2016** |
| | $ | $ | $ | $ |
| **Earnings and Cash Flow** | | | | |
| Interest income | 226,919 | 222,602 | 256,735 | 269,783 |
| Operating expenses | (2,478,863) | (1,425,970) | (1,204,053) | (1,168,289) |
| Net (loss) income for the period | (8,305,428) | (5,387,201) | (351,915) | 18,842,378 |
| Basic and diluted (loss) earnings per share | (0.05) | (0.03) | (0.00) | 0.12 |
| Cash flow from operating activities | 1,910,825 | (4,295,911) | (13,971,585) | (1,654,857) |
| Cash flow from investing activities | (63,276,213) | (16,403,918) | (36,689,415) | (89,198,557) |
| Cash flow from financing activities | 36,527,306 | 32,538,916 | 59,271,268 | 92,869,953 |
| **Balance Sheet** | | | | |
| Total assets | 783,761,882 | 752,824,874 | 732,958,630 | 693,922,768 |

| | Three months ended | | | |
|---|---|---|---|---|
| | **December 31 2015** | **September 30 2015** | **June 30 2015** | **March 31 2015** |
| | $ | $ | $ | $ |
| **Earnings and Cash Flow** | | | | |
| Interest income | 457,389 | 241,928 | 297,166 | 133,936 |
| Operating expenses | (2,367,544) | (676,617) | (2,588,372) | (684,043) |
| Net loss for the period | (10,247,682) | (26,590,291) | (5,760,241) | (570,757) |
| Basic and diluted loss per share | (0.06) | (0.17) | (0.04) | (0.00) |
| Cash flow from operating activities | (1,591,933) | (369,311) | (1,586,871) | (695,435) |
| Cash flow from investing activities | (57,622,213) | (23,496,193) | (186,756,514) | 12,127,757 |
| Cash flow from financing activities | 36,315,623 | 32,484,728 | 104,313,186 | 92,076,884 |
| **Balance Sheet** | | | | |
| Total assets | 582,848,108 | 553,299,200 | 510,358,416 | 409,428,267 |

## COSTS AND EXPENSES

*The costs and expenses for the three months and year ended December 31, 2016 compared to the three months and year ended December 31, 2015 are comparable except for the following:*

### Consulting fees and payroll

Consulting fees for the three months ended December 31, 2016 and 2015 respectively were $1,713,672 and $1,727,384. For the years ended December 31, 2016 and 2015, consulting fees and payroll respectively were $2,891,253 and $4,123,689. Included in these amounts for the year ended December 31, 2016 and 2015 respectively were $468,573 and $2,268,263 relating to stock based compensation. In October 2015, a Vice President of diamond marketing was appointed and during 2016 the Company engaged two additional staff in the diamond marketing division.

### Professional fees

Professional fees for the three months ended December 31, 2016 and 2015 respectively were $158,526 and $309,582. For the years ended December 31, 2016 and 2015, professional fees respectively were $1,465,656 and $678,842. The increase from 2016 compared to 2015 relates to various legal and audit related matters. For the year ended December 31, 2016, legal fees of approximately $619,000 were incurred in connection with executing, consulting, sorting and marketing agreements with reputable companies, in advance of the first diamond sale that took place in January 2017.

### Promotion and investor relations

Promotion and investor relations for the three months ended December 31, 2016 and 2015 respectively were $196,591 and $21,966. For the years ended December 31, 2016 and 2015, promotion and investor relations respectively were $386,495 and $134,606. The main reason for the significant increase in 2016, is due to a one-time cost for 49% of the opening mine ceremony of the GK Mine.

### Transfer agent and regulatory fees

Transfer agent and regulatory fees for the three months ended December 31, 2016 and 2015 respectively were $53,584 and $63,655. For the years ended December 31, 2016 and 2015, transfer agent and regulatory fees respectively were $327,677 and $408,834. Due to the rights offering in 2015, transfer agent and regulatory fees were higher than in 2016.

### Interest income

Interest income for the three months ended December 31, 2016 and 2015 respectively was $226,919 and $457,389. For the years ended December 31, 2016 and 2015, interest income respectively was $976,039 and $1,130,419. The decrease in 2016 is as a result of a lower average balance in the proceeds accounts compared to 2015.

### Derivative gains (losses)

Derivative gains (losses) for the three months ended December 31, 2016 and 2015, respectively, were $3,665,191 and ($991,720). For the years ended December 31, 2016 and 2015, derivative gains (losses), respectively, were $6,028,173 and ($19,408,350). On April 7, 2015, foreign exchange and interest rate swap contracts were entered into and on July 10, 2015 additional foreign exchange contracts were executed. For the year ended December 31, 2016, the derivative gain is attributed to the relative strengthening of the Canadian dollar to the U.S. dollar over 2015, which has resulted in a derivative gain on the foreign currency strip contracts. The increase in derivative gain is as a result of the majority of the foreign currency forward strip contracts being settled during the year. The remaining foreign currency forward strip contracts will be settled by February 2017.

### Foreign exchange gains (losses)

Foreign exchange losses for the three months ended December 31, 2016 and 2015 respectively were $9,513,171 and $7,296,986. For the years ended December 31, 2016 and 2015, foreign exchange gains (losses) respectively were $4,835,228 and ($18,224,300). The foreign exchange gain for the year ended December 31, 2016 is a result of the Canadian dollar strengthening relative to the U.S. dollar and the translation of the Loan Facility and U.S. dollar cash balances to Canadian dollar at the spot rate at the period end. During the year ended December 31, 2016, the spot exchange rate fell from $1.384/US$1, at December 31, 2015, to 1.3427/US$1.

## INCOME AND RESOURCE TAXES

The Company is subject to income and mining taxes in Canada with the statutory income tax rate at 26.5%.

No deferred tax asset has been recorded in the financial statements as a result of the uncertainty associated with the ultimate realization of these tax assets.

The Company is subject to assessment by Canadian authorities, which may interpret tax legislation in a manner different from the Company. These differences may affect the final amount or the timing of the payment of taxes. When such differences arise, the Company makes provision for such items based on management's best estimate of the final outcome of these matters.

## FINANCIAL POSITION AND LIQUIDITY

The development of the GK Mine is complete and commercial production was declared on March 1, 2017. The underlying value and recoverability of the amounts shown as "Property and Equipment" are dependent upon future profitable production and proceeds from disposition of the Company's mineral properties. Failure to meet the obligations for the Company's share in the GK Mine may lead to dilution of the interest in the GK Mine and may require the Company to write off costs capitalized to date. As discussed above, the Company arranged the necessary equity and Loan Facility to fund its share of the construction and commissioning costs of the GK Mine. The Company held its first sales of diamonds in January and February 2017 and will conduct sales approximately every five weeks thereafter.

Under the terms of the Company's Loan Facility Agreement, the Company will be subject to funding of reserve accounts and certain financial covenants as discussed in Note 9 of the financial statements. The Loan Facility Agreement also contains material adverse effect clauses. In the absence of amendments or receipt of waivers, non-compliance with reserve funding requirements or other financial covenants, or the occurrence of a material adverse effect event, would be an event of default under the terms of the Loan Facility Agreement.

Commencing on March 31, 2017, the Company is subject to maintaining a cash call reserve account balance based upon certain budgeted amounts which will vary over the term of the Loan Facility. Approximately US$27.9 million was originally required to be deposited in the cash call reserve account on March 31, 2017. On March 27, 2017, the Company received a waiver deferring the requirement to fund the cash call reserve account to May 31, 2017. As conditions of the waiver, certain information must be furnished to the lenders by May 31, 2017 including: an updated financial model and life of mine plan; a diamond pricing valuation comparison between production to date and historic samples from April 2011 to be prepared by the lender's independent diamond consultant; and a reconciliation of cumulative diamond production including a statistical comparison of total diamond carats, size and quality. The failure to comply with any of the requirements of the waiver constitutes an event of default.

Under the terms of the Loan Facility Agreement, the Company is also required to fund reserve accounts (Note 9 of the financial statements) estimated as follows for the period from January 1, 2017 to December 31, 2017:

| Date additional funding is required | | Funding requirements |
|---|---|---|
| September 2017 | US $ | 100,100,000 |
| December 2017 | | 50,900,000 |

At September 30, 2017, the Company can use the remaining balance available in the restricted cost overrun account (Note 6 of the financial statements) to fund a portion of the above reserve accounts. Based on the delay in achieving commercial production and current market prices in the diamond industry, management believes the Company will not be able to comply with the requirement to fully fund these reserve accounts and may not comply with the other financial covenants in the Loan Facility.

Management expects the Company will seek additional waivers or amendments from the lenders as to the timing and amount of all of these funding requirements. There are no assurances the lenders will accommodate further waivers or amendments the Company will seek. If the Company is unable to fully fund the required reserve accounts, or is unable to comply with other financial covenants, and is not successful in obtaining suitable waivers or amendments, or a material adverse event occurs, it would result in an event of default, and the Loan Facility outstanding balance would become payable on demand. Further, management may seek alternative sources of financing. These conditions indicate the existence of a material uncertainty that results in substantial doubt as to the Company's ability to continue as a going concern. The financial statements do not include the adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern. These adjustments may be material.

Cash flow used in operating activities, including change in non-cash working capital for the year ended December 31, 2016 were $18,011,528 compared to $4,243,550 for the same period in 2015. The increase is mainly as a result of the purchase of supplies inventory totalling approximately $11.7 million.

Investing activities for the year ended December 31, 2016 were $205,568,103 compared to $255,747,163 for the same period in 2015. For the year ended December 31, 2016, the outflow for the purchase of equipment and the expenditures directly related to the development of the GK Mine were $195,255,074 compared to $239,795,590 for the same period in 2015. Capitalized interest paid for the year ended December 31, 2016 was $25,006,731. Cash used for investing activities for the year ended December 31, 2016 include $10,633,930 in restricted cash, $195,255,074 in property and equipment, $25,006,731 for capitalized interest paid, $538,708 in amounts receivable, offset by $976,039 of interest income. For the year ended December 31, 2015, $239,795,590 was used for property and equipment, which was offset by the redemption of $77,261,842 in short-term investments and $1,130,419 of interest income and $168,185 of amounts receivable.

Financing activities for the year ended December 31, 2016 were $221,207,443 compared to $265,190,421 for the same period in 2015. Cash flows from financing activities for the year ended December 31, 2016, related to cash draws of US$174 million or approximately $223.6 million Canadian dollar equivalent from January 1, 2016 to December 31, 2016 from the Loan Facility, net of financing costs, approximately $2.89 million. For the year ended December 31, 2015, approximately $27.7 million was used in financing costs and approximately $94.9 million of proceeds from share issuance, net of costs, was received and cash draws of US$158 million (or approximately $198.2 million Canadian dollar equivalent) were made from the Loan Facility.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

## FINANCIAL INSTRUMENTS RISKS

The Company examines the various financial risks to which it is exposed and assesses the impact and likelihood of those risks. These risks include credit risk, liquidity risk, market risk, foreign currency risk and interest rate risk.

### Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its obligations.

On December 31, 2016 and 2015, the Company does not have any allowance for doubtful accounts, and does not consider that any such allowance is necessary.

All of the Company's cash and restricted cash is held with a major Canadian financial institution and thus the exposure to credit risk is considered insignificant. Management actively monitors the Company's exposure to credit risk under its financial instruments, including with respect to amounts receivable. The Company considers the risk of loss for its amounts receivable to be remote and significantly mitigated due to the financial strength of the parties from whom most of the amounts receivable are due - the Canadian government for harmonized sales tax ("HST") refunds receivable in the amount of approximately $1,659,371 (2015 - $1,312,782).

The Company's current policy is to hold excess cash in bank accounts. It periodically monitors the investment income it makes and is satisfied with the credit ratings of its bank.

### Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations associated with financial liabilities. Funds from the Loan Facility (Note 9 of the financial statements) will be required to fund its share of the remaining capital and operating costs to commercial production of the GK Mine. The Company's approach to managing liquidity risk is to monitor forecast cash flows so that it will have sufficient liquidity to meet liabilities when due. The Company has a planning and budgeting process in place by which it anticipates and determines the funds required to support its ongoing requirements. The Company coordinates this planning and budgeting process with its financing activities through its capital management process. As discussed in Note 1 of the financial statements, the Company does not expect to generate sufficient liquidity to fully fund the reserve accounts which are conditions of the Loan Facility. If the Company is unable to fully fund the required reserve accounts, or is unable to comply with other covenants, and is not successful in obtaining suitable waivers or amendments, or a material adverse event occurs, it would result in an event of default, and the Loan Facility outstanding balance would become payable on demand. Being able to comply with the covenants, and/or maintain sufficient liquidity, is dependent upon many factors including, but not limited to, diamond prices, exchange rates, operating costs and levels of production. Adverse changes in one or more of these factors negatively impact the Company's ability to comply with the covenants and/or maintain sufficient liquidity.

Under the terms of the Loan Facility Agreement, the Company is also required to fund reserve accounts (Note 9 of the financial statements) estimated as follows for the period from January 1, 2017 to December 31, 2017:

| Date additional funding is required | | Funding requirements |
|---|---|---|
| September 2017 | US $ | 100,100,000 |
| December 2017 | | 50,900,000 |

At September 30, 2017, the Company can use the remaining balance available in the restricted cost overrun account (Note 6 of the financial statements) to fund a portion of the above reserve accounts. Based on the delay in achieving commercial production and current market prices in the diamond industry, management believes the Company will not be able to comply with the requirement to fully fund these reserve accounts and may not comply with the other financial covenants in the Loan Facility.

Management expects the Company will seek additional waivers or amendments from the lenders as to the timing and amount of all of these funding requirements. There are no assurances the lenders will accommodate further waivers or amendments the Company will seek. If the Company is unable to fully fund the required reserve accounts, or is unable to comply with other financial covenants, and is not successful in obtaining suitable waivers or amendments, or a material adverse event occurs, it would result in an event of default, and the Loan Facility outstanding balance would become payable on demand. Further, management may seek alternative sources of financing. These conditions indicate the existence of a material uncertainty that results in substantial doubt as to the Company's ability to continue as a going concern. The financial statements do not include the adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern. These adjustments may be material.

As at December 31, 2016, the Company had drawn US$332 million or $445.8 million Canadian dollar equivalent from the Loan Facility.

### Market risk

Market risk is the risk that changes in market prices such as foreign exchange rates, interest rates and equity prices will affect the Company's income and the value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters while optimizing returns.

### Interest rate risk

The Company is exposed to interest rate risk on its outstanding borrowings and interest rate swap contracts. The Company has entered into interest rate swaps to fix its interest rate exposure for 75% of its U.S. dollar Loan Facility and therefore has interest rate exposure to the remaining 25%. At December 31, 2016, the total Loan Facility drawn was US$332 million and interest rate swaps of US$228.9 million were in effect.

At December 31, 2016, a 100 basis point increase in the LIBOR interest rate for the interest rate swap portion and interest rate on the Loan Facility would have resulted in a decrease to interest by approximately $6.71 million. A 100 basis point decrease in the LIBOR interest rate for the interest rate swap portion and interest rate on the Loan Facility would have resulted in an increase to interest for the year ended December 31, 2016 by approximately $6.87 million.

### Foreign currency risk

The Company is exposed to market risk related to foreign exchange rates. The Company operates in Canada and has foreign currency exposure to transactions in U.S. dollars. The majority of development costs of the GK Mine are in Canadian dollars, but funded through the U.S. dollar Loan Facility (Note 9 of the financial statements). The Company has entered into foreign currency forward strip contracts to mitigate the risk that a devaluation of the U.S. dollar against the Canadian dollar would reduce the Canadian dollar equivalent of the U.S. dollar Loan Facility and the Company would not have sufficient Canadian dollar funds to develop the GK Mine. The foreign currency forward strip contracts increase the exposure to risk related to foreign exchange rates. Currency risk relates to the U.S. dollar Loan Facility, foreign currency forward strip contracts and cash and restricted cash denominated in U.S. dollar.

As at December 31, 2016, the Company had cash and restricted cash, accounts payable and accrued liabilities, derivative liabilities and the Loan Facility that are in U.S. dollars. The Canadian dollar equivalent is as follows:

| | | |
|---|---|---|
| Cash | $ | 2,700,000 |
| Restricted cash | | 12,100,000 |
| Accounts payable and accrued liabilities | | (900,000) |
| Derivative liabilities | | (3,000,000) |
| Loan facility | | (445,800,000) |
| **Total** | **$** | **(434,900,000)** |

A 10% appreciation or depreciation of the Canadian dollar relative to the U.S. dollar at December 31, 2016 would have resulted in an increase or decrease to net income for the year ended December 31, 2016 of approximately $43.5 million.

## SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the Company's consolidated financial statements requires management to make judgments and/or estimates that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. These judgements and estimates are continuously evaluated and are based on management's experience and knowledge of the relevant facts and circumstances. Actual results may differ from the estimates. The key areas where judgements, estimates and assumptions have been made are summarized below.

i) Significant judgments in applying accounting policies

The areas which require management to make significant judgments in applying the Company's accounting policies are:

a) *Impairment analysis – mineral properties*

As required under IAS 36 – Impairment of Assets, the Company reviews its mineral properties for impairment based on results to date and when events and changes in circumstances indicate that the carrying value of the assets may not be recoverable. The Company is required to make certain judgments in assessing indicators of impairment. The Company's assessment is that as at December 31, 2016 and 2015 no indicator of an impairment in the carrying value of its mineral properties had occurred.

b) *Commencement of commercial production*

There are a number of quantitative and qualitative measures the Company considers when determining if conditions exist for the transition from pre-commercial production to commencement of commercial production of an operating mine, which include:

- all major capital expenditures have been completed to bring the mine to the condition necessary for it to be capable of operating in the manner intended by management;
- mineral recoveries are at or near expected production levels;
- the ability to sustain ongoing production of ore; and
- the ability to operate the plant as intended.

The list of measures is not exhaustive and management takes into account the surrounding circumstances before making any specific decision.

ii) Significant accounting estimates and assumptions

The areas which require management to make significant estimates and assumptions in determining carrying values include, but are not limited to:

a) *Mineral reserves and resources*

Mineral reserve and resource estimates include numerous uncertainties and depend heavily on geological interpretations and statistical inferences drawn from drilling and other data, and

require estimates of the future price for the commodity and future cost of operations. The mineral reserve and resources are subject to uncertainty and actual results may vary from these estimates. Results from drilling, testing and production, as well as material changes in commodity prices and operating costs subsequent to the date of the estimate, may justify revision of such estimates. Changes in the proven and probable mineral reserves or measured and indicated and inferred mineral resources estimates may impact the carrying value of the properties. This will also impact the carrying value of the decommissioning and restoration liability and future depletion charges.

b) *Provision for decommissioning and restoration*

The decommissioning and restoration liability and the accretion recorded are based on estimates of future cash flows, discount rates, and assumptions regarding timing. The estimates are subject to change and the actual costs for the decommissioning and restoration liability may change significantly.

c) *Stock options*

The stock option pricing model requires the input of highly subjective assumptions including the expected life and volatility. Changes in the subjective input assumptions can materially affect the fair value estimate.

d) *Deferred taxes*

Deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and on unused 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.

## STANDARDS AND AMENDMENTS TO EXISTING STANDARDS

At the date of authorization of these financial statements, certain new standards and amendments to existing standards have been published but are not yet effective, and have not been adopted early by the Company. The Company anticipates that all of the relevant standards will be adopted by the Company in the first period beginning after the effective date of the standard. Information on new standards and amendments that are expected to be relevant to the Company's financial statements is provided below.

**Share-based payments**

In June 2016, the IASB issued amendments to International Financial Reporting Standard 2, Share-based Payment ("IFRS 2"). IFRS 2 is effective for periods beginning on or after January 1, 2018 and is to be applied prospectively. The amendments clarify the classification and measurement of share-based payment transactions. Management is currently assessing the impact of the amendment to IFRS 2 on the consolidated financial statements.

**Revenue**

In May 2014, the IASB issued International Financial Reporting Standard 15, Revenue from Contracts with Customers ("IFRS 15"). IFRS 15 is effective for periods beginning on or after January 1, 2018 and is to be applied retrospectively. IFRS 15 clarifies the principles for recognizing revenue from contracts with customers. Management will adopt IFRS 15 effective for the period beginning on January 1, 2017.

### Financial instruments

In July 2014, the IASB issued the final version of International Financial Reporting Standard 9, Financial Instruments ("IFRS 9"), bringing together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement. The mandatory effective date of IFRS 9 is annual periods beginning on or after January 1, 2018, with early adoption permitted. We are currently assessing the impact of adopting IFRS 9 on the consolidated financial statements along with timing of adoption of IFRS 9.

### Leases

On January 13, 2016, the IASB issued International Financial Reporting Standard 16, Leases ("IFRS 16"). The new standard will replace existing lease guidance in IFRS and related interpretations, and requires companies to bring most leases on-balance sheet. The new standard is effective for annual periods beginning on or after January 1, 2019. The Company is currently assessing the impact of IFRS 16.

### Statement of cash flows

In January 2016, the IASB issued an amendment to International Accounting Standard 7, Statement of Cash Flows. The amended standard introduced additional disclosure requirements for liabilities arising from financing activities. The amendment is effective for annual periods beginning on or after January 1, 2017. The Company does not expect this amendment to have a significant impact on its consolidated financial statements.

## RELATED PARTY TRANSACTIONS

The Company's related parties include the operator of the GK Mine, Dermot Desmond, Bottin, key management and their close family members, and the Company's directors. Kennady Diamonds Inc. ("Kennady Diamonds") is also a related party since the Company and Kennady Diamonds have common members of key management. International Investment and Underwriting ("IIU") is also a related party since it is controlled by Mr. Dermot Desmond.

Related party transactions are recorded at their exchange amount, being the amount agreed to by the parties. Outstanding balances are settled in cash.

The Company had the following transactions and balances with its related parties including key management personnel and the Company's directors, Dermot Desmond, Bottin, the operator of the GK Mine, and Kennady Diamonds. The transactions with key management personnel are in the nature of remuneration. The transactions with the operator of the GK Mine relate to the funding of the Company's interest in the GK Mine for the current year's expenditures, capital additions, management fee, and pre-production sales related to the 49% share of fancies and special diamonds. The transactions with Kennady Diamonds are for a monthly management fee charged by the Company and reimbursement of expenses paid on behalf of Kennady Diamonds. The transactions with IIU are for the director fees and travel expenses of the Chairman of the Company.

As discussed in Note 11 of the financial statements, in 2015 the Company issued 712,500 common shares or the equivalent of $2,850,000 to Mr. Dermot Desmond as a standby fee.

The balances as at December 31, 2016 and 2015 were as follows:

| | | December 31, 2016 | | December 31, 2015 |
|---|---|---|---|---|
| Payable to the operator of the GK Mine* | $ | **926,079** | $ | 1,210,408 |
| Receivable from Kennady Diamonds | | **-** | | 8,475 |
| Payable to International Investment and Underwriting | | **52,762** | | - |
| Payable to key management personnel | | **3,279** | | - |

*included in accounts payable and accrued liabilities

The transactions for the year ended December 31, 2016 and 2015 were as follows:

| | | Year ended December 31, 2016 | | Year ended December 31, 2015 |
|---|---|---|---|---|
| The total of the transactions: | | | | |
| Kennady Diamonds | $ | **90,000** | $ | 90,000 |
| International Investment and Underwriting | | **52,762** | | 40,000 |
| Remuneration to key management personnel | | **2,077,129** | | 3,843,355 |
| Pre-production sales to De Beers Canada Inc. | | **3,622,441** | | - |
| Assets purchased from De Beers Canada Inc. | | **552,838** | | 32,945 |
| Management fee charged by the operator of the GK Mine | | **5,211,315** | | 6,522,109 |

The remuneration expense of directors and other members of key management personnel for the year ended December 31, 2016 and 2015 were as follows:

| | | Year ended December 31, 2016 | | Year ended December 31, 2015 |
|---|---|---|---|---|
| Consulting fees, director fees, bonus and other short-term benefits | $ | **1,608,556** | $ | 1,575,092 |
| Share-based payments | | **468,573** | | 2,268,263 |
| | $ | **2,077,129** | $ | 3,843,355 |

In accordance with International Accounting Standard 24 Related Parties, key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company directly or indirectly, including any directors (executive and non-executive) of the Company.

The Company has a consulting agreement with the President and CEO for his services in this capacity.

## CONTRACTUAL OBLIGATIONS

The following table summarizes the contractual maturities of the Company's significant financial liabilities and capital commitments, including contractual obligations:

| | Less than 1 Year | 1 to 3 Years | 4 to 5 Years | After 5 Years | Total |
|---|---|---|---|---|---|
| Operating lease obligations | $ 157,998 | $ 456,354 | $ 465,744 | $ 545,559 | **$ 1,625,655** |
| Gahcho Kué Diamond Mine commitments | 22,539,444 | - | - | - | **22,539,444** |
| Trade and other payables | 16,115,963 | - | - | - | **16,115,963** |
| Loan facility - Principal* | 33,286,991 | 261,549,181 | 147,452,601 | 3,487,627 | **445,776,400** |
| Loan facility - Interest | 32,617,000 | 44,743,300 | 14,617,200 | 69,900 | **92,047,400** |
| Sunk cost repayment - principal | 10,000,000 | 24,400,000 | - | - | **34,400,000** |
| Sunk cost repayment - interest | - | 25,800,000 | - | - | **25,800,000** |
| Interest Rate Swap Contracts: | | | | | |
| Outflows | 2,397,642 | 98,087 | 7,719 | - | **2,503,448** |
| Forward Exchange Contracts**: | | | | | |
| (Inflows) | (10,547,404) | - | - | - | **(10,547,404)** |
| Outflows | 11,377,495 | - | - | - | **11,377,495** |
| | **$ 117,945,129** | **$ 357,046,922** | **$ 162,543,264** | **$ 4,103,086** | **$ 641,638,401** |

*In accordance with the terms of the Loan Facility at March 31, 2017, the Company is subject to maintaining a cash call reserve account balance in the amount of approximately US$27.9 million. As of March 27, 2017, the lenders have provided a waiver indicating the amount is now to be funded by May 31, 2017. Under the terms of the Loan Facility Agreement, the Company is also required to fund reserve accounts estimated (Note 9 of the financial statements) of US$100.1 million in September 2017, and additional amounts of US$50.9 million and US$14.4 million at December 31, 2017 and March 31, 2018, respectively.
**The foreign exchange contracts inflows and outflows have been signed with the syndicate of lenders. In the scenario where one or more of these lenders are unable to pay, the Company could be exposed to the outflow of agreed upon funds for the remaining contracts at that time. Any offsetting would be at the discretion of the lenders. The Company believes it has no significant credit risk.

## SUBSEQUENT EVENTS

Subsequent to December 31, 2016, 355,000 stock options were exercised for gross proceeds of $1,576,850. The aggregate market price of the common shares on the exercise date was $2,315,750. In addition, 135,000 stock options expired.

Subsequent to the year ended December 31, 2016, stock options were granted and valued using the assumption below:

| | |
|---|---|
| Date of grant | February 6, 2017 |
| Number of options granted | 100,000 |
| Fair value per option | $1.7097 |
| Fair value total for grant | $170,970 |
| Term of option | 5 years |
| Vesting | See description below* |
| **Assumptions:** | |
| Exercise price | $5.86 |
| Expected volatility | 31.03% |
| Expected option life | 5 years |
| Expected forfeiture | none |
| Expected dividend yield | 0% |
| Risk-free interest rate | 1.11% |

## OTHER MANAGEMENT DISCUSSION AND ANALYSIS REQUIREMENTS

### Risks

Mountain Province's business of developing and operating mineral resources involves a variety of operational, financial and regulatory risks that are typical in the mining industry. The Company attempts to mitigate these risks and minimize their effect on its financial performance, but there is no guarantee that the Company will be profitable in the future, and investing in the Company's common shares should be considered speculative.

Mountain Province's business of developing and operating mineral properties is subject to a variety of risks and uncertainties, including, without limitation:

- risk that the development of the mine will not be consistent with the Company's expectation;
- risks and uncertainties relating to the interpretation of drill results, the geology, grade and continuity of mineral deposits;
- results of initial feasibility, pre-feasibility and feasibility studies, and the possibility that future exploration, development or mining results will not be consistent with the Company's expectations; mining exploration risks, including risks related to accidents, equipment breakdowns or other unanticipated difficulties with or interruptions in production;
- risks related to foreign exchange fluctuations and prices of diamonds;
- risks related to commodity price fluctuations;
- the uncertainty of profitability based upon the Company's history of losses;
- risks related to failure of its joint venture partner;
- risks relating to complying with the covenants in our Loan Facility and the Company's ability to negotiate further waivers and amendments from the lenders which may be required;
- risk of events of default occurring, under Loan Facility, and not being able to continue as a going concern;
- development and production risks including and particularly risks for weather conducive to the building and use of the Tibbitt to Contwoyto Winter Road;
- risks related to environmental regulation, permitting and liability;
- risks related to legal challenges to operating permits that are approved and/or issued;
- political and regulatory risks associated with mining, exploration and development;
- the ability to develop and operate the Company's GK Mine on an economic basis and in accordance with applicable timelines;
- aboriginal rights and title;
- failure of plant, equipment, processes and transportation services to operate as anticipated;
- possible variations in ore grade or recovery rates, permitting timelines, capital expenditures, reclamation activities, land titles, and social and political developments, and other risks of the mining industry; and
- other risks and uncertainties related to the Company's prospects, properties and business strategy.

As well, there can be no assurance that any further funding required by the Company will become available to it, and if so, that it will be offered on reasonable terms, or that the Company will be able to secure such funding. Furthermore, there is no assurance that the Company will be able to secure new mineral properties or Projects, or that they can be secured on competitive terms.

## DISCLOSURE OF OUTSTANDING SHARE DATA

The Company's common shares are traded on the Toronto Stock Exchange (TSX) under the symbol MPVD and on the NASDAQ under the symbol MPVD.

At March 28, 2017, there were 160,173,833 shares issued, 2,630,000 stock options and 320,000 restricted share units outstanding. There were no warrants outstanding.

There are an unlimited number of common shares without par value authorized to be issued by the Company.

## CONTROLS AND PROCEDURES

## DISCLOSURE CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2016 (the "Evaluation Date"). Based upon that evaluation, as a result of the material weaknesses in internal control over financial reporting described in Management's Annual Report on Internal Control Over Financial Reporting below, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were not effective as of the Evaluation Date.

## MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management has evaluated the effectiveness of its internal controls over financial reporting as of December 31, 2016 and management's assessment is contained in Management's Annual Report on Internal Control Over Financial Reporting appearing on page 4 of our consolidated financial statements for the year ended December 31, 2016 filed on SEDAR, and is incorporated by reference herein. Management has assessed that due to material weaknesses in our internal control over financial reporting, the Company's internal control over financial reporting was not effective as of December 31, 2016. Our auditors, KPMG LLP, an independent registered public accounting firm, have issued an attestation report on management's assessment of internal control over financial reporting expressing an adverse opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2016. This report appears on page 8 of such consolidated financial statements.

## CHANGES IN INTERNAL CONTROLS

In addition to the material weaknesses disclosed on page 4 of the consolidated financial statements there have been additional changes in the Company's internal control over financial reporting during the fiscal year ended December 31, 2016. The Operator of the GK Mine relocated from Toronto to Calgary, which resulted in the majority of the new compliment of staff being recruited in Calgary. As part of the restructuring, the accounts payable, effective July 1, 2016 was outsourced to Anglo American Global Shared Services.

## CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS

*Certain of the statements made and information contained herein is "forward-looking information" within the meaning of the Ontario Securities Act. Forward-looking information may include, but is not limited to, statements with respect to the success of exploration activities, future mineral exploration, permitting time lines, requirements for additional capital, sources and uses of funds, the estimation of mineral reserves and mineral resources, the realization of mineral reserve and mineral resource estimates, future remediation and reclamation activities, the timing of activities and the amount of estimated revenues and expenses. Forward-looking information is based on various assumptions including, without limitation, the expectations and beliefs of management, the assumed long term price of diamonds; that the Company can access financing, appropriate equipment and sufficient labour and that the political environment where the Company operates will continue to support the development and operation of mining projects. Should underlying assumptions prove incorrect, or one or more of the risks and uncertainties described below materialize, actual results may vary materially from those described in forward-looking statements. Accordingly, readers are advised not to place undue reliance on forward-looking statements.*

*Forward-looking information is subject to a variety of risks and uncertainties which could cause actual events or results to differ from those reflected in the forward-looking information, including, without limitation, risks and uncertainties relating to foreign currency fluctuations; risks inherent in mining including environmental hazards, industrial accidents, unusual or unexpected geological formations, ground control problems and flooding; delays or the inability to obtain necessary governmental permits or financing; risks associated with the estimation of mineral resources and reserves and the geology, grade and continuity of mineral deposits; the possibility that future exploration, development or mining results will not be consistent with the Company's expectations; the potential for and effects of labor disputes or other unanticipated difficulties with or shortages of labor or interruptions in production; failure of plant, equipment or processes to operate as anticipated; actual ore mined varying from estimates of grade, tonnage, dilution and metallurgical and other characteristics; the inherent uncertainty of production and cost estimates and the potential for unexpected costs and expenses, diamond price fluctuations; uncertain political and economic environments; changes in laws or policies, and other risks and uncertainties, including those described under Risk Factors. Historical results of operations and trends that may be inferred from the following discussions and analysis may not necessarily indicate future results from operations. The Company undertakes no obligation to publicly update or review the forward-looking statements whether as a result of new information, future events or otherwise, other than as required under applicable securities laws.*

### *Cautionary Note to U.S. Investors – Information Concerning Preparation of Resource Estimates*

*This MD&A has been prepared in accordance with the requirements of the securities laws in effect in Canada, which differ from the requirements of United States securities laws. Unless otherwise indicated, all resource and reserve estimates included in this MD&A have been prepared in accordance with NI 43-101 and the Canadian Institute of Mining and Metallurgy Classification System. NI 43-101 is a rule developed by the Canadian Securities Administrators which establishes standards for all public disclosure an issuer makes of scientific and technical information concerning mineral projects.*

*Canadian standards, including NI 43-101, differ significantly from the requirements of Industry Guide 7 promulgated by the United States Securities and Exchange Commission ("SEC") under the United States Securities Act of 1933, as amended, and resource and reserve information contained herein may not be comparable to similar information disclosed by U.S. companies. In particular, and without limiting the generality of the foregoing, the term "resource" does not equate to the term "reserves". Under U.S. standards, mineralization may not be classified as a "reserve" unless the determination has been made that the mineralization could be economically and legally produced or extracted at the time the reserve determination is made. The SEC's disclosure standards under Industry Guide 7 do not define the terms and normally do not permit the inclusion of information concerning "measured mineral resources", "indicated mineral resources" or "inferred mineral resources" or other descriptions of the amount of mineralization in mineral deposits that do not constitute "reserves" by U.S. standards in documents filed with the SEC. U.S. Investors should also understand that "inferred mineral resources" have a great*

*amount of uncertainty as to their existence and great uncertainty as to their economic and legal feasibility. It cannot be assumed that all or any part of an "inferred mineral resource" will ever be upgraded to a higher category. Under Canadian rules, estimated "inferred mineral resources" may not form the basis of feasibility or pre-feasibility studies except in rare cases. Investors are cautioned not to assume that all or any part of an "inferred mineral resource" exists or is economically or legally mineable.*

*Disclosure of "contained ounces" (or "contained carats") in a resource is permitted disclosure under Canadian regulations; however, the SEC normally only permits issuers to report mineralization that does not constitute "reserves" by SEC standards as in place tonnage and grade without reference to unit measures. The requirements of NI 43-101 for identification of "reserves" are also not the same as those of the SEC's Industry Guide 7, and reserves reported by the Company in compliance with NI 43-101 may not qualify as "reserves" under Industry Guide 7 standards. Accordingly, information concerning mineral deposits set forth herein may not be comparable with information made public by companies that report in accordance with U. S. standards.*