

DEFIANCE SILVER CORP.

(an exploration stage company)

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED

DECEMBER 31, 2016

(Unaudited – Prepared by Management)

(expressed in Canadian dollars)

DEFIANCE SILVER CORP.

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3) (a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditor.

DEFIANCE SILVER CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION
(Unaudited – Prepared by Management)
(Canadian dollars)

	December 31, 2016	June 30, 2016
ASSETS		
Current assets		
Cash (Note 3)	\$ 1,038,590	\$ 932,315
Receivables (Note 4)	6,957	13,941
Prepaid expenses	13,559	1,085
	<u>1,059,106</u>	<u>947,341</u>
Value added tax (Note 4)	191,107	243,786
Exploration and evaluation assets (Note 5)	<u>2,194,330</u>	<u>2,019,716</u>
TOTAL ASSETS	<u>\$ 3,444,543</u>	<u>\$ 3,210,843</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (Note 6)	\$ 345,561	\$ 392,693
	<u>345,561</u>	<u>392,693</u>
Deferred income taxes	36,000	36,000
	<u>381,561</u>	<u>428,693</u>
Shareholders' equity		
Share capital (Note 8)	9,062,555	8,578,279
Share-based payments reserve	753,700	629,115
Deficit	<u>(6,753,273)</u>	<u>(6,425,244)</u>
	<u>3,062,982</u>	<u>2,782,150</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 3,444,543</u>	<u>\$ 3,210,843</u>

Nature and continuance of operations (Note 1)

On behalf of the Board:

"Darrell A. Rader"

Darrell A. Rader

"Bruce Winfield"

Bruce Winfield

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

DEFIANCE SILVER CORP.**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF LOSS AND COMPREHENSIVE LOSS**

(Unaudited – Prepared by Management)

(Canadian dollars)

	Three months ended		Six months ended	
	2016	2015	2016	2015
Expenses				
Investor relations	\$ 551	\$ 14,169	\$ 15,961	\$ 26,142
Legal and audit	22,442	6,458	41,150	14,217
Management and consulting fees (Note 9)	39,311	85,824	75,200	173,753
Office and administration	19,781	20,580	44,346	35,369
Share-based compensation (Note 8)	93,013	6,493	136,636	25,029
Transfer agent and filing fees	5,513	4,420	6,940	5,424
Travel	2,721	1,067	3,203	8,677
	<u>(183,332)</u>	<u>(139,011)</u>	<u>(323,436)</u>	<u>(288,611)</u>
Interest income	908	-	1,953	1,024
Foreign exchange gain (loss)	<u>(283)</u>	<u>(804)</u>	<u>(6,546)</u>	<u>1,463</u>
NET LOSS AND COMPREHENSIVE LOSS FOR THE PERIOD	<u>\$ (182,707)</u>	<u>\$ (139,815)</u>	<u>\$ (328,029)</u>	<u>\$ (286,124)</u>
Loss per common share – basic and diluted	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>
Weighted average number of common shares outstanding – basic and diluted	91,169,124	62,777,770	90,232,249	62,671,248

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

DEFIANCE SILVER CORP.**CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

(Unaudited – Prepared by Management)

(Canadian dollars)

	Number of Shares	Share Capital	Share-based Reserves	Deficit	Total
Balance, June 30, 2015	62,377,770	\$ 6,940,896	\$ 600,970	\$ (5,774,743)	\$ 1,767,123
Share-based compensation	-	-	25,029	-	25,029
Shares issued upon the exercise of warrants	400,000	20,000	-	-	20,000
Net loss for the period	-	-	-	(286,124)	(286,124)
Balance, December 31, 2015	62,777,770	\$ 6,960,896	\$ 625,999	\$ (6,060,867)	\$ 1,526,028
Balance, June 30, 2016	89,160,320	\$ 8,578,279	\$ 629,115	\$ (6,425,244)	\$ 2,782,150
Share-based compensation	-	-	136,636	-	136,636
Shares issued upon the exercise of options	130,000	25,051	(12,051)	-	13,000
Shares issued upon the exercise of warrants	3,061,500	459,225	-	-	459,225
Net loss for the period	-	-	-	(328,029)	(328,029)
Balance, December 31, 2016	92,351,820	\$ 9,062,555	\$ 753,700	\$ (6,753,273)	\$ 3,062,982

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

DEFIANCE SILVER CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS

(Unaudited – Prepared by Management)

(Canadian dollars)

Six months ended December 31,

	2016	2015
Operating Activities		
Net loss for the period	\$ (328,029)	\$ (286,124)
Adjustments for:		
Share-based compensation	136,636	25,029
Interest on loan payable	-	570
Net changes in non-cash working capital items:		
Receivables	6,984	9,703
Value added tax	52,679	(44,952)
Prepaid expenses	(12,474)	51,000
Accounts payable and accrued liabilities	(45,929)	85,187
Net cash used in operating activities	<u>(190,133)</u>	<u>(159,587)</u>
Investing Activities		
Expenditures on exploration and evaluation assets	(184,000)	(425,815)
Recovery of exploration and evaluation assets	8,183	9,560
Net cash used in investing activities	<u>(175,817)</u>	<u>(416,255)</u>
Financing Activities		
Proceeds from loan payable	-	160,000
Proceeds from exercise of warrants	459,225	20,000
Proceeds from exercise of options	13,000	-
Net cash provided by financing activities	<u>472,225</u>	<u>180,000</u>
Change in cash	106,275	(395,842)
Cash, beginning of period	932,315	419,343
Cash, end of period	<u>\$ 1,038,590</u>	<u>\$ 23,501</u>

Supplemental disclosure with respect to cash flows (Note 10)

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

DEFIANCE SILVER CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited – Prepared by Management)

(Canadian Dollars)

Six months ended December 31, 2016 and 2015

1. NATURE AND CONTINUANCE OF OPERATIONS

Defiance Silver Corp (“the Company”) was incorporated on July 19, 2007 under the Business Corporations Act of the Province of British Columbia. The Company’s principal business is the acquisition and exploration of exploration and evaluation assets. The Company’s registered and records office is at 595 Burrard Street Suite 2900, Vancouver, BC, V6C 2T6. The Company’s head office is at Suite 2300, 1177 West Hastings Street, Vancouver, BC, V6E 2K3.

At the date of these condensed consolidated interim financial statements, the Company has not been able to identify a known body of commercial grade ore on any of its exploration and evaluation assets. The ability of the Company to realize the costs it has incurred to date on these exploration and evaluation assets is dependent upon the Company being able to identify a commercial ore body, to finance its exploration costs and to resolve any environmental, regulatory or other constraints which may hinder the successful development of the exploration and evaluation asset. To date, the Company has not earned revenues and is considered to be in the exploration stage.

These condensed consolidated interim financial statements have been prepared assuming the Company will continue on a going-concern basis. The Company has incurred losses since inception and the ability of the Company to continue as a going-concern depends upon its ability to develop profitable operations and to continue to raise adequate financing. Management is actively targeting sources of additional financing through other business and financial transactions which would assure continuation of the Company’s operations and exploration programs. In order for the Company to meet its liabilities as they come due and to continue its operations, the Company is solely dependent upon its ability to generate such financing. The Company expects to use similar financing techniques in the future and is pursuing such additional sources of financing as estimated to be required to sufficiently support its operations until such time that its operations become self-sustaining. These material uncertainties may cast significant doubt on the Company’s ability to continue as a going concern.

These condensed consolidated interim financial statements were authorized by the Board of Directors of the Company on February 23, 2017.

2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

These condensed consolidated interim financial statements for the period ended December 31, 2016, have been prepared in accordance with IAS 34, ‘Interim Financial Reporting’. The condensed consolidated interim financial statements should be read in conjunction with the annual consolidated financial statements for the year ended June 30, 2016, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The condensed consolidated interim financial statements have been prepared on a historical cost basis, except for financial instruments classified as financial instruments at fair value through profit or loss, which are stated at their fair value. In addition, these condensed consolidated interim financial statements have been prepared using the accrual basis of accounting except for cash flow information.

The preparation of these condensed consolidated interim financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the condensed consolidated interim financial statements and the reported expenses during the period. Actual results could differ from these estimates.

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the end of the reporting period, that could result in a material adjustment to the carrying amounts of assets and liabilities in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

- i) The recoverability of receivables which are included in the condensed consolidated interim statements of financial position;
- ii) The carrying value and the recoverability of exploration and evaluation assets, which are included in the condensed consolidated interim statements of financial position;
- iii) The inputs used in accounting for share-based compensation expense, which are included in the condensed consolidated interim statements of loss & comprehensive loss; and
- iv) The amount of deferred income taxes recognized.

DEFIANCE SILVER CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited – Prepared by Management)

(Canadian Dollars)

Six months ended December 31, 2016 and 2015

2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Critical accounting judgments

Examples of significant judgments, apart from those involving estimation, include:

- the accounting policies for exploration and evaluation assets;
- classification of financial instruments; and
- determination of functional currency.

Basis of consolidation

These condensed consolidated interim financial statements include the financial statements of the Company and the entities controlled by the Company. The financial statements of subsidiaries are included in the condensed consolidated interim financial statements from the date that control commences until the date that control ceases. All intercompany transactions and balances have been eliminated.

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company possesses power over an investee, has exposure to variable returns from the investee and has the ability to use its power over the investee to affect its returns. Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by the Company.

The principal subsidiaries of the Company as of December 31, 2016 are as follows:

Name of subsidiary	Principal activity	Place of Incorporation	Ownership Interest December 31, 2016	Ownership Interest June 30, 2016
Minera Santa Remy S.A. de CV	Mineral property exploration	Mexico	100%	100%
DefCap (BVI) Inc.	Holding company	British Virgin Islands	100%	100%

Significant accounting policies

The preparation of financial data is based on accounting principles and practices consistent with those used in the preparation of the audited annual consolidated financial statements as at June 30, 2016. These unaudited condensed consolidated interim financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended June 30, 2016.

DEFIANCE SILVER CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited – Prepared by Management)

(Canadian Dollars)

Six months ended December 31, 2016 and 2015

2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Recent accounting pronouncements

Accounting standards, amendments and interpretations not yet effective

Certain pronouncements were issued by the IASB or the IFRIC that are mandatory for accounting periods beginning after January 1, 2017 or later periods. The following new standards, amendments and interpretations that have not been early adopted in these condensed consolidated financial statements, are not expected to have a material effect on the Company's future results and financial position:

- IAS 27 & IFRS 1, Equity Method in Separate Financial Statements - IAS 27 is amended to restore the option to use the equity method to account for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements. IFRS 1 is amended to permit use of the business combinations exemption for investments in subsidiaries accounted for using the equity method in the separate financial statements of the first-time adopter. IAS 27 and IFRS 1 will be effective for annual periods beginning on or after January 1, 2016.
- IFRS 9, Financial Instruments replaces the current standard IAS 39 Financial Instruments: Recognition and Measurement, replacing the current classification and measurement criteria for financial assets and liabilities with only two classification categories: amortized cost and fair value. IASB has tentatively decided to require an entity to apply IFRS 9 for annual periods beginning on or after January 1, 2018.
- IFRS 15, Revenue Recognition - Revenue from Contracts with Customers establishes the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. IASB has tentatively decided to require an entity to apply IFRS 15 for annual periods beginning on or after January 1, 2018.
- IFRS 16 specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. The extent of the impact of adoption has not yet been determined.

Other accounting standards or amendments to existing accounting standards that have been issued but have future effective dates are either not applicable or not expected to have a significant impact on the Company's condensed consolidated financial statements.

3. CASH

Cash consists of the following:

	December 31, 2016	June 30, 2016
Cash on deposit	\$ 438,590	\$ 332,315
Guaranteed investment certificate	600,000	600,000
	<u>\$ 1,038,590</u>	<u>\$ 932,315</u>

DEFIANCE SILVER CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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(Canadian Dollars)

Six months ended December 31, 2016 and 2015

4. RECEIVABLES

The Company's receivables primarily arise from refundable sales tax receivable from government taxation authorities in Canada and Mexico and interest receivable on the Company's guaranteed investment certificate.

	December 31, 2016	June 30, 2016
Interest receivable	\$ 1,953	\$ -
Goods and services tax ("GST")	5,004	13,941
	<u>\$ 6,957</u>	<u>\$ 13,941</u>
Value added tax ("VAT")	\$ 191,107	\$ 243,786

DEFIANCE SILVER CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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(Canadian Dollars)

Six months ended December 31, 2016 and 2015

5. EXPLORATION AND EVALUATION ASSETS

Title to exploration and evaluation assets involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral claims. The Company has investigated title to all of its exploration and evaluation assets and, to the best of its knowledge, title to all of its interests are in good standing.

	San Acacio Project	Minerva Property	Total
Balance, June 30, 2015	\$ 1,376,568	\$ 23,248	\$ 1,399,816
Acquisition costs			
Property option payments	335,325	-	335,325
Exploration costs			
Claim fees	11,793	-	11,793
Camp	15,170	-	15,170
Drilling	203,243	-	203,243
Sampling and assays	12,664	-	12,664
Geology & mapping	41,705	-	41,705
	284,575	-	284,575
Balance, June 30, 2016	1,996,468	23,248	2,019,716
Acquisition costs			
Property option payments	106,319	-	106,319
Exploration costs			
Claim fees	4,230	-	4,230
Consulting fees	6,853	-	6,853
Camp	4,913	-	4,913
Drilling	53,030	-	53,030
Sampling and assays	2,084	-	2,084
Geology & mapping	(2,815)	-	(2,815)
	68,295	-	68,295
Balance, December 31, 2016	\$ 2,171,082	\$ 23,248	\$ 2,194,330
Represented by:			
Acquisition costs	\$ 1,145,353	\$ 9,574	\$ 1,154,927
Exploration costs	1,025,729	13,674	1,039,403
Balance, December 31, 2016	\$ 2,171,082	\$ 23,248	\$ 2,194,330

DEFIANCE SILVER CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited – Prepared by Management)

(Canadian Dollars)

Six months ended December 31, 2016 and 2015

5. EXPLORATION AND EVALUATION ASSETS (cont'd...)

San Acacio Project

The Company entered into an option agreement on October 24, 2011 with the Mexican owners (“the Vendors”) for an option to purchase a 100% interest in the San Acacio property consisting of 10 mining concessions and associated surface rights and tailings (“the Assets”). The San Acacio property is located approximately 6.5 km north of the city of Zacatecas, Mexico.

Terms of the original option to the purchase agreement are as follows:

- Payment of US\$25,000 (paid) for an initial 90 day due diligence period on the date of signing on October 24, 2011;
- Optional Payment of US\$50,000 (paid) for an additional 90 day due diligence extension from the initial 90 day due diligence period; and
- Payment of US\$200,000 (paid) for a 12 month period from signing of the trust agreement in which to acquire the assets.

Purchase price of the Assets (“Final Payment”) under the original option to the purchase agreement consists of the following payments which were due one year from signing of the trust agreement:

- 10 mining concessions for US\$5,500,000;
- 1 parcel of surface rights for US\$5,000; and
- 1 parcel of land with a tailings deposit for US\$1.50 per tonne of tailings estimated in the amount of 300,000 tonnes.

On July 25, 2012, the Company and the Vendors entered into an amending purchase agreement to extend the Final Payment by up to 24 months.

As per the amending agreement, the Company had the option to pay US \$150,000 (paid) to extend the final payment 24 months from the date of signing the trust agreement and an additional US \$225,000 (paid) to extend the final payment 36 months from the date of signing the trust agreement.

On September 26, 2014, the Company renegotiated its San Acacio purchase agreement, extending its option by an additional three years. The amended agreement required the Company to make annual payments as follows:

Date	Extension payment	Amount credited toward final payment	Total yearly payment
September 27, 2015	US\$ 150,000	US\$ 200,000	US\$ 350,000
September 27, 2016	US\$ 150,000	US\$ 400,000	US\$ 550,000
September 27, 2017	US\$ 150,000	US\$ 600,000	US\$ 750,000
September 27, 2018	-	US\$4,300,000	US\$4,300,000

DEFIANCE SILVER CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited – Prepared by Management)

(Canadian Dollars)

Six months ended December 31, 2016 and 2015

5. EXPLORATION AND EVALUATION ASSETS (cont'd...)

During the year ended June 30, 2016, the Company renegotiated payment terms whereas the US\$350,000 payment due on September 27, 2015 will be paid in four quarterly payments of US\$87,500 commencing on September 27, 2015. During the year ended June 30, 2016, the first and second instalments have been paid, and the third and fourth instalments were re-negotiated as discussed below.

During the year ended June 30, 2016, the Company also renegotiated payment terms on its San Acacio silver project purchase agreement and postponed payments of US\$300,000 originally due by September 27, 2017 to September 27, 2018. Under the renegotiated agreement, the Company will pay only four quarterly payments of US\$37,500 totaling US\$150,000 to December 27, 2016. During the period ended December 31, 2016, the Company made two quarterly payments of US\$37,500 each towards the agreement. The new terms of the agreement are as follows (all amounts in U.S. dollars):

Date	Extension payment	Amount credited toward final payment	Total yearly payment
By December 27, 2016	US\$ 150,000	\$Nil	US\$ 150,000
By September 27, 2017	US\$ 225,000	US\$ 800,000	US\$ 1,025,000
On September 27, 2018	-	US\$ 4,600,000	US\$ 4,600,000

At the discretion of the Company, the yearly payment due on September 27th, 2017 can be replaced by a payment of US\$1,000,000, all of which will be credited toward the final payment. If the Company chooses to accelerate its payment, the balance payable will range between US\$4,200,000 and US\$4,600,000.

The property is subject to a 2.5% net smelter return royalty ("NSR") payable to the vendors on production from the property. The Company will have the right to purchase the NSR at any time for US\$2,500,000 which will escalate with the official Mexican Inflation Index after a five year period.

Following the first anniversary of the purchase of the Assets, the Company must make minimum annual royalty payments of US\$125,000. The minimum royalty commitment terminates in the event that the production royalty paid is equal to or higher than the equivalent to the minimum that would have been due during 6 consecutive months.

Surface rights agreements

In August 2014, the Company obtained authorization to temporarily occupy and explore certain land holdings on the San Acacio property. In order to keep the agreement in good standing, the Company is required to make semi-annual payments of MX\$ 9,000 during the exploration phase and MX\$ 60,000 during the development phase. The agreement will be valid for 20 years with the option to extend in the future.

On February 27, 2015, the Company entered into an additional surface rights agreement for the right to occupy and perform exploration work on the San Acacio property. The Company will have authorization to explore the surface of the property for a term of three years which can be extended for an additional 3 years at the Company's choice, by making annual advance payments of MX\$ 120,000 (paid) and by paying a onetime fee of MX\$ 100,000 (paid) on the signing of the agreement.

On July 14, 2016, the Company entered into an additional surface rights agreement for the right to occupy and perform exploration work on the San Acacio property. The Company will have authorization to explore the surface of the property for a term of five years which can be renewed for a further 5 years at the Company's choice by making advance annual payments of MX\$120,000 (paid) and by paying a onetime fee of MX\$ 100,000 (paid) on signing of the agreement.

Minerva property

During the year ended June 30, 2012, the Company applied for a mining claim located in Coahuila State, Mexico, known as the Minerva property. As of December 31, 2016, the application was still pending approval by the Mexican mining authorities.

DEFIANCE SILVER CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(Unaudited – Prepared by Management)

(Canadian Dollars)

Six months ended December 31, 2016 and 2015

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Payables and accrued liabilities for the Company are comprised as follows:

	December 31, 2016	June 30, 2016
Accrued liabilities	\$ 294,953	\$ 364,838
Trade payables	50,608	27,855
	<u>\$ 345,561</u>	<u>\$ 392,693</u>

All payables and accrued liabilities for the Company fall due within the next 12 months.

7. LOAN PAYABLE

During the year ended June 30, 2016, the Company received loan proceeds of \$160,000 from a third party. The loan bore interest of 10% per annum, was due on March 31, 2016, and was callable at any time by the lender. On April 18, 2016, the Company repaid the loan in full and interest of \$5,348.

8. SHARE CAPITAL

Authorized

Unlimited number of common shares without par value. All issued shares are fully paid.

Stock options

Under the Company's rolling stock option plan, the Company may grant options, with a maximum term of ten years, for up to 10% of the Company's issued and outstanding common shares, to directors, employees and technical consultants at exercise prices to be determined by the market value on the date of grant. The number of common shares reserved for issuance to any individual director or officer will not exceed 5% of the issued and outstanding common shares, and the number of common shares reserved for issuance to all technical consultants will not exceed 2% of the issued and outstanding common shares. Incentive stock options issued have an immediate vesting term, unless vesting is imposed by the Company's board of directors.

During the period ended December 31, 2016, the Company received proceeds of \$13,000 from the exercise of 130,000 stock options.

8. SHARE CAPITAL (cont'd...)

Stock options (cont'd...)

Stock option transactions and the number of stock options outstanding are summarized as follows:

	Number of Options	Weighted Average Exercise Price
Balance, June 30, 2015	3,995,000	\$ 0.19
Granted	50,000	0.10
Expired	(675,000)	0.33
Balance, June 30, 2016	3,370,000	0.15
Granted	1,060,000	0.34
Exercised	(130,000)	0.10
Expired	(460,000)	0.29

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Balance, December 31, 2016	3,840,000	\$ 0.19
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The following weighted average assumptions were used for the Black-Scholes valuation of the stock options:

	2016	2015
Risk-free interest rate	1.07%	0.90%
Expected life of option	5 years	5 years
Expected dividend yield	0%	0%
Expected stock price volatility	142.23%	146.36%

The following incentive stock options were outstanding to directors, officers and employees at December 31, 2016:

Number of Options Outstanding	Exercise Price (\$)	Expiry Date	Number of Options Exercisable	Exercise Price (\$)
440,000	0.27	November 22, 2017	440,000	0.27
100,000	0.27	December 10, 2017	100,000	0.27
1,840,000	0.10	November 6, 2019	1,840,000	0.10
100,000	0.15	March 12, 2020	100,000	0.15
250,000	0.11	June 10, 2020	250,000	0.11
50,000	0.10	November 27, 2020	50,000	0.10
200,000	0.41	July 20, 2021	100,000	0.41
830,000	0.32	December 14, 2021	276,667	0.32
30,000	0.32	December 16, 2021	10,000	0.32
3,840,000	0.19		3,166,667	0.16

The weighted average remaining life of the stock options was 3.20 years.

8. SHARE CAPITAL (cont'd...)

Share-based compensation

The Company recognizes compensation for all stock options granted using the fair value based method of accounting. During the period ended December 31, 2016, the Company recognized \$136,636 (2015 - \$25,029) in share-based compensation expense for options issued in previous periods.

Warrants

During the period ended December 31, 2016, the Company received proceeds of \$459,225 from the exercise of 3,061,500 warrants.

Warrant transactions and the number of warrants outstanding are summarized as follows:

	Number of Warrants	Weighted Average Exercise Price
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DEFIANCE SILVER CORP.**NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

(Unaudited – Prepared by Management)

(Canadian Dollars)

Six months ended December 31, 2016 and 2015

Balance, June 30, 2015	30,919,050	\$ 0.07
Expired	(1,075,000)	0.15
Exercised	<u>(26,782,550)</u>	<u>0.06</u>
Balance, June 30, 2016	3,061,500	0.15
Exercised	<u>(3,061,500)</u>	<u>0.15</u>
Balance, December 31, 2016	<u>-</u>	<u>\$ -</u>

At December 31, 2016, there were no warrants were outstanding.

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(Canadian Dollars)

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9. RELATED PARTY TRANSACTIONS

Related parties include the Board of Directors, officers, close family members and entities that are controlled by these individuals.

As at December 31, 2016, accounts payable and accrued liabilities included \$8,898 (June 30, 2016 - \$36,156) payable to directors, officers and companies controlled or related to directors and/or officers. Amounts payable to related parties have no specific terms of repayment, are unsecured and do not bear interest.

During the period ended December 31, 2016, the Company:

- (a) paid or accrued management fees of \$30,000 (2015 – \$45,000) to a company controlled by the CEO, President and director of the Company.
- (b) paid or accrued management fees of \$5,200 (2015 – \$49,753) to an officer of the Company.
- (c) paid or accrued management fees of \$15,000 (2015 - \$15,000) to a company controlled by a director of the Company.
- (d) paid or accrued management fees of \$Nil (2015 - \$10,000) to a former officer of the Company.
- (e) paid or accrued management fees of \$7,000 (2015 - \$2,000) to a company controlled by the CFO of the Company.
- (f) paid or accrued \$Nil (2015 - \$12,000) in rent expense, included in office and administration, to a company related by common directors.
- (g) paid or accrued geological consulting fees of \$525 (2015 - \$Nil) to a director of the Company.

Share-based compensation includes stock options granted to directors and officers recorded at a fair value of \$122,965 (2015 - \$12,629).

10. SUPPLEMENTAL DISCLOSURES WITH RESPECT TO CASH FLOWS

Significant non-cash transactions for the period ended December 31, 2016 included:

- a) A balance of \$3,541 included in exploration and evaluation assets relating to accounts payable and accrued liabilities.
- b) Transferred a fair value of \$12,051 from share-based payments reserve to share capital on the exercise of 130,000 stock options.

Significant non-cash transactions for the period ended December 31, 2015 included:

- a) A balance of \$62,747 included in exploration and evaluation assets relating to accounts payable and accrued liabilities.

DEFIANCE SILVER CORP.

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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11. SEGMENTED INFORMATION

The Company operates in one reportable operating segment, being the acquisition and exploration of exploration and evaluation assets in Mexico. All of the costs at December 31, 2016 and June 30, 2016 were for exploration and evaluation assets in Mexico.

12. FINANCIAL AND CAPITAL RISK MANAGEMENT

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and

Level 3 – Inputs that are not based on observable market data.

The fair value of the Company's receivables, accounts payable and accrued liabilities, approximate carrying value, due to their short-term nature. The Company's other financial instrument, cash, under the fair value hierarchy, is measured based on level one quoted prices in active markets for identical assets or liabilities. The Company is exposed to varying degrees to a variety of financial instrument related risks:

Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations.

The Company's cash is held at large Canadian financial institutions in interest bearing accounts. The Company has no investment in asset backed commercial paper.

The Company's receivables consist mainly of GST/VAT due from the governments of Canada and Mexico. As such, the Company does not believe it is subject to significant credit risk.

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2016, the Company had cash of \$1,038,590 (June 30, 2016 - \$932,315) to settle current liabilities of \$345,561 (June 30, 2016 - \$392,693). The Company is considered to be in the exploration and evaluation stage. Thus, it is dependent on obtaining regular financings in order to continue its exploration and evaluation programs. Despite previous success in acquiring these financings, there is no guarantee of obtaining future financings. The Company's cash is invested in business accounts with quality financial institutions, is available on demand for the Company's programs, and is not invested in any asset backed commercial paper.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

a) Interest rate risk

The Company has cash balances and interest-bearing investments. The interest earned on the investments approximates fair value rates, and the Company is not at a significant risk to fluctuating interest rates. The Company's current policy is to invest excess cash in investment-grade short-term deposit certificates issued by its financial institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. As at December 31, 2016, the Company had a total of \$600,000 (June 30, 2016 - \$600,000) in investment-grade short-term deposit certificates.

The risk that the Company will realize a loss as a result of a decline in the fair value of the short-term deposits included in cash is minimal because of the short-term nature of these investments.

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NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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13. FINANCIAL AND CAPITAL RISK MANAGEMENT (cont'd...)

Market risk (cont'd...)

b) Foreign currency risk

The Company is not exposed to significant foreign currency risk on fluctuations related to cash and accounts payable and accrued liabilities that are denominated in United States dollars ("US\$") and Mexican pesos ("MX\$"). The Company does not use derivatives or other techniques to manage foreign currency risk.

c) Price risk

The Company is exposed to price risk with respect to commodity prices. Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. The Company closely monitors the commodity prices of precious metals, and the stock market to determine the appropriate course of action to be taken by the Company.

Based on management's knowledge and experience of the financial markets, management does not believe that the Company's current financial instruments will be affected by interest rate risk, currency risk and credit risk.

Capital management

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to pursue the exploration of its exploration and evaluation assets, acquire additional exploration and evaluation assets and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk. In the management of capital, the Company includes components of debt and shareholders' equity. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue debt, acquire or dispose of assets or adjust the amount of cash.

There were no changes in the Company's approach to capital management.