



# ARGONAUT GOLD

Consolidated Financial Statements

**December 31, 2018 and 2017**

(Expressed in thousands of United States dollars)

## **Management's responsibility for financial reporting**

These consolidated financial statements have been prepared by management of Argonaut Gold Inc. (the "Company") in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and, where appropriate, reflect management's best estimates and judgments based on currently available information.

The Audit Committee of the Board of Directors meets periodically with management and the independent auditors to review the scope and results of the annual audit, and to review the consolidated financial statements and related financial reporting matters prior to submitting the financial statements to the Board of Directors for approval.

The Company's independent auditors, who are appointed by the shareholders, conduct their audits in accordance with Canadian generally accepted auditing standards to allow them to express an opinion on the consolidated financial statements.

A system of internal control is maintained to provide reasonable assurance that financial information is accurate and reliable. Management conducts ongoing reviews of these controls and reports on their findings to the Audit Committee.

/s/ Peter C. Dougherty

President and Chief Executive Officer

/s/ David A. Ponczoch

Chief Financial Officer

February 19, 2019



## *Independent auditor's report*

To the Shareholders of Argonaut Gold Inc.

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### *Our opinion*

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Argonaut Gold Inc. and its subsidiaries, (together, the Company) as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

#### **What we have audited**

The Company's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 31, 2018 and 2017;
- the consolidated statements of income (loss) for the years then ended;
- the consolidated statements of comprehensive income (loss) for the years then ended;
- the consolidated statements of cash flows for the years then ended;
- the consolidated statements of changes in shareholders' equity for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

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### *Basis for opinion*

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

#### **Independence**

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

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### *Other information*

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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### *Responsibilities of management and those charged with governance for the consolidated financial statements*

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

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### *Auditor's responsibilities for the audit of the consolidated financial statements*

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.



As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.



We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Graziano DeLucchi.

**(Signed) "PricewaterhouseCoopers LLP"**

**Chartered Professional Accountants**

Vancouver, British Columbia  
February 19, 2019

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**ARGONAUT GOLD INC.****CONSOLIDATED STATEMENTS OF FINANCIAL POSITION****As at December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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	2018	2017
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 15,378	\$ 14,060
Receivables (Note 6)	23,646	19,449
Inventories (Note 7)	68,689	68,911
Prepaid income tax	256	768
Prepaid expenses and other	2,278	1,034
Foreign exchange derivative assets (Note 23(b))	510	-
	110,757	104,222
Non-current portion of inventory (Note 7)	20,480	-
Mineral properties, plant and equipment (Notes 8 and 24)	556,054	579,395
Deferred income taxes (Note 9)	6,789	5,911
Other assets	436	332
<b>Total assets</b>	<b>\$ 694,516</b>	<b>\$ 689,860</b>
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable and accrued liabilities (Note 10)	\$ 34,788	\$ 22,881
Income taxes payable	1,724	758
Foreign exchange derivative liabilities (Note 23(b))	-	552
	36,512	24,191
Debt (Note 11)	13,000	8,000
Reclamation provision (Note 12)	16,801	9,434
Deferred income taxes (Note 9)	16,581	13,033
Other liabilities	2,597	2,756
<b>Total liabilities</b>	<b>85,491</b>	<b>57,414</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 13(b))	786,200	784,447
Contributed surplus	17,137	16,100
Deficit	(98,965)	(91,344)
Accumulated other comprehensive loss	(95,347)	(76,757)
<b>Total shareholders' equity</b>	<b>609,025</b>	<b>632,446</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 694,516</b>	<b>\$ 689,860</b>

Commitments and contingencies (Note 22)

Approved by the Board of Directors

/s/ Peter C. Dougherty, Director

/s/ Dale C. Peniuk, Director

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

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**ARGONAUT GOLD INC.****CONSOLIDATED STATEMENTS OF INCOME (LOSS)****For the years ended December 31, 2018 and 2017**  
**(Expressed in thousands of United States dollars)**

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	2018	2017
Revenue	\$ 196,056	\$ 155,089
Cost of sales		
Production costs (Note 15)	122,921	98,765
Depreciation, depletion and amortization	33,177	25,027
Inventory write down (Note 7)	21,482	-
<b>Total cost of sales</b>	<b>177,580</b>	<b>123,792</b>
<b>Gross profit</b>	<b>18,476</b>	<b>31,297</b>
Exploration expenses	547	436
General and administrative expenses	12,958	11,667
Other operating expenses (Note 12)	3,112	780
Impairment of mineral properties, plant and equipment (Note 24)	2,011	-
<b>Profit (loss) from operations</b>	<b>(152)</b>	<b>18,414</b>
Finance income	33	153
Finance expenses (Note 16)	(1,201)	(1,334)
Gains on foreign exchange derivatives (Note 23(b))	1,071	1,994
Other income (expense) (Note 17)	(716)	1,791
<b>Income (loss) before income taxes</b>	<b>(965)</b>	<b>21,018</b>
Current income tax expense (Note 9)	3,986	1,180
Deferred income tax expense (recovery) (Note 9)	2,670	(4,014)
<b>Net income (loss)</b>	<b>\$ (7,621)</b>	<b>\$ 23,852</b>
<b>Earnings (loss) per share</b>		
Basic and diluted	\$ (0.04)	\$ 0.14
<b>Weighted average number of common shares outstanding</b> (Note 14)		
Basic	177,719,713	173,183,225
Diluted	177,719,713	174,393,968

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

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**ARGONAUT GOLD INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****For the years ended December 31, 2018 and 2017**  
**(Expressed in thousands of United States dollars)**

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	2018		2017
<b>Net income (loss)</b>	\$ (7,621)	\$	23,852
<b>Other comprehensive income (loss), net of tax</b>			
<b>Items that may be reclassified subsequently to net income (loss)</b>			
Foreign currency translation differences	(18,590)		16,915
<b>Comprehensive income (loss)</b>	\$ (26,211)	\$	40,767

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

**ARGONAUT GOLD INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the years ended December 31, 2018 and 2017

(Expressed in thousands of United States dollars)

	2018	2017
<b>Operating activities</b>		
Net income (loss)	\$ (7,621)	\$ 23,852
Items not affecting cash:		
Depreciation, depletion and amortization	33,301	25,193
Gain on disposal of mineral properties, plant and equipment	(365)	(221)
Share-based compensation	2,610	2,385
Finance income and expense	1,168	1,181
Unrealized foreign exchange (gain) loss	1,149	(513)
Gains on foreign exchange derivatives	(1,071)	(1,994)
Deferred income taxes	2,670	(4,014)
Change in estimate of reclamation costs where mining activities have ceased (Note 12)	2,799	-
Inventory write down (Note 7)	21,482	-
Impairment of mineral properties, plant and equipment (Note 24)	2,011	-
	58,133	45,869
Changes in non-cash operating working capital items		
Receivables	(4,193)	(4,301)
Inventories	(35,420)	(4,470)
Prepaid expenses and other	(297)	(177)
Accounts payable and accrued liabilities	11,760	2,938
Income taxes	2,561	1,529
Changes in other long-term assets	2	2
Changes in other long-term liabilities	193	467
Income taxes paid	(1,068)	(3,190)
Interest received	33	153
Net cash provided by operating activities	31,704	38,820
<b>Investing activities</b>		
Expenditures on mineral properties, plant and equipment	(35,910)	(70,215)
Proceeds on disposal of mineral properties, plant and equipment	425	649
Cash consideration paid on property acquisitions (Note 5)	(120)	(40,943)
Decrease in restricted cash	-	1,628
Net cash used in investing activities	(35,605)	(108,881)
<b>Financing activities</b>		
Proceeds from issuance of common shares, net of share issuance costs (Note 13(b))	-	32,046
Proceeds from debt	17,000	8,000
Repayment of debt	(12,000)	(916)
Debt financing and transaction costs	(372)	(200)
Proceeds from settlement of derivatives (Note 23(b))	9	2,546
Interest paid	(598)	(198)
Net cash provided by financing activities	4,039	41,278
Effects of exchange rate changes on cash and cash equivalents	1,180	745
<b>Increase (decrease) in cash and cash equivalents</b>	<b>1,318</b>	<b>(28,038)</b>
Cash and cash equivalents, beginning of year	14,060	42,098
<b>Cash and cash equivalents, end of year</b>	<b>\$ 15,378</b>	<b>\$ 14,060</b>
Supplemental cash flow information (Note 18)		

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

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**ARGONAUT GOLD INC.****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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	2018	2017
<b>Share capital (Note 13(b))</b>		
Balance at the beginning of the year	\$ 784,447	\$ 750,472
Issuance of common shares by way of public offering	-	31,509
Issuance of common shares related to a community agreement	182	-
Stock options exercised	-	812
Restricted shares and restricted share units vested, net of shares withheld to satisfy tax withholding	1,571	1,654
Balance at the end of the year	786,200	784,447
<b>Contributed surplus</b>		
Balance at the beginning of the year	16,100	15,644
Stock options exercised	-	(275)
Restricted shares and restricted share units vested	(1,573)	(1,654)
Share-based compensation	2,610	2,385
Balance at the end of the year	17,137	16,100
<b>Deficit</b>		
Balance at the beginning of the year	(91,344)	(115,196)
Net income (loss)	(7,621)	23,852
Balance at the end of the year	(98,965)	(91,344)
<b>Accumulated other comprehensive loss</b>		
Balance at the beginning of the year	(76,757)	(93,672)
Other comprehensive income (loss)	(18,590)	16,915
Balance at the end of the year	(95,347)	(76,757)
<b>Total shareholders' equity</b>	<b>\$ 609,025</b>	<b>\$ 632,446</b>

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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**1 NATURE OF OPERATIONS**

Argonaut Gold Inc. (the “Company” or “Argonaut”) is a Canadian public company listed on the Toronto Stock Exchange and engaged in gold mining, mine development and mineral exploration activities at gold-bearing mineral properties in North America. As at December 31, 2018, the Company owned the producing El Castillo and San Agustin mines (which together form the El Castillo mining complex) in the State of Durango, Mexico, the producing La Colorada mine in the State of Sonora, Mexico, the advanced exploration stage San Antonio project in the State of Baja California Sur, Mexico, the advanced exploration stage Cerro del Gallo project in the State of Guanajuato, Mexico, the advanced exploration stage Magino project in the Province of Ontario, Canada and several other exploration stage projects, all of which are located in North America.

The registered office of the Company is located at Suite 3400, One First Canadian Place, 100 King Street West, Toronto, Ontario, M5X 1A4, Canada. The head office and principal address of Argonaut Gold (U.S.) Corp., a subsidiary of the Company providing management services, is 9600 Prototype Ct., Reno, Nevada, 89521, USA.

**2 SIGNIFICANT ACCOUNTING POLICIES**

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied in all material respects to all the years presented, unless otherwise noted.

**a) Basis of presentation**

The consolidated financial statements of the Company and its subsidiaries have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”) and included in Part 1 of the Handbook of the Chartered Professional Accountants of Canada. These consolidated financial statements have been prepared in accordance with the significant accounting policies presented below and are based on the IFRS and IFRS Interpretations Committee (“IFRIC”) interpretations issued and effective as of December 31, 2018. The consolidated financial statements have been prepared on a going concern basis, under the historical cost convention, except for certain financial assets and financial liabilities measured at fair value.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 3.

These consolidated financial statements include the accounts of Argonaut Gold Inc. and its subsidiaries. Subsidiaries are entities over which the Company has control. The Company controls a subsidiary when it is exposed to, or has rights to, variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary. Inter-company transactions, balances, and unrealized gains or losses on transactions between the Company and its subsidiaries and between the Company’s subsidiaries are eliminated. When necessary, amounts reported by subsidiaries have been adjusted to conform to the Company’s accounting policies.

The financial statements were authorized for issue by the Company’s board of directors on February 19, 2019.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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## b) Segment reporting

Operating segments are determined in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive Officer. The Company's operating segments, before aggregation, have been identified as the Company's individual operating mines. Aggregation of one or more operating segments into a single operating segment is permitted if aggregation is consistent with the core principle of the standard, the operating segments have similar economic characteristics, and the operating segments have a number of other similarities, including similarities in the nature of their products, production processes, and regulatory environment.

## c) Foreign currency translation

Items included in the financial statements of each of the Company's subsidiaries are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in United States ("US") dollars, which is the Company's presentation currency.

Foreign currency transactions are translated into the functional currency using the average monthly exchange rates, where this is a reasonable approximation of the exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into US dollars at period-end exchange rates. Non-monetary assets and liabilities denominated in foreign currencies are translated using the historical rate on the date of the transaction. Revenue and expenses are translated using the average monthly exchange rates, with the exception of depletion, depreciation, and amortization which is translated using the historical rate on the date of the transaction. Foreign currency exchange gains and losses are presented in the statement of income (loss) within other income (expense).

Assets and liabilities of entities that have a functional currency different from the presentation currency are translated into the presentation currency at the period-end rates of exchange and the results of their operations are translated into the presentation currency at average rates of exchange for the period. The resulting exchange differences are recognized in accumulated other comprehensive loss in shareholders' equity.

## d) Cash and cash equivalents

Cash and cash equivalents are unrestricted as to use and consist of cash on hand and demand deposits which can readily be liquidated to known amounts of cash and are subject to an insignificant risk of change in value.

## e) Receivables and accounts payable

Receivables and accounts payable are non-interest bearing and are recognized initially at fair value and subsequently measured at amortized cost. When necessary, receivables include allowances for uncollectable amounts.

## f) Inventories

Inventories are stated at the lower of weighted average cost and net realizable value. Cost of supplies inventory includes acquisition, freight and other directly attributable costs. Work-in-process inventory includes ore in the leaching process, stockpiled ore at mining operations, and gold on carbon. Finished goods include gold in dore or bullion. For work-in-process and finished goods inventories, cost includes all direct costs incurred in production including direct labor and materials, freight, depreciation and amortization of plant and equipment used in the production process, depletion of acquisition cost and directly attributable overhead costs. If the net realizable value is lower than the expected cost of the finished product, the inventory is written down to estimated selling price less cost of completion and disposal. The write down may be reversed if circumstances change.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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Work-in-process inventory that the Company does not expect to process in the 12 months following the statement of financial position date are classified as non-current and net realizable value is calculated on a discounted cash flow basis over the planned processing timeframe.

g) Non-current assets and disposal groups held for sale

Non-current assets and disposal groups are classified as assets held for sale (“HFS”) if it is highly probable that the value of these assets will be recovered primarily through sale rather than through continuing use. They are recorded at the lower of carrying amount and fair value less direct costs of disposal (“FVLCD”). Impairment losses on initial classification as HFS and subsequent gains and losses on remeasurement are recognized in the statement of income (loss). Once classified as HFS, mineral properties, plant and equipment are no longer amortized. The assets and liabilities are presented as HFS in the consolidated statements of financial position when the sale is highly probable, the asset or disposal group is available for immediate sale in its present condition and management is committed to the sale, which should be expected to be completed within one year from the date of classification.

h) Mineral properties, plant and equipment

i) Plant and equipment

Plant and equipment are recorded at cost less accumulated depreciation and impairment charges. The cost of buildings, plant and processing equipment used in the Company’s mining operations are amortized on either a straight-line basis over the estimated useful life of the related asset or on a unit-of-production basis over estimated proven and probable reserves, resources or other relevant metric. The cost of office equipment, furniture and fixtures and vehicles is amortized on a straight-line basis over the estimated useful life of the related asset.

ii) Assets under construction

Mineral property development commences when approved by management and the Company has obtained all regulatory permissions to proceed. During development, plant and equipment expenditures are capitalized and classified as assets under construction. Assets under construction are not amortized until construction of the asset has been completed. Once completed, all applicable assets related to construction are reclassified to plant and equipment. Other development expenditures relating to mineral properties are capitalized directly to mineral properties.

iii) Mineral properties and mine development costs

The costs of acquiring, exploring and developing mineral properties or property rights, and to increase future output by providing access to additional sources of reserves or resources, are capitalized. Revenue and expenses derived from mining activities prior to the assets being ready for use in the manner intended by management are included in the cost of the related mineral property.

Mineral properties are recorded at cost less accumulated depletion and impairment charges. When assets are ready for use as intended by management, mineral properties and mine development costs are amortized on a unit-of-production basis over the estimated proven and probable reserves, resources or other relevant metric to which they relate. Mine development costs associated with each distinct section of the mine are amortized over the reserves, resources or other relevant metric to which they relate. Upon sale or abandonment of mineral properties, the cost and related accumulated depletion are written off and any gains or losses thereon are included in the statement of income (loss).

During the production phase, mining expenditures (exploration or development costs) incurred either to develop new ore bodies or to develop mine areas in advance of current production are capitalized to mineral properties. Stripping

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**For the years ended December 31, 2018 and 2017**

**(Expressed in thousands of United States dollars)**

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costs incurred in the production phase are accounted for as variable production costs. However, stripping costs will be capitalized and recorded on the statement of financial position as deferred stripping, a component of mineral properties, when the stripping activity provides access to sources of reserves or resources that will be produced in future periods that would not have otherwise been accessible in the absence of this activity. The deferred stripping will be depleted on a unit-of-production basis over the reserves or resources that directly benefited from the stripping activity.

iv) Exploration and evaluation assets

Exploration and evaluation expenditures relate to properties where the Company has valid ownership and exploration rights, and comprise costs that are directly attributable to:

- researching and analyzing existing exploration data;
- conducting geological studies, exploratory drilling and sampling;
- examining and testing extraction and treatment methods; and
- activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

Exploration and evaluation expenditures for each area of interest are carried forward as an asset provided that one of the following conditions is met:

- such costs are expected to be recouped in full through successful exploration and development of the area of interest or alternatively, by its sale; or
- exploration and evaluation activities in the area of interest have not yet reached a stage which permits a reasonable assessment of the existence of economically recoverable reserves or resources, and active and significant operations in relation to the area are continuing, or planned for the future.

Once management has determined that the development potential of the property is economically viable and technically feasible and the necessary permits are in place for its development, the exploration and evaluation asset is reclassified to mineral properties within mineral properties, plant and equipment.

The carrying values of capitalized amounts are reviewed at each reporting date, or when indicators of impairment are present. In the case of undeveloped projects, there may be only inferred resources to form a basis for the impairment review. The review is based on the Company's intentions for development of such a project. If a project does not prove viable, all unrecoverable costs associated with the project are charged to the statement of income (loss).

v) Amortization of mineral properties, plant and equipment

The carrying amounts of mineral properties, plant and equipment are depreciated, depleted or amortized to their estimated residual value over the estimated economic life of the specific assets to which they relate, or using the straight-line method over their estimated useful lives indicated below:

- Plant and equipment - 1 to 10 years straight-line or based on a unit-of-production basis over estimated proven and probable reserves, resources or other relevant metric;
- Assets under construction - not amortized;
- Exploration and evaluation assets - not amortized;
- Mineral properties - based on a unit-of-production basis over estimated proven and probable reserves, resources or other relevant metric;
- Mine development - based on a unit-of-production basis over estimated proven and probable reserves, resources or other relevant metric; and
- Deferred stripping - based on a unit-of-production basis over estimated proven and probable reserves or resources of the related area.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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Estimates of residual values, useful lives, and proven and probable reserves, resources or other relevant metrics are reassessed annually and any change in estimate is taken into account in the determination of remaining depreciation, depletion or amortization charges. Depreciation, depletion or amortization commences on the date the asset is available for use as intended by management.

vi) Borrowing costs

Interest and other financing costs relating to the construction of mineral properties, plant and equipment or development of mineral properties are capitalized as assets under construction or in mineral properties until they are complete and available for use, at which time they are transferred to plant and equipment or to depletable mineral properties. Interest costs incurred after the asset has been placed into service are charged to the statement of income (loss).

i) Debt

Debt is initially recorded at fair value, net of transaction costs incurred. Debt is subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of income (loss) over the period of the debt using the effective interest method.

Financing and transaction costs paid on the establishment of debt facilities are recognized as transaction costs of the debt to the extent that it is probable that some or all of the facility will be drawn down. In this case, the costs are deferred until the draw down occurs. To the extent there is no evidence on the establishment of the debt that it is probable that some or all of the facility will be drawn down, the costs are capitalized as a pre-payment for liquidity services and amortized over the period of the loan to which they relate.

j) Provisions

*Reclamation provision*

Provision is made for close down, reclamation and environmental rehabilitation costs (which include the dismantling and demolition of infrastructure, removal of residual materials and remediation of disturbed areas) in the financial period when the related environmental disturbance occurs, based on the estimated future costs using information available at the date of the statement of financial position. At the time of establishing the provision, a corresponding asset is capitalized, where it gives rise to a future benefit, and depreciated over future production from the operations to which it relates. For properties where mining activities have ceased or are in reclamation, changes to the reclamation provision are charged directly to the statement of income (loss). The provision is discounted using a current market-based, risk-free discount rate and the accretion of the discount is included in finance expenses.

The provision is reviewed at each reporting date for changes to obligations, legislation or discount rates that impact estimated costs or lives of operations. The cost of the related asset is adjusted for changes in the provision resulting from changes in the estimated cash flows or discount rate and the adjusted cost of the asset is depreciated prospectively.

*Other provisions*

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated. Where the effect is material, the provision is discounted to its present value using an appropriate current, market-based, pre-tax discount rate and the accretion of the discount is included in finance expenses.

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## k) Impairment of non-current assets

At each reporting date, the Company reviews its non-current assets to determine whether there are any indications of impairment. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any.

Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash generating unit (“CGU” or “CGUs”) to which the asset belongs. The recoverable amount is determined as the higher of FVLCD and the asset’s value in use. FVLCD is the amount that would be obtained from the sale of an asset or CGU in an arm’s length transaction between knowledgeable and willing parties, less the costs of disposal. For mineral assets, when a binding sale agreement is not readily available, FVLCD is often estimated using a discounted cash flow approach using a post-tax discount rate. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate. Estimated future cash flows are calculated using estimated recoverable reserves or resources, future commodity prices and future operating, capital and reclamation costs. The discount rate applied to the estimated future cash flows reflects current market assessments of the time value of money and the risks specific to the asset. Determining the discount rate includes appropriate adjustments for the risk profile of the countries in which the individual CGUs operate. If the carrying amount of an asset or CGU exceeds its recoverable amount, the carrying amount of the asset or CGU is reduced to its recoverable amount. An impairment loss is recognized as an expense in the statement of income (loss).

Non-financial assets that have been impaired are tested for possible reversal of the impairment whenever events or changes in circumstance indicate that the impairment may have reversed. Where an impairment charge subsequently reverses, the carrying amount of the asset or CGU is increased to the revised estimate of its recoverable amount, but only so that the increased carrying amount does not exceed the carrying amount that would have been determined (net of depreciation, depletion, or amortization) had no impairment loss been recognized for the asset in prior years. A reversal of impairment is recognized as a gain in the statement of income (loss).

## l) Revenue recognition

Revenue is recognized to the extent that it is probable that economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable, excluding discounts, rebates, and sales taxes or duty. Revenue from the sale of goods is recognized when control has transferred, which is generally considered to occur when title passes to the customer. Once the title has passed to the customer, the significant risks and rewards of ownership have been transferred and the customer is able to direct the use of and obtain substantially all of the remaining benefits from the goods.

## m) Share-based compensation

The Company grants share-based awards to employees, directors and consultants as an element of compensation. The fair value of the awards is recognized over the vesting period as compensation expense and contributed surplus. The fair value of options is determined using the Black-Scholes option pricing model using estimates at the date of the grant. Restricted share units (“RSU” or “RSUs”) are recorded at fair value based on the market value of the grant. Performance share units (“PSU” or “PSUs”) are subject to certain vesting requirements based on performance criteria over the vesting period established by the Company. PSUs are recorded at fair value as follows: the portion of the PSUs related to market conditions are recorded at fair value based on the application of a Monte Carlo pricing model at the date of grant and the portion related to non-market conditions is fair valued based on the market value of the shares at the date of the grant. At each reporting date prior to vesting, the cumulative expense representing the extent to which the vesting period has expired and management’s best estimate of the awards that are ultimately expected to vest is computed. The movement in cumulative expense is recognized in the statement of income (loss) with a corresponding entry within equity, against contributed

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surplus. No expense is recognized for awards that do not ultimately vest. When stock options are exercised, the proceeds received, together with any related amount in contributed surplus, are credited to share capital. When RSUs and PSUs vest, the share-based compensation expense associated with the net units issued that is included in contributed surplus is credited to share capital. The fair value of shares withheld to satisfy tax withholding obligations associated with vested units is accounted for as a debit from contributed surplus.

n) Income taxes

Current tax for each taxable entity of the Company is based on the local taxable income at the local statutory tax rate enacted or substantively enacted at the date of the statement of financial position, and includes adjustments to tax payable or recoverable in respect of previous years.

Deferred tax is accounted for using the liability method, providing for the tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their respective tax bases.

Deferred income tax liabilities are recognized for all taxable temporary differences except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit or loss nor taxable profit or loss.

Deferred income tax assets are recognized for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax losses can be utilized.

The carrying amount of deferred income tax assets is reviewed at each reporting date and is adjusted to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be utilized. To the extent that an asset not previously recognized fulfils the criteria for recognition, a deferred income tax asset is recorded.

Deferred tax is measured on an undiscounted basis using the tax rates that are expected to apply in the period when the liability is expected to be settled or the asset is expected to be realized, based on tax rates and tax laws enacted or substantively enacted at the date of the statement of financial position. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis. Current and deferred taxes relating to items recognized directly in equity are recognized in equity and not in the statement of income (loss).

Mining taxes and royalties are treated and disclosed as current and deferred taxes if they have the characteristics of an income tax. This is considered to be the case when they are imposed under government authority and the amount payable is calculated by reference to revenue derived (net of any allowable deductions) after adjustment for items comprising temporary differences.

o) Financial instruments

Financial instruments are recognized when the Company becomes party to a contractual obligation. At initial recognition, financial instruments are measured at fair value, net of the attributable transaction costs, except for financial assets and liabilities classified as fair value through profit or loss ("FVTPL"). The transaction costs attributable to assets and liabilities carried at FVTPL are expensed in the period in which they are incurred. Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership. Financial liabilities are derecognized when, and only when, the Company's obligations are discharged, cancelled or they expire.

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On initial recognition, financial assets and liabilities are classified as and measured at: amortized cost, FVTPL and fair value through other comprehensive income (“OCI”) according to their contractual cash flow characteristics and the business models under which they are held.

Financial assets are measured at amortized cost if they are held for the collection of contractual cash flows where those cash flows solely represent payments of principal and interest. The Company’s intent is to hold these financial assets in order to collect contractual cash flows and the contractual terms give rise to cash flows on specified dates that are solely payments of principal and interest on the principal amount outstanding.

Financial assets that are debt instruments are measured at fair value through OCI if they are held for the collection of contractual cash flows and for selling the financial assets, where the assets’ cash flows represent solely payments of principal and interest. The Company initially recognizes these financial assets at their fair value with subsequent changes to fair values recognized in OCI. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to the statement of income (loss). The Company does not have any financial assets that are equity instruments.

Financial assets are measured at FVTPL if they do not qualify as financial assets at amortized cost or fair value through OCI. The Company initially recognizes these financial assets at their fair value with subsequent changes to fair values recognized in the statement of income (loss).

Financial liabilities are measured at amortized cost unless they are required to be measured at FVTPL.

Financial liabilities are measured at FVTPL if they are specific liabilities, including derivatives, which cannot be classified as financial liabilities at amortized cost. The Company initially recognizes these financial liabilities at their fair value with subsequent changes to fair values recognized in the statement of income (loss).

*Impairment of financial assets*

The Company assesses on a forward looking basis the expected credit losses associated with its financial assets carried at amortized cost and fair value through OCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables, the Company applies the simplified approach permitted by IFRS 9, Financial Instruments (“IFRS 9”), which requires expected lifetime losses to be recognised from initial recognition of the receivables.

p) Share capital

The proceeds from the issuance of common shares and the exercise of stock options together with the fair value of stock options, RSUs and PSUs previously recorded over the vesting period are recorded as share capital. Share capital issued for non-monetary consideration is recorded at an amount based on fair value on the date of grant. Incremental costs directly attributable to the issue of common shares are charged to share capital.

q) Flow-through common shares

The Company may, from time to time, issue flow-through common shares (as defined in the *Income Tax Act* (Canada)) to finance a portion of its Canadian exploration programs. Pursuant to the terms of the flow-through share agreements, these shares transfer the tax deductibility of qualifying resource expenditures to investors. On issuance, the Company bifurcates the proceeds received from flow-through shares into: i) a flow-through share premium, equal to the estimated premium, if any, investors pay for the flow-through feature, which is recognized as a liability, and ii) share capital. The Company derecognizes the flow-through share premium liability when the qualifying resource expenditures are made and recognizes a deferred tax liability or recovery for the amount of the tax reduction renounced to the shareholders that relates to the

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qualifying expenditures made.

r) Earnings (loss) per share

Basic earnings (loss) per share is calculated using the weighted average number of shares outstanding during the period. Contingently issuable shares are treated as outstanding and are included in the calculation of basic earnings (loss) per share only from the date when all necessary conditions are satisfied. Shares that are issuable solely after the passage of time are not contingently issuable shares, because the passage of time is a certainty. PSUs are treated as contingently issuable shares because their issue is contingent upon satisfying specified conditions in addition to the passage of time.

Diluted earnings per share is calculated using the weighted average number of common shares outstanding adjusted to include the effects of dilutive common share equivalents such as stock options, RSUs and PSUs. Diluted earnings per share is calculated using the treasury method, whereby proceeds from the exercise of stock options, RSUs and PSUs and the amount of compensation expense measured but not yet recognized in the statement of income (loss), which together form the assumed exercise prices, are assumed to be used to purchase common shares of the Company at the average market price during the period. The number of PSUs included in the diluted earnings per share calculation, if the conditions are not satisfied, is based on the number of shares that would be issuable if the end of the period were the end of the contingency period.

The diluted earnings per share calculation excludes any potential conversion of RSUs, PSUs or stock options that would increase earnings per share. In periods of loss, diluted loss per share is the same as basic loss per share as the effect would be anti-dilutive.

s) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date. Leases in which substantially all of the risks and rewards of ownership are transferred to the Company are classified as finance leases. The leased assets are measured initially at an amount equal to the lower of their fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the assets are accounted for in accordance with the accounting policy applicable to that asset. Assets held under other leases are classified as operating leases and are not recognized in the statement of financial position.

Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of income (loss) on a straight-line basis over the term of the lease. Minimum lease payments made under finance leases are apportioned between finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

### **3 SIGNIFICANT ESTIMATES AND JUDGMENTS**

a) Significant areas where judgment is applied, apart from those involving estimations, are:

*Functional currency*

The functional currency for each of the Company's entities is the currency of the primary economic environment in which the entity operates. The determination of the functional currency may involve judgments to determine the primary economic environment, if the functional currency is not or may not be clear. The Company reconsiders the functional currency if there is a change in conditions used to determine the economic environment. The Company has determined the

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functional currency of its parent company and Prodigy Gold Inc. to be Canadian dollars (“CA\$”) and its other subsidiaries to be the US dollar.

*Acquisition accounting*

The acquisition of a company may result in the reporting of the acquisition as a business combination or an asset acquisition as defined within IFRS. Judgment is required to determine the basis of accounting for the acquisition.

*Deferred income taxes*

The determination of deferred income tax requires management to make judgments related to the probability that future taxable profit will be sufficient to allow the recognition of deferred income tax assets and the likelihood that tax positions taken will be sustained upon assessments by applicable tax authorities.

Tax judgments and assumptions are subject to risk and uncertainty, hence there is a possibility that changes in circumstances will alter expectations, which may impact the amount of deferred tax assets and deferred tax liabilities recognized on the statement of financial position and the amount of other tax losses and temporary differences not yet recognized. In such circumstances, some or the entire carrying amount of recognized deferred tax assets and liabilities may require adjustment, resulting in a corresponding credit or charge to the statement of income (loss). Deferred tax assets, including those arising from tax losses, capital losses and temporary differences, are recognized only where it is probable that taxable earnings will be available against which the losses or deductible temporary differences can be utilized. Assumptions about the generation of future taxable earnings and repatriation of retained earnings depend on management’s estimates of future cash flows. These depend on estimates of future production and sales volumes, commodity prices, reserves, resources, operating costs, closure and decommissioning costs, capital expenditures, dividends and other capital management transactions.

*Stripping costs*

The Company incurs waste removal costs (stripping costs) during the pre-production and production phases of its surface mining operations. During the production phase, stripping costs (production stripping costs) can be incurred both in relation to the production of inventory in that period and the creation of improved access and mining flexibility in relation to ore to be mined in the future. The former are included as part of production costs, while the latter are capitalized as deferred stripping, when certain criteria are met. Significant judgment is required to distinguish between pre-production stripping and production stripping and to distinguish between production stripping that relates to the extraction of inventory and that which relates to the creation of a deferred stripping asset.

Once the Company has identified its production stripping for each surface mining operation, it identifies the separate components of the ore bodies for each of its mining operations. An identifiable component is a specific volume of the ore body that is made more accessible by the stripping activity. Significant judgment is required to identify and define these components, and also to determine the expected volumes (e.g. in tonnes) of waste to be stripped and ore to be mined in each of these components. These assessments are undertaken for each individual mining operation based on the information available in the mine plan.

Judgment is also required to identify a suitable production measure to be used to allocate production stripping costs between inventory and any deferred stripping asset for each component. The Company considers that the ratio of the expected volume of waste to be stripped for an expected volume of ore to be mined for a specific component of the ore

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body is the most suitable production measure.

- b) The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may vary from those estimates due to inherent uncertainty or other factors. The Company regularly reviews its estimates. Revisions to estimates and the resulting effects on the carrying amounts of the assets and liabilities are accounted for prospectively. Key sources of estimation uncertainty that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are discussed below.

*Fair value of assets and liabilities acquired through an acquisition*

Judgment and estimates are used to determine the fair value of the assets and liabilities acquired by way of an acquisition. In the determination of the fair value of the assets and liabilities, management makes certain judgments and estimates regarding reserves, resources, exploration potential, capital expenditures, commodity prices, operating costs, economic lives, reclamation costs and discount rates, among others. It may take time to obtain the information necessary to measure their fair values. In the case of a business combination, changes to the provisional measurements of assets and liabilities acquired are retrospectively adjusted when new information is obtained until the final values are determined. Final values will be determined within one year of closing the acquisition.

*Work-in-process inventory / Production costs*

The Company's management makes estimates of the amount of recoverable ounces in work-in-process inventory which is used in the determination of the cost of sales during the period. Changes in these estimates can result in a change in the carrying amount of inventories and production costs of future periods. The Company monitors the recovery of gold ounces from the leach pads and may refine its estimate based on these results. Assumptions used in inventory valuation include type of ore tonne mined, rock density, grams of gold per tonne, expected recovery rate based on the type of ore placed on the leach pads, timing of recovery, remaining costs of completion to bring inventory into its saleable form and assays of solutions and gold on carbon, among others.

During 2018, the Company recognized a net non-cash impairment write down on work-in-process inventory of \$1,117 at the El Castillo mine and \$1,575 at the La Colorada mine (see note 7).

*Mineral properties*

The cost of acquiring, exploring and developing mineral properties and the cost to increase future output by providing access to additional reserves or resources, are deferred. After a mine commences production, these costs are amortized over the proven and probable reserves to which they relate if available; otherwise, the Company will use its best estimate based on measured and indicated resources or other relevant metric. The determination of reserves and resources is complex and requires the use of estimates and assumptions related to geological sampling and modeling, future commodity prices and costs to extract and process the ore. The mineral reserve or resource is used in estimating the value of the mineral property and in the determination of recoverable ounces which is further used in depletion and depreciation calculations.

*Impairment of non-current assets*

The Company reviews the carrying amounts of non-current assets whenever events or changes in circumstances indicate that the carrying amounts may exceed the estimated recoverable amounts determined by reference to estimated future

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operating results and discounted future cash flows. An impairment loss is recognized when the carrying amount of those assets is not recoverable. Non-current assets that have been impaired are tested for possible reversal of the impairment whenever events or changes in circumstance indicate that the impairment may have reversed. Calculating the estimated recoverable amount of the CGUs for non-current asset impairment tests requires management to make estimates and assumptions with respect to estimated recoverable reserves and resources, estimated future commodity prices, future production and sales volume, the expected future operating, capital and reclamation costs, discount rates and exchange rates. These estimates are subject to various risks and uncertainties which may ultimately have an effect on the estimated recoverability of the carrying amounts of non-current assets.

The Company, from time to time, acquires exploration and evaluation assets. When a number of properties are acquired in a portfolio, the Company must make a determination of the fair value attributable to each of the properties within the total portfolio. When the Company conducts further exploration on acquired properties, it may determine that certain properties do not support the fair values applied at the time of acquisition. If such determination is made, the property is impaired and could have a material effect on the consolidated statements of financial position and consolidated statements of income (loss).

During 2018, the Company recognized a non-cash impairment of mineral properties, plant and equipment of \$4,825 (see note 24).

*Deferred income taxes*

The determination of current income tax expense (recovery) and deferred income tax expense (recovery) involves judgment and estimates as to the future taxable earnings and interpretation of laws in the countries in which the Company operates. The Company is subject to assessments by tax authorities who may interpret the tax law differently. Changes in these estimates may materially affect the final amount of current or deferred income taxes or the timing of tax payments.

*Reclamation provision*

Reclamation provision represents the present value of estimated future costs for the reclamation of the Company's mines and properties. These estimates include assumptions as to the future activities, cost of services, timing of the reclamation work to be performed, inflation rates, exchange rates and interest rates. The actual cost to reclaim a mine may vary from the estimated amounts because there are uncertainties in factors used to estimate the cost and potential changes in regulations or laws governing the reclamation of a mine. Management periodically reviews the reclamation requirements and adjusts the liability as new information becomes available and will assess the impact of new regulations and laws as they are enacted.

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**4 RECENT ACCOUNTING PRONOUNCEMENTS***New and amended standards adopted by the Company*

The Company has adopted the following new and amended standards in the annual period commencing January 1, 2018 and as a result, changed the relevant accounting policies described in note 2. These changes were made in accordance with the applicable transitional provisions.

IFRS 9, Financial Instruments

IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities. It replaces the guidance in International Accounting Standard (“IAS”) 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through OCI and FVTPL. There is now a new expected credit loss model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in OCI for liabilities designated as FVTPL.

The Company applied IFRS 9 retrospectively; however, the adoption of IFRS 9 did not require any adjustments to the classification or measurement of the Company’s financial assets and financial liabilities. The adoption of the new expected credit loss model under IFRS 9 had a negligible impact on the carrying amounts of our financial assets on the transition date given the Company transacts exclusively with large international financial institutions and other organizations with strong credit ratings.

IFRS 15, Revenue from Contracts with Customers (“IFRS 15”)

IFRS 15 deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, timing and uncertainty of revenue and cash flows arising from an entity’s contracts with customers. The standard replaces IAS 18, Revenue, and IAS 11, Construction Contracts, and related interpretations. Under IFRS 15, revenue is recognized upon transfer of control over goods or services to the customer. The recognition of revenue upon transfer of control to the customer is consistent with the Company’s revenue recognition policy applied in the annual consolidated financial statements for the year ended December 31, 2017, as the condition is generally satisfied when title transfers to the customer. The Company elected to apply IFRS 15 using a modified retrospective approach; however, the adoption of IFRS 15 resulted in no measurement impact on the financial statements of the Company, as the timing of revenue recognition was unchanged.

*New and amended standards not yet adopted by the Company*

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after January 1, 2018, and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the Company, except the following set out below:

IFRS 16, Leases (“IFRS 16”), was issued in January 2016 by the IASB. According to the new standard, all leases will be on the statement of financial position of lessees, except those that meet the limited exception criteria. The standard is effective for annual periods beginning on or after January 1, 2019. The Company expects IFRS 16 will result in the recognition of additional assets and liabilities in the statement of financial position and a corresponding increase in depreciation, depletion and amortization and finance expenses and a decrease in production costs in the statement of income (loss). The Company also expects cash flows from operating activities to increase under IFRS 16 as lease payments will be recorded as financing outflows in the statement of cash flows. The Company has identified and collected data relating to existing agreements and has reviewed this information to identify which agreements are in scope for IFRS 16. Based on the review performed to date, the Company believes that the adoption of IFRS 16 will not have a material impact on the amounts recognized in the consolidated financial statements.

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There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the consolidated financial statements of the Company.

**5 PROPERTY ACQUISITIONS**

- a) On November 24, 2017, the Company completed the acquisition of the Cerro del Gallo project through the purchase of all the issued and outstanding shares of San Anton Resource Corporation, a wholly-owned subsidiary of Primero Mining Corp. ("Primero") for total consideration of \$15,194. Cash of \$15,000 was paid to Primero on closing. The transaction was accounted for as an asset acquisition. The purchase consideration was as follows:

Cash consideration	\$	15,000
Transaction costs		194
Consideration given	\$	15,194

The allocation of the purchase price to the assets acquired and liabilities assumed was based upon estimated fair values at the date of acquisition as set out below:

Cash and cash equivalents	\$	131
Mexican value added tax receivable		1,540
Prepaid expenses and other		12
Mineral properties, plant and equipment		13,514
Accounts payable and accrued liabilities		(3)
Net assets acquired	\$	15,194

- b) On February 23, 2017, the Company acquired the San Juan mineral concession adjacent to the El Castillo mine from a wholly-owned subsidiary of Fresnillo plc ("El Aguila") pursuant to a purchase and sale agreement dated February 23, 2017 between El Aguila and Minera Real del Oro S.A. de C.V., a wholly-owned subsidiary of Argonaut, for total consideration of \$25,490. Cash of \$13,000, plus 16% value added tax ("VAT"), was paid on execution of the agreement. Additionally, deferred cash consideration of \$13,000, plus 16% VAT, was paid on December 15, 2017. At the date of acquisition, an amount of \$12,490 was included in the purchase price, representing the estimated net present value of the deferred cash consideration. Accretion of the deferred cash consideration from date of acquisition to December 15, 2017 was included in finance expenses. The transaction was accounted for as an asset acquisition. The purchase price has been allocated to mineral properties based upon the estimated fair value of the assets acquired at the date of acquisition.

**6 RECEIVABLES**

	2018	2017
Mexican value added tax receivable	\$ 20,482	\$ 19,179
Due from customer	2,932	196
Other receivables	232	74
	\$ 23,646	\$ 19,449

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**7 INVENTORIES**

	2018	2017
Supplies	\$ 11,796	\$ 8,854
Work-in-process	75,452	59,720
Finished goods	1,921	337
	89,169	68,911
Non-current portion of inventory	(20,480)	-
	\$ 68,689	\$ 68,911

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Cost of inventories recognized as expense in cost of sales for 2018 totalled \$177,580 (2017 - \$123,792). During the three months ended September 30, 2018, the Company recorded a non-cash impairment write down of \$4,346 at the El Castillo mine and \$2,522 at the La Colorada mine related to the net realizable value of the work-in-process inventory, as a result of a decrease in the price of gold as at September 30, 2018. During the three months ended December 31, 2018, the Company recorded a non-cash impairment reversal of \$2,546 at the El Castillo mine and \$947 at the La Colorada mine related to the net realizable value of the work-in-process inventory, as a result of an increase in the price of gold as at December 31, 2018. During the year ended December 31, 2018, the Company recognized in total a net non-cash impairment write down on work-in-process inventory of \$1,800 at the El Castillo mine and \$1,575 at the La Colorada mine.

Additionally, the Company recorded a negative inventory adjustment of \$3,985 at the El Castillo complex and \$1,305 at the La Colorada mine related to finished goods inventory currently part of a bankruptcy case (see note 22).

During 2018, the Company transferred \$33,297 from current work-in-process inventory to non-current reflecting ore on leach pads at the El Castillo mine that the Company does not expect to process in the next 12 months. During the year ended December 31, 2018, the Company recorded a non-cash impairment of \$12,817 at the El Castillo mine related to the net realizable value of the non-current portion of work-in-process inventory. The net realizable value of the non-current portion of inventory was calculated based on the estimated price at the time of sale using long-term gold prices less estimated future production costs to convert the inventories into saleable form discounted over the planned processing timeframe.

The net write down of inventories has been presented in a separate component of cost of sales in the statement of income (loss).

**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**8 MINERAL PROPERTIES, PLANT AND EQUIPMENT**

	Mineral properties <sup>(1)</sup>	Exploration and evaluation assets	Plant and equipment <sup>(1)</sup>	Total <sup>(2)</sup>
<b>Cost</b>				
Balance at January 1, 2018	\$ 474,033	\$ 384,166	\$ 139,202	\$ 997,401
Additions	26,092	7,159	6,254	39,505
Disposals	-	(62)	(4,446)	(4,508)
Adjustment on currency translation	-	(20,955)	(2)	(20,957)
Balance at December 31, 2018	500,125	370,308	141,008	1,011,441
<b>Accumulated depreciation, depletion, amortization and impairment</b>				
Balance at January 1, 2018	319,012	-	98,994	418,006
Additions	32,267	-	7,489	39,756
Disposals	-	-	(4,386)	(4,386)
Impairment (reversal) (Note 24) <sup>(3)</sup>	3,260	-	(1,249)	2,011
Balance at December 31, 2018	354,539	-	100,848	455,387
Net book value at December 31, 2018	\$ 145,586	\$ 370,308	\$ 40,160	\$ 556,054
<b>Cost</b>				
Balance at January 1, 2017	\$ 413,009	\$ 345,114	\$ 117,845	\$ 875,968
Acquisitions (Note 5)	25,490	13,431	83	39,004
Additions	35,534	8,980	24,050	68,564
Disposals	-	-	(2,834)	(2,834)
Adjustment on currency translation	-	16,641	58	16,699
Balance at December 31, 2017	474,033	384,166	139,202	997,401
<b>Accumulated depreciation, depletion, amortization and impairment</b>				
Balance at January 1, 2017	297,408	-	94,466	391,874
Additions	21,604	-	6,764	28,368
Disposals	-	-	(2,236)	(2,236)
Balance at December 31, 2017	319,012	-	98,994	418,006
Net book value at December 31, 2017	\$ 155,021	\$ 384,166	\$ 40,208	\$ 579,395

<sup>(1)</sup>As at December 31, 2018, plant and equipment includes \$81 and mineral properties includes \$877 of assets under construction primarily related to the El Castillo mining complex (December 31, 2017 - \$1,754 and \$1,575, respectively), which were not subject to depreciation and depletion at the statement of financial position date.

<sup>(2)</sup>Certain mineral properties, plant and equipment are held as security on the Company's revolving credit facility (see note 11).

<sup>(3)</sup>During 2018, in addition to the impairment and impairment reversal described in note 24, an impairment of \$238 (2017 - nil) was recognized to reflect circumstances where the recoverable amount of equipment was less than the carrying amount.

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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**9 INCOME TAXES**

- (a) Income tax expense (recovery) included in the statement of income (loss) is as follows:

	2018	2017
Current income tax expense	\$ 3,986	\$ 1,180
Deferred income tax expense (recovery)	2,670	(4,014)
	\$ 6,656	\$ (2,834)

- (b) The income tax expense (recovery) differs from that computed by applying the applicable Canadian federal and provincial statutory rates before taxes as follows:

	2018	2017
Income (loss) before income taxes	\$ (965)	\$ 21,018
Canadian federal and provincial income tax rate	26.5%	26.5%
Income tax expense (recovery) based on Canadian federal and provincial income tax rates	(256)	5,570
Increase (decrease) attributable to:		
Change in unrecognized deferred tax assets	2,841	(5,194)
Effects of different foreign statutory tax rates on earnings of subsidiaries	118	861
Impact of Mexican inflation on tax values	(1,613)	(2,088)
Impact of Mexican Special Mining Duty	2,015	(546)
Impact of tax rate changes <sup>(1)</sup>	-	576
Non-taxable portion of foreign exchange	(1,358)	979
Impact of foreign exchange on deferred income taxes	3,362	(4,155)
Foreign withholding taxes	360	320
Non-deductible expenses	527	707
Adjustments related to prior periods	477	187
Other	183	(51)
Income tax expense (recovery)	\$ 6,656	\$ (2,834)

<sup>(1)</sup> On December 22, 2017, the Tax Cuts and Jobs Act of 2017 came into effect in the US, which created a single US Federal income tax rate of 21%. This decline in income tax rate from 35% to 21% has resulted in a reduction of deferred income tax assets and a deferred income tax expense for the period.

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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- (c) The significant components of the Company's deferred income tax assets (liabilities), without taking into consideration the offsetting of balances within the same tax jurisdiction, as at December 31 are as follows:

	2018	2017
Deferred income tax assets		
Unused non-capital losses	\$ 8,911	\$ 7,508
Reclamation provision	3,214	1,554
Share-based compensation	1,238	1,090
Mexican Special Mining Duty deduction	3,082	2,353
Other	2,692	2,757
	19,137	15,262
Deferred income tax liabilities		
Mineral properties, plant and equipment	(26,467)	(22,010)
Inventories	(2,462)	(374)
	(28,929)	(22,384)
Deferred income tax liabilities, net	\$ (9,792)	\$ (7,122)

On the statement of financial position, deferred tax assets and liabilities have been offset where they relate to income taxes within the same taxation jurisdiction and where the Company has the legal right and intent to offset. Deferred tax assets (liabilities) per the statement of financial position as at December 31 are as follows:

	2018	2017
Deferred income tax assets	\$ 6,789	\$ 5,911
Deferred income tax liabilities	(16,581)	(13,033)
Deferred income tax liabilities, net	\$ (9,792)	\$ (7,122)

- (d) In 2017, the Company recognized a deferred tax asset of \$6,763 related to the net operating losses ("NOLs") from prior years of its subsidiary, Minera Real del Oro S.A. de C.V., which were not previously recognized as the utilization of the NOLs became probable with the declaration of commercial production at the San Agustin mine effective October 1, 2017.

Management believes that sufficient uncertainty exists regarding the realization of certain deferred tax assets such that they have not been recognized. The tax benefits not recognized reflect management's assessment regarding the future realization of Canadian and foreign tax assets and estimates of future earnings and taxable income in these jurisdictions as of December 31, 2018. As at December 31, 2018, the Company and its subsidiaries had unrecognized Canadian operating loss carryforwards of \$55,128 which expire between the years 2019 and 2038 and unrecognized Canadian preproduction investment tax credits of \$5,075 which expire between 2024 and 2033. Deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax assets are recognized in the statement of financial position as at December

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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31 are as follows:

	2018	2017
Unused tax losses	\$ 55,128	\$ 61,264
Preproduction investment tax credits	5,075	5,519
Cumulative eligible capital	1,902	1,950
Mineral properties, plant and equipment	72,111	50,507
Net capital losses <sup>(1)</sup>	1,616	1,769
Intercompany balances	1,956	3,477
Reclamation provision	10,223	6,545
Other	1,449	-
	\$ 149,460	\$ 131,031

<sup>(1)</sup> Capital losses have no expiry date.**10 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

	2018	2017
Trade accounts payable	\$ 22,451	\$ 14,351
Accrued liabilities	12,337	8,530
	\$ 34,788	\$ 22,881

**11 DEBT**

In February 2018, the Company entered into an amended and restated credit agreement (the “Amended Revolving Facility” or “ARF”) with a syndicate of Canadian banks for an aggregate amount of \$50,000, representing a \$20,000 increase from the principal amount of \$30,000 under the original revolving credit facility. The ARF encompasses an extension of maturity through March 31, 2021 and a \$25,000 accordion feature, providing for total availability of up to \$75,000. The ARF is subject to eight commitment reductions of \$3,125 per quarter, plus the ratable amount of any incremental commitment derived from the accordion, with reductions to commence on June 30, 2019 and extend through maturity. The ARF bears interest at the London Inter-bank Offered Rate (“LIBOR”) plus 2.25% to 3.25% on drawn amounts and 0.51% to 0.73% on undrawn amounts, based on the Company’s consolidated leverage ratio, as defined in the agreement.

The Company incurred transaction costs and upfront fees on closing of the original and amended revolving credit facility, which are being amortized over the term of the revolving credit facility. The ARF is secured by all of the Company’s assets and is subject to various covenants including those that require the Company to maintain certain net tangible worth and ratios for leverage and interest coverage. As at December 31, 2018, the Company was in compliance with these covenants.

As at December 31, 2018, the Company had utilized \$13,000 of the revolving credit facility (December 31, 2017 - \$8,000).

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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**12 RECLAMATION PROVISION**

The Company's reclamation provision relates to the restoration and closure of its mineral properties, plant and equipment, primarily related to the Company's operating mines. The reclamation provision has been recorded as a long-term liability at net present value. The Company reviews and adjusts provisions at each reporting date. The total provision for reclamation at December 31, 2018 is \$16,801 (December 31, 2017 - \$9,434). The undiscounted value of this obligation is \$19,040 (December 31, 2017 - \$10,880), calculated using an inflation rate of 2.1% (December 31, 2017 - 2.0%). Accretion expense of \$197 has been charged to the statement of income (loss) for 2018 (2017 - \$160) to reflect an increase in the carrying amount of the reclamation provision, which has been determined using discount rates specific to the liabilities of 2.3% to 2.9% (December 31, 2017 - 2.0% to 2.3%).

The following table summarizes changes to the Company's reclamation provision:

	2018	2017
Balance at the beginning of the year	\$ 9,434	\$ 10,376
Accretion expense	197	160
Reclamation incurred	(35)	-
Adjustment on currency translation	(22)	18
Revisions in estimates <sup>(1)</sup>	7,227	(1,120)
Balance at the end of the year	\$ 16,801	\$ 9,434

<sup>(1)</sup>The revisions in estimates for 2018 is comprised of an increase of \$3,665 at La Colorada (2017 - \$1,362 decrease) and \$3,562 at the El Castillo mining complex (2017 - \$242). Included in other operating expenses for 2018 is an expense of \$2,799 (2017 - nil) reflecting revised estimated costs related to a section of the La Colorada mine where mining activities have ceased.

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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**13 SHAREHOLDERS' EQUITY**

- (a) Authorized share capital: Unlimited common shares without par value
- (b) Issued and outstanding share capital

	Number of shares	Amount
Balance at January 1, 2017	158,163,137	\$ 750,472
Issuance of common shares by way of public offering	18,750,000	31,509
Restricted share units issued to directors	87,915	164
Restricted shares issued to employees - vested <sup>(1)</sup>	-	1,448
Restricted share units issued to employees	19,899	42
Stock options exercised (Note 13(c))	479,676	812
Forfeiture of restricted shares previously issued to employees (Note 13(c))	(272,854)	-
Balance at December 31, 2017	177,227,773	784,447
Issuance of common shares related to a community agreement	100,000	182
Restricted share units issued to directors	131,594	258
Restricted shares issued to employees - vested <sup>(1)</sup>	-	637
Restricted share units issued to employees, net of shares withheld <sup>(2)</sup>	343,544	676
Balance at December 31, 2018	177,802,911	\$ 786,200

<sup>(1)</sup> During 2018, 445,095 restricted shares granted to employees vested (2017 - 889,668). All of these restricted shares were issued in prior years.

<sup>(2)</sup> During 2018, 2,047 vested RSUs were withheld to satisfy tax withholding requirements under the Company's net settlement feature for vested RSUs (2017 - nil).

*Public offering*

In February 2017, the Company entered into an agreement with a syndicate of underwriters, under which the underwriters agreed to buy on a bought deal basis 16,700,000 common shares of the Company at a price of CA\$2.40 per share for gross proceeds of \$29,771 (CA\$40,080). The Company granted the underwriters an option, exercisable at the offering price for a period of 30 days following the closing of the offering, to purchase up to an additional 15% of the offering to cover over-allotments, if any. The initial offering closed on March 15, 2017. On March 21, 2017, the syndicate of underwriters partially exercised the over-allotment option to acquire an additional 2,050,000 common shares of the Company at a price of CA\$2.40 per share for additional gross proceeds of \$3,686 (CA\$4,920). After general offering costs and a 5% underwriting fee, the net proceeds to the Company totaled \$31,509.

- (c) Share-based compensation

The Company has established the Share Incentive Plan, as amended, which was adopted by the Board of Directors on February 12, 2010, was approved by shareholders in 2010 and was re-approved by shareholders on May 1, 2018. The Share Incentive Plan provides that the maximum number of common shares available to be granted by the Board of Directors as stock options, restricted shares, RSUs, PSUs and any other share-based compensation arrangements is 7.25% of the total common shares issued and outstanding.

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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*Stock options*

Stock options are granted to directors, selected employees and consultants. The options vest one-third per year for three years and have a contractual option term of ten years. The Company has no legal or constructive obligation to repurchase or settle the options in cash.

The following table summarizes information relating to stock options outstanding and exercisable at December 31, 2018:

Exercise price per share (CA\$)	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price (CA\$)	Options exercisable	Weighted average exercise price (CA\$)
\$ 1.10 - 1.31	1,424,432	7.10	\$ 1.10	949,617	\$ 1.10
1.32 - 2.48	859,622	8.05	2.44	311,500	2.39
2.49 - 4.00	877,085	6.22	2.67	695,925	2.70
4.01 - 7.00	395,967	4.24	4.72	395,967	4.72
7.01 - 10.35	454,307	3.85	8.74	454,307	8.74
\$ 1.10 - 10.35	4,011,413	6.46	\$ 2.95	2,807,316	\$ 3.39

The following table summarizes stock option activity for the Company:

	Options	Weighted average exercise price (CA\$)
Outstanding at January 1, 2017	4,612,579	\$ 3.13
Granted	904,799	2.45
Exercised	(479,676)	1.42
Forfeited	(1,120,717)	3.91
Outstanding at December 31, 2017	3,916,985	2.96
Granted	151,815	2.49
Forfeited	(57,387)	2.43
Outstanding at December 31, 2018	4,011,413	\$ 2.95

The weighted average share price at the time of exercise for 2017 was CA\$2.55 per share. The total share-based compensation expense related to stock options granted by the Company for 2018 was \$494 (2017 - \$853). As at December 31, 2018, there was \$188 of unamortized stock-based compensation expense related to stock options granted (December 31, 2017 - \$494).

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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The following weighted average assumptions were used in computing the fair value of stock options granted:

		2018		2017
Weighted average share price	CA\$	2.49	CA\$	2.45
Expected dividend yield		Nil		Nil
Expected volatility		68.3%		64.0%
Risk-free interest rate		2.1%		1.2%
Estimated forfeiture rate		8.0%		8.2%
Expected life		5 years		6 years
Weighted average fair value per stock option granted	CA\$	1.44	CA\$	1.43

The Company uses its historical volatility as the basis for the expected volatility assumption in the Black-Scholes option pricing model.

*Restricted shares and Restricted Share Units*

The following table summarizes the restricted share and RSU activity for the Company:

	Restricted shares and RSUs	Weighted average fair value (CA\$)
Outstanding at January 1, 2017	1,933,533	\$ 1.62
Granted <sup>(1)</sup>	751,355	2.45
Vested <sup>(2)</sup>	(997,482)	1.91
Forfeited <sup>(3)</sup>	(299,584)	1.39
Outstanding at December 31, 2017	1,387,822	1.91
Granted <sup>(1)</sup>	1,143,511	2.50
Vested <sup>(2)</sup>	(922,280)	2.07
Forfeited <sup>(3)</sup>	(76,380)	2.37
Outstanding at December 31, 2018	1,532,673	\$ 2.23

<sup>(1)</sup> The RSUs granted during 2018 include 1,011,917 RSUs granted to employees that will be issued once the shares vest according to the terms below (2017 - 663,440).

<sup>(2)</sup> The restricted shares and RSUs vested during 2018 include 445,095 restricted shares granted to employees (2017 - 889,668), 345,591 RSUs granted to employees (2017 - 19,899), and 131,594 RSUs granted to directors (2017 - 87,915).

<sup>(3)</sup> The restricted shares and RSUs forfeited during 2018 include 76,380 RSUs (2017 - 26,730).

RSUs granted to directors are immediately vested and are restricted for the shorter of two years after the grant date or six months after a director retires from the board. RSUs granted to employees vest one-third per year for three years. The references to outstanding restricted shares and RSUs in the above table refer to restricted shares and RSUs granted but not yet vested. The total share-based compensation expense related to restricted shares and RSUs for 2018 was \$1,666 (2017 - \$1,532). As at December 31, 2018, there was \$789 of unamortized stock-based compensation expense related to restricted shares and RSUs (December 31, 2017 - \$633).

During 2018, the Company adopted a net withholding settlement feature for vested RSUs, where a portion of the vested RSUs can be withheld, at the election of the employee, to satisfy tax withholding obligations, pursuant to which the

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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Company withholds the number of shares necessary to satisfy such withholding obligations and remits the tax withholdings to the taxing authorities on behalf of the employee.

*Performance share units*

The following table summarizes the PSU activity for the Company:

	PSUs	Weighted average fair value (CA\$)
Outstanding at January 1, 2017 and 2018	-	\$ -
Granted	776,668	3.07
Forfeited	(40,161)	3.07
Outstanding at December 31, 2018	736,507	\$ 3.07

The PSUs are subject to certain vesting requirements and vest at the end of three years. The vesting requirements are based on certain performance criteria over the vesting period established by the Company. The number of units that vest is determined by multiplying the number of units granted to the participant by an adjustment factor, which ranges from 0 to 2.0. The total share-based compensation expense related to PSUs for 2018 was \$450 (2017 - nil). As at December 31, 2018, there was \$1,039 of unamortized stock-based compensation expense related to PSUs (December 31, 2017 - nil).

**14 SHARES OUTSTANDING**

	2018	2017
Basic weighted average shares outstanding	177,719,713	173,183,225
Weighted average shares dilution adjustments: <sup>(1)(2)</sup>		
Stock options	-	868,699
Restricted share units	-	342,044
Diluted weighted average shares outstanding	177,719,713	174,393,968

<sup>(1)</sup> Impact of dilutive stock options and other share-based compensation arrangements was determined using the Company's average share price for 2017 of CA\$2.38. During 2017, certain stock options and other share-based compensation arrangements were excluded from the calculation of diluted earnings per share due to the assumed exercise prices being greater than the average market price.

<sup>(2)</sup> As a result of the net loss incurred during 2018, stock options and other share-based compensation arrangements have been excluded from the calculation of diluted loss per share as they were anti-dilutive.

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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**15 PRODUCTION COSTS BY NATURE**

	2018	2017
Mining	\$ 65,538	\$ 45,659
Crushing	28,904	19,472
Processing	47,217	26,263
Mine general and administrative and royalties	10,711	8,115
Refining and desorption	2,917	2,619
Change in inventories	(32,366)	(3,363)
	\$ 122,921	\$ 98,765

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**16 FINANCE EXPENSES**

	2018	2017
Interest	\$ (439)	\$ (36)
Accretion on deferred cash consideration	-	(510)
Accretion on other liabilities	(145)	(198)
Accretion on reclamation provision	(197)	(160)
Amortization of debt financing and transaction costs	(233)	(278)
Other finance expenses	(187)	(152)
	\$ (1,201)	\$ (1,334)

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**17 OTHER INCOME (EXPENSE)**

	2018	2017
Foreign exchange gain (loss)	\$ (2,098)	\$ 802
Other income	1,382	989
	\$ (716)	\$ 1,791

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**18 SUPPLEMENTAL CASH FLOW INFORMATION**

The significant non-cash investing and financing transactions during the year are as follows:

	2018	2017
Increase (decrease) in expenditures on mineral properties for change in estimate of reclamation provision (Note 12)	\$ (4,428)	\$ 1,120
Increase in expenditures on mineral properties, plant and equipment related to a decrease in accounts payable and accrued liabilities	\$ 258	\$ 634
Fair value of common shares issued related to a community agreement capitalized as mineral property additions	\$ 182	\$ -
Fair value of restricted shares and restricted share units allocated from contributed surplus to share capital upon issuance	\$ 1,571	\$ 1,654

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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**19 SEGMENT INFORMATION**

Operating segments are those operations whose operating results are reviewed by the chief operating decision maker (the Chief Executive Officer) to make decisions about resources to be allocated to the segments and assess their performance, provided those operations pass certain quantitative thresholds. In order to determine if operating segments shall be aggregated, management reviews various factors, including economic characteristics, nature of their products, production process, regulatory environment, geographical location and managerial structure. After aggregation criteria have been considered, operations whose revenues, earnings or assets exceed 10% of the total consolidated revenues, earnings or assets are considered to be reportable segments. Early-stage exploration and other operations, including Cerro del Gallo, are reported in the Corporate and other segment. The producing El Castillo and San Agustin mines have been aggregated into the El Castillo mining complex reportable segment. The Company operates in the mining industry and its principal product is gold. During 2018, sales were to four customers (2017 - three customers) and recognized at a point in time. The Company's revenue is generated on the sale of product originating from Mexico. The Company's significant mineral properties are located in Canada (Magino) and Mexico (El Castillo mining complex, La Colorada and San Antonio). The following tables summarize segment information of the Company:

	El Castillo mining complex	La Colorada	San Antonio	Magino	Corporate and other	Total
<b>Year ended December 31, 2018</b>						
Revenue	\$ 133,640	\$ 62,416	\$ -	\$ -	\$ -	\$ 196,056
Production costs	78,888	44,033	-	-	-	122,921
Depreciation, depletion and amortization	24,696	8,481	-	-	-	33,177
Inventory write down	18,602	2,880	-	-	-	21,482
Total cost of sales	122,186	55,394	-	-	-	177,580
Gross profit	11,454	7,022	-	-	-	18,476
Exploration expenses	-	538	-	9	-	547
General and administrative expenses	2,271	1,658	-	-	9,029	12,958
Other operating expenses	-	2,799	-	-	313	3,112
Impairment (reversal) of mineral properties, plant and equipment	25,266	(25,935)	-	-	2,680	2,011
Income (loss) from operations	\$ (16,083)	\$ 27,962	\$ -	\$ (9)	\$ (12,022)	\$ (152)
Capital expenditures	\$ 24,182	\$ 5,722	\$ 1,423	\$ 3,997	\$ 4,181	\$ 39,505
<b>December 31, 2018</b>						
Mineral properties, plant and equipment	\$ 113,960	\$ 63,643	\$ 113,847	\$ 241,120	\$ 23,484	\$ 556,054
Total assets	\$ 214,049	\$ 92,704	\$ 114,206	\$ 241,433	\$ 32,124	\$ 694,516

**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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	El Castillo mining complex	La Colorada	San Antonio	Magino	Corporate and other	Total
Year ended December 31, 2017						
Revenue	\$ 89,804	\$ 65,285	\$ -	\$ -	\$ -	\$ 155,089
Production costs	61,503	37,262	-	-	-	98,765
Depreciation, depletion and amortization	9,884	15,143	-	-	-	25,027
Total cost of sales	71,387	52,405	-	-	-	123,792
Gross profit	18,417	12,880	-	-	-	31,297
Exploration expenses	-	410	-	17	9	436
General and administrative expenses	1,696	1,580	-	-	8,391	11,667
Other operating expenses	587	36	-	-	157	780
Income (loss) from operations	\$ 16,134	\$ 10,854	\$ -	\$ (17)	\$ (8,557)	\$ 18,414
Capital expenditures	\$ 63,118	\$ 18,830	\$ 1,410	\$ 7,520	\$ 16,690	\$ 107,568
December 31, 2017						
Mineral properties, plant and equipment	\$ 144,285	\$ 39,859	\$ 112,424	\$ 258,063	\$ 24,764	\$ 579,395
Total assets	\$ 213,143	\$ 68,911	\$ 112,759	\$ 258,665	\$ 36,382	\$ 689,860

**20 RELATED PARTY TRANSACTIONS AND KEY MANAGEMENT COMPENSATION**

- (a) Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note. Transactions with related parties for goods and services are made on normal commercial terms and are considered to be at arm's length.

The details of the Company's entities and ownership interests are:

	Location	Ownership	Status
Pediment Gold Corp.	Canada	100%	Consolidated
Castle Gold Corporation	Canada	100%	Consolidated
Prodigy Gold Inc.	Canada	100%	Consolidated
San Anton Resource Corporation	Canada	100%	Consolidated
Argonaut Gold (U.S.) Corp.	USA	100%	Consolidated
Minera Real del Oro S.A. de C.V.	México	100%	Consolidated
Compania Minera Pitalla S.A. de C.V.	México	100%	Consolidated
Minexson S.A. de C.V.	México	100%	Consolidated
Megashear Mining-Exploration S.A. de C.V.	México	100%	Consolidated
Castle Gold Services S.A. de C.V.	México	100%	Consolidated
Minera Sud California S.A. de C.V.	México	100%	Consolidated
Kings-San Anton S.A. de C.V.	México	100%	Consolidated
San Anton de las Minas S.A. de C.V.	México	100%	Consolidated
San Anton del Oro S.A. de C.V.	México	100%	Consolidated

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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- (b) The compensation of the Company's directors and other key management personnel is detailed in the following table:

	2018	2017
Salaries and other short-term employee benefits	\$ 3,116	\$ 2,619
Post-employment benefits	106	112
Share-based compensation	3,212	2,375
	\$ 6,434	\$ 5,106

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company and consist of directors and certain senior officers.

## 21 CAPITAL MANAGEMENT

The Company manages and adjusts its capital structure based on available funds in order to support its operations and the acquisition, exploration and development of mineral properties. The capital of the Company consists of share capital, contributed surplus and debt (including the undrawn amount of \$37,000 as at December 31, 2018 on the ARF), net of cash and cash equivalents. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The Company's objectives in managing capital are to safeguard its ability to operate as a going concern and to generate a superior return to shareholders. The Company may finance acquisition and exploration activity through cash flows from operations, joint ventures and raising additional debt or share capital when market conditions are suitable.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the size of the Company, is reasonable.

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**ARGONAUT GOLD INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****For the years ended December 31, 2018 and 2017****(Expressed in thousands of United States dollars)**

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**22 COMMITMENTS AND CONTINGENCIES**

At December 31, 2018, the Company has the following commitments:

	2019	2020	2021	2022	2023	Thereafter	Total
Operating lease obligations	\$ 126	\$ 76	\$ 79	\$ 68	\$ -	\$ -	\$ 349
Land agreement obligations <sup>(1)(3)</sup>	2,006	1,189	1,123	1,169	990	9,446	15,923
Purchase obligations <sup>(2)(3)</sup>	56,642	45,506	22,136	-	-	-	124,284
Debt	-	-	13,000	-	-	-	13,000
Reclamation provision <sup>(4)</sup>	731	995	1,016	8,277	4,333	3,689	19,041
	\$ 59,505	\$ 47,766	\$ 37,354	\$ 9,514	\$ 5,323	\$ 13,135	\$ 172,597

<sup>(1)</sup> The Company has entered into agreements for surface and access rights to land associated with operating mines, development projects and exploration projects.

<sup>(2)</sup> The Company has entered into commitments totaling \$115,722 for mining services, \$4,799 for capital projects, \$3,438 for supplies and \$325 for maintenance services.

<sup>(3)</sup> Certain commitments may contain cancellation clauses, however the Company discloses its commitments based on management's intent to fulfill the contracts.

<sup>(4)</sup> Reclamation provision amounts represent management's estimate of when the reclamation expenditures are expected to be paid.

Various tax and legal matters are outstanding from time to time. Judgments and assumptions regarding these matters are subject to risk and uncertainty, hence there is a possibility that changes in circumstances will alter expectations. In the event that management's estimate of the future resolution of these matters changes, the Company will recognize the effects of these changes in the consolidated financial statements on the date such changes occur.

The Company understands that refiner Republic Metals Corporation ("Republic") filed for protection under chapter 11 of the United States Bankruptcy Code on November 2, 2018 (the "Petition Date") in the United States Bankruptcy Court for the Southern District of New York. Republic processed material from certain of the Company's properties in the past and, as of the Petition Date, had in its possession approximately 4,600 and 13,600 ounces of the Company's gold and silver, respectively (see note 7). The Company has engaged counsel to assert its legal right for the return of its material and otherwise protect its rights in Republic's bankruptcy case. It is not possible at this time to accurately assess the prospects for success of the Company's claims against Republic or the length of time it will take to resolve them. The Company has relationships with other refineries and does not anticipate any material disruption in its overall production as a result of Republic's bankruptcy filing.

**23 FINANCIAL INSTRUMENTS AND RISKS***Overview*

The Company's activities expose it to risks, including financial and operational risks of varying degrees of significance which could affect its ability to achieve its strategic objectives for growth and shareholder returns. The principal financial risks related to financial instruments to which the Company is exposed are credit risk, foreign exchange risk, liquidity risk and interest rate risk. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management

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framework and reviews the Company's policies on an ongoing basis.

(a) Credit risk

Credit risk arises from the non-performance by counterparties of contractual financial obligations. The Company maintains substantially all of its cash with major financial institutions. Deposits held with these institutions may exceed the amount of insurance provided on such deposits. The Company manages credit risk for trade and other receivables through established credit monitoring activities. To reduce credit risk, the Company regularly reviews the collectability of its amounts receivable and establishes an allowance based on its best estimate of potentially uncollectible amounts. The Company currently transacts with highly rated counterparties for the sale of gold. Management believes that the credit risk concentration with respect to these financial instruments is remote.

(b) Foreign exchange risk

Because the Company operates on an international basis, foreign exchange risk exposures arise from transactions and balances denominated in foreign currencies. The Company's foreign exchange risk arises primarily with respect to the Canadian dollar and the Mexican peso. The Company's cash flows from Mexican operations are exposed to foreign exchange risk as commodity sales are denominated in US dollars and the majority of operating expenses and capital expenditures are denominated in Mexican pesos and US dollars. Administrative transactions and exploration expenditures associated with the Magino project are primarily denominated in Canadian dollars.

The Company is exposed to foreign exchange risk through the following financial instruments denominated in currencies other than the US dollar as at December 31:

	US dollar value of Canadian dollar balances		US dollar value of Mexican peso balances	
	2018	2017	2018	2017
Cash and cash equivalents	\$ 85	\$ 645	\$ 369	\$ 1,238
Other receivables	-	-	192	-
Accounts payable and accrued liabilities	(1,011)	(1,083)	(19,746)	(13,074)
Other liabilities	-	-	(1,270)	(1,593)
	\$ (926)	\$ (438)	\$ (20,455)	\$ (13,429)

Based on the above net exposures at December 31, 2018, a 10% appreciation in the Canadian dollar would result in a \$93 decrease (December 31, 2017 - \$44) in the Company's other comprehensive income (loss). A 10% appreciation in the Mexican peso would result in a \$2,046 decrease (December 31, 2017 - \$1,343) in the Company's income (loss) before income taxes.

*Foreign exchange derivative contracts*

On January 20, 2017 (referred to as the "2017 foreign exchange contracts"), on September 25 and December 28, 2017 (together referred to as the "2018 foreign exchange contracts") and on November 13, 2018 (referred to as the "2019 foreign exchange contracts"), the Company entered into zero-cost collar contracts whereby it purchased a series of foreign exchange call option contracts and sold a series of foreign exchange put option contracts with equal and offsetting values at inception. These contracts were entered into to normalize operating expenses and capital expenditures to be incurred by

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the Company's Mexican operations as expressed in US dollar terms. The foreign exchange derivative contracts are classified as Level 2 in the fair value hierarchy. The details of the contracts were as follows:

<u>2017 foreign exchange contracts at inception</u>	<u>Amount</u>	<u>Term</u>	<u>Average strike price</u>
Foreign exchange call options - purchased	\$ 30,000	February 2017 - November 2017	20.00 Mexican pesos per US dollar
Foreign exchange put options - sold	\$ 30,000	February 2017 - November 2017	24.58 Mexican pesos per US dollar
<u>2018 foreign exchange contracts at inception</u>	<u>Amount</u>	<u>Term</u>	<u>Average strike price</u>
Foreign exchange call options - purchased	\$ 30,000	January 2018 - December 2018	17.90 Mexican pesos per US dollar
Foreign exchange put options - sold	\$ 30,000	January 2018 - December 2018	22.46 Mexican pesos per US dollar
<u>2019 foreign exchange contracts at inception</u>	<u>Amount</u>	<u>Term</u>	<u>Strike price</u>
Foreign exchange call options - purchased	\$ 24,000	January 2019 - December 2019	20.00 Mexican pesos per US dollar
Foreign exchange put options - sold	\$ 24,000	January 2019 - December 2019	23.56 Mexican pesos per US dollar

The resulting fair values of the outstanding contracts at December 31, 2018 have been recognized, on a net basis, in foreign exchange derivative assets on the statement of financial position. These derivative instruments were not designated as hedges by the Company and are marked-to-market at the end of each reporting period with the mark-to-market adjustment recorded in the statement of income (loss). Details are as follows:

	2018	2017
<u>2017 foreign exchange contracts</u>		
Realized gains	\$ -	\$ 2,546
<u>2018 foreign exchange contracts</u>		
Unrealized gains (losses)	593	(552)
Reversal of unrealized gains from prior period	(41)	-
Realized gains	9	-
<u>2019 foreign exchange contracts</u>		
Unrealized gains	510	-
Net gains on foreign exchange derivatives	\$ 1,071	\$ 1,994

**(c) Liquidity risk**

The Company manages liquidity risk by maintaining adequate cash and cash equivalent balances and credit facilities. The Company continuously monitors and reviews both actual and forecasted cash flows, and also matches the maturity profile of financial assets and liabilities. As at December 31, 2018, the Company had a cash balance of \$15,378 (December 31, 2017 - \$14,060), an undrawn ARF of \$37,000 (December 31, 2017 - \$22,000) and current liabilities of \$36,512 (December 31, 2017 - \$24,191).

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## (d) Interest rate risk

Interest rate risk is the risk that the fair values and future cash flows of the financial instruments will fluctuate because of changes in market interest rates. The Company has interest bearing cash balances, which are subject to fluctuations in the interest rate. A 10% increase or decrease in the interest earned from financial institutions on deposits held would result in a nominal increase or decrease in the Company's income (loss) before income taxes. The Company has additional exposure to interest rate risk on the ARF, which is subject to a floating interest rate. Floating interest rates are based on the LIBOR plus a fixed margin. The Company does not enter into derivative contracts to manage this risk. Based on the utilized AFR balance of \$13,000 at December 31, 2018, a 0.1% increase in LIBOR rates (10 basis point increase) would result in a nominal decrease in the Company's income (loss) before income taxes.

*Financial instruments*

The Company's financial instruments consist of cash and cash equivalents, receivables, foreign exchange derivative assets, accounts payable and accrued liabilities, debt, other liabilities and foreign exchange derivative liabilities.

The fair value hierarchy that reflects the significance of the inputs used in making the measurements has the following levels:

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

Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

Level 3 - inputs for the asset or liability that are not based on observable market data.

The following table shows the carrying amounts of financial assets and financial liabilities by category as at December 31:

	2018	2017
Financial assets at amortized cost <sup>(1)</sup>	\$ 18,500	\$ 14,263
Financial assets at FVTPL <sup>(2)</sup>	\$ 510	\$ -
Financial liabilities at amortized cost <sup>(3)</sup>	\$ (47,987)	\$ (31,944)
Financial liabilities at FVTPL <sup>(4)</sup>	\$ -	\$ (552)

<sup>(1)</sup> Financial assets at amortized cost include cash and cash equivalents and receivables.

<sup>(2)</sup> Financial assets at FVTPL include foreign exchange derivative assets.

<sup>(3)</sup> Financial liabilities at amortized cost include accounts payable and accrued liabilities, debt and other liabilities.

<sup>(4)</sup> Financial liabilities at FVTPL include foreign exchange derivative liabilities.

As at December 31, 2018 and 2017, the carrying amounts of cash and cash equivalents, receivables, and accounts payable and accrued liabilities are considered to be reasonable approximations of their fair values due to the short-term nature of these instruments. As at December 31, 2018 and 2017, the carrying amounts of other liabilities and debt are considered to be reasonable approximations of their fair values as there have been no significant changes in market interest rates since inception.

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**24 IMPAIRMENT AND REVERSAL OF MINERAL PROPERTIES, PLANT AND EQUIPMENT**

During 2018, the Company recognized a net non-cash impairment of mineral properties, plant and equipment of \$2,011 (2017 - nil), as summarized in the following table:

	Mineral properties	Plant and equipment	Total
El Castillo mine	\$ 23,123	\$ 4,585	\$ 27,708
La Colorada mine	(19,863)	(6,072)	(25,935)
Other	-	238	238
Total impairment (reversal)	\$ 3,260	\$ (1,249)	\$ 2,011

*Indicators of impairment / reversal*

In the fourth quarter of 2018, the Company reviewed the updated life-of-mine (“LOM”) plans for its operating mines for indicators of impairment or reversal. The Company noted an indicator of potential impairment at El Castillo and an indicator of potential impairment reversal at La Colorada. Further, as at December 31, 2018, management of the Company determined the continued weakness in the Company’s share price during 2018, resulting in the Company’s market capitalization being below the carrying amount of net assets, constituted an impairment indicator. Therefore, the Company completed an assessment for each of the Company’s CGUs whereby the carrying value of the CGU, including acquisition cost, was compared to its recoverable amount. The recoverable amount was determined as the FVLCD for each CGU. FVLCD was determined using a discounted future cash flow model. The determination of FVLCD for each CGU uses Level 3 valuation techniques. Management has determined that no impairments are required to be recognized on its San Agustin mine or on its exploration and evaluation assets as at December 31, 2018.

El Castillo experienced a decrease in the estimated FVLCD during 2018, primarily due to an increase in operating costs. As a result of this assessment, the Company recorded a non-cash impairment of mineral properties, plant and equipment of \$27,708. The recoverable amount based on El Castillo’s FVLCD was \$53,413.

As a result of an increase in mineral reserves and resources of the La Colorada mine, the Company has observed an increase in the FVLCD that has resulted in a partial reversal of the non-cash impairment of mineral properties, plant and equipment recorded during 2015. A non-cash impairment reversal of \$25,935 was recorded during 2018. The recoverable amount based on La Colorada’s FVLCD was \$62,825.

*Key assumptions*

The projected cash flows used in impairment testing are significantly affected by changes in assumptions for metal prices, production costs estimates, future capital expenditures, changes in the amount of recoverable reserves, resources, and exploration potential, discount rates, inflation and exchange rates. The determination of FVLCD includes the following key applicable assumptions:

- Gold price per ounce: \$1,250 in 2019 and beyond (2017 - \$1,250 in 2018 and beyond)
- Operating and capital costs based on historical costs incurred and estimated forecasts
- Production volume and recoveries as indicated in the LOM plan
- After-tax discount rates between 5% and 8% based on the stage and associated risk of each project

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*Sensitivities*

The Company has performed a sensitivity analysis on CGUs where an impairment or reversal was recorded. The Company assumed a 5% change in the gold price assumption and a 5% change in the operating cost assumption while holding all other assumptions constant. Based on the impairment testing performed as at December 31, 2018, the sensitivity to changes in these key assumptions appear below for El Castillo and La Colorada.

	Change in recoverable amount from a 5% change in gold price	Change in recoverable amount from a 5% change in operating costs
El Castillo	\$ 9,809	\$ 5,770
La Colorada	\$ 9,430	\$ 5,550

Additionally, the Company has performed a sensitivity analysis on CGUs where no impairment or reversal was recognized. The table below indicates the long-term gold price assumption which would cause a CGU's carrying value to equal the recoverable amount while holding all other assumptions constant.

	Long-term price per ounce required for recoverable amount to equal carrying amount
San Agustin	\$ 1,242
San Antonio	\$ 987
Magino	\$ 1,229

The Company believes that adverse changes in metal price assumptions would also impact certain other inputs in the LOM plans which may offset, to a certain extent, the impact of these adverse gold price changes.