

Condensed Interim Financial Statements  
(Expressed in Canadian Dollars)

**KENNADY DIAMONDS INC.**

Three and six months ended June 30, 2014  
(Unaudited)

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**NOTICE OF NO AUDITOR REVIEW OF  
CONDENSED INTERIM FINANCIAL STATEMENTS**

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

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

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

**RESPONSIBILITY FOR CONDENSED INTERIM FINANCIAL STATEMENTS**

The accompanying unaudited condensed interim financial statements of Kennady Diamonds Inc. (“Kennady Diamonds” or the “Company”) are the responsibility of the Board of Directors.

The unaudited condensed interim financial statements have been prepared by management, on behalf of the Board of Directors, in accordance with the accounting policies disclosed in the notes to the Company’s audited financial statements as at December 31, 2013, with any changes described in these unaudited condensed interim financial statements. Where necessary, management has made informed judgments and estimates in accounting for transactions which were not complete at the balance sheet date. In the opinion of management, the condensed interim financial statements have been prepared within acceptable limits of materiality and are in accordance with International Accounting Standard 34 Interim Financial Reporting using accounting policies consistent with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) appropriate in the circumstances.

Management has established processes, which are in place to provide sufficient knowledge to support management representations that it has exercised reasonable diligence that the unaudited condensed interim financial statements fairly present in all material respects the financial condition, results of operations and cash flows of the Company, as of the date of and for the periods presented by the unaudited condensed interim financial statements.

The Board of Directors is responsible for reviewing and approving the unaudited condensed interim financial statements together with other financial information of the Company and for ensuring that management fulfills its financial reporting responsibilities. An Audit Committee assists the Board of Directors in fulfilling this responsibility.

The Audit Committee meets with management to review the financial reporting process and unaudited condensed interim financial statements together with other financial information of the Company. The Audit Committee approves the unaudited condensed interim financial statements together with other financial information of the Company for issuance to the shareholders on behalf of the Board of Directors.

Management recognizes its responsibility for conducting the Company’s affairs in compliance with IFRS as issued by the IASB, and applicable laws and regulations, and for maintaining proper standards of conduct for its activities.

*“Patrick C. Evans”*  
Patrick C. Evans  
President and Chief Executive Officer

*“Bruce Ramsden”*  
Bruce Ramsden  
VP Finance and Chief Financial Officer

Toronto, Canada  
August 13, 2014

**Condensed Interim Statements of Financial Position**

In Canadian dollars  
(Unaudited)

	Notes	June 30, 2014	December 31, 2013
<b>ASSETS</b>			
Current assets			
Cash	4	\$ 255,363	\$ 2,663,300
Short-term investments	4	6,682,044	12,354,665
Amounts receivable	4	243,081	97,778
Advances and prepaid expenses		27,656	21,292
		<b>7,208,144</b>	<b>15,137,035</b>
Reclamation deposit	5	325,000	30,000
Mineral properties	6	349,054	349,054
<b>Total assets</b>		<b>\$ 7,882,198</b>	<b>\$ 15,516,089</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current liabilities			
Accounts payable and accrued liabilities	4	\$ 673,540	\$ 125,606
Deferred premium on flow-through shares	7, 9(ii)	114,238	1,163,492
		<b>787,778</b>	<b>1,289,098</b>
Decommissioning and restoration liability	8	113,074	112,444
Shareholders' equity:			
Share capital	9	22,015,246	22,015,246
Share-based payments reserve	9	1,891,554	703,879
Deficit		(16,925,454)	(8,604,578)
Total shareholders' equity		<b>6,981,346</b>	<b>14,114,547</b>
<b>Total liabilities and shareholders' equity</b>		<b>\$ 7,882,198</b>	<b>\$ 15,516,089</b>

The notes to the condensed interim financial statements are an integral part of these statements.

On behalf of the Board:

\_\_\_\_\_  
"Patrick Evans"

Director

\_\_\_\_\_  
"Jonathan Comerford"

Director

**Condensed Interim Statements of Comprehensive Loss**

In Canadian dollars

(Unaudited)

	Notes	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
<b>Expenses</b>					
Exploration and evaluation expenses	11	\$ (4,556,897)	\$ (2,182,957)	\$ (7,909,383)	(2,761,823)
Management fees	10	(22,500)	(47,500)	(45,000)	(107,500)
Share-based payment expense	9, 10	(6,285)	(18,854)	(1,187,675)	(78,357)
Professional fees		(13,746)	(23,674)	(25,831)	(35,536)
Promotion and investor relations		(48,382)	(49,150)	(99,689)	(49,150)
Director fees		(8,121)	-	(18,443)	-
Transfer agent & regulatory fees		(20,378)	(11,569)	(30,564)	(19,516)
Finance expenses		(4,693)	-	(21,669)	-
Consulting fees	10	(41,770)	(22,777)	(87,944)	(30,169)
Office expenses		(11,295)	(7,724)	(15,009)	(10,715)
Travel expenses		(6,414)	-	(6,414)	-
Total expenses		(4,740,481)	(2,364,205)	(9,447,621)	(3,092,766)
Accretion expense on decommissioning and restoration liability	8	(316)	-	(630)	-
Interest and other income	4, 7	642,932	5,943	1,127,375	75,136
<b>Net loss and comprehensive loss for the period</b>		<b>\$ (4,097,865)</b>	<b>\$ (2,358,262)</b>	<b>\$ (8,320,876)</b>	<b>(3,017,630)</b>
<b>Basic and diluted loss per share</b>	9 (iii)	<b>\$ (0.18)</b>	<b>\$ (0.13)</b>	<b>\$ (0.36)</b>	<b>(0.16)</b>

The notes to the condensed interim financial statements are an integral part of these statements.

**Condensed Interim Statements of Equity**

In Canadian dollars

(Unaudited)

	Notes	Number of shares	Share capital	Share-based payments reserve	Deficit	Total
<b>Balance, January 1, 2013</b>		18,700,469	\$ 5,914,281	\$ 587,400	\$ (2,757,079)	\$ 3,744,602
Net loss for the period		-	-	-	(3,017,630)	(3,017,630)
Share-based payment expense	<b>9</b>	-	-	78,357	-	78,357
<b>Balance, June 30, 2013</b>		18,700,469	\$ 5,914,281	\$ 665,757	\$ (5,774,709)	\$ 805,329
<b>Balance, January 1, 2014</b>		22,857,675	\$ 22,015,246	\$ 703,879	\$ (8,604,578)	\$ 14,114,547
Net loss for the period		-	-	-	(8,320,876)	(8,320,876)
Share-based payment expense		-	-	1,187,675	-	1,187,675
<b>Balance, June 30, 2014</b>		<b>22,857,675</b>	<b>\$ 22,015,246</b>	<b>\$ 1,891,554</b>	<b>\$ (16,925,454)</b>	<b>\$ 6,981,346</b>

*The notes to the condensed interim financial statements are an integral part of these statements.*

**Condensed Interim Statements of Cash Flows**

In Canadian dollars

(Unaudited)

	Notes	Six months ended June 30, 2014	Six months ended June 30, 2013
Cash provided by (used in):			
Operating activities:			
Net loss for the period		\$ (8,320,876)	\$ (3,017,630)
Adjustments:			
Accretion expense on decommissioning and restoration liability		630	-
Interest income		(78,121)	(19,098)
Other income - flow-through premium		(1,049,254)	(59,038)
Share-based payment expense		1,187,675	78,357
Changes in non-cash operating working capital:			
Amounts receivable		(145,303)	(18,467)
Advances and prepaid expenses		(6,364)	9,201
Accounts payable and accrued liabilities		547,934	(75,465)
		<b>(7,863,679)</b>	<b>(3,102,140)</b>
Investing activities:			
Interest income		78,121	19,098
Reclamation deposit		(295,000)	-
Mineral properties		-	(149,999)
Redemption of short-term investments		5,672,621	2,949,801
		<b>5,455,742</b>	<b>2,818,900</b>
Increase in cash		<b>(2,407,937)</b>	<b>(283,240)</b>
Cash, beginning of period		<b>2,663,300</b>	<b>454,417</b>
Cash, end of period		<b>\$ 255,363</b>	<b>\$ 171,177</b>

*The notes to the condensed interim financial statements are an integral part of these statements.*



**KENNADY DIAMONDS INC.**  
**Notes to Condensed Interim Financial Statements**  
**For the Three and Six Months Ended June 30, 2014**  
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**(Unaudited)**

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**1. NATURE OF OPERATIONS**

Kennady Diamonds Inc. (“Kennady Diamonds” or the “Company”) was incorporated on February 27, 2012 under the Ontario Business Corporation Act to effect the transfer of Mountain Province Diamonds Inc.’s (“Mountain Province”) Kennady North Project assets and operations to a new company as contemplated under a Mountain Province plan of arrangement (Note 6). Until the closing of the plan of arrangement, Kennady Diamonds was a wholly-owned subsidiary of Mountain Province.

The address of the Company’s registered office and its principal place of business is 161 Bay Street, Suite 2315, PO Box 216, Toronto, ON, Canada, M5J 2S1. The Company’s shares are listed on the TSX Venture Exchange under the symbol ‘KDI’.

Kennady Diamonds is involved in the exploration, discovery and development of diamond properties in Canada’s Northwest Territories. The underlying value and recoverability of amounts shown as “Mineral Properties” is dependent upon the ability of the Company to discover economically recoverable reserves, permitting and development, and upon future profitable production or proceeds from disposition of the Company’s mineral properties. Failure to discover and develop economically recoverable reserves will require the Company to write off costs capitalized to date.

*Authorization of Financial Statements*

The unaudited condensed interim financial statements for the period ended June 30, 2014 were approved by the Audit Committee on behalf Board of Directors on August 13, 2014.

**2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

These unaudited condensed interim financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting*. Except as discussed below, these condensed interim financial statements follow the same accounting policies and methods of computation as compared with the most recent annual financial statements, being for the year ended December 31, 2013, which were prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). Accordingly, these condensed interim financial statements should be read in conjunction with the Company’s most recent annual financial statements.

*(i) Basis of Preparation*

These unaudited condensed interim financial statements have been prepared on a historical cost basis except for cash which has been measured at fair value.

The Company has elected to present the ‘Statement of Comprehensive Loss’ as a single financial statement with its Statement of Income, titled ‘Condensed Interim Statement of Comprehensive Loss’.

The significant accounting policies adopted in the preparation of these unaudited condensed interim financial statements are set out below.

*(ii) Interest income*

Interest income from financial assets is recognized when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income is accrued on the basis of time that has passed by reference to the principal outstanding and at the effective interest rate.

*(iii) Mineral properties and exploration and evaluation costs*

Exploration and evaluation (“E&E”) costs are those costs required to find a mineral property and determine technical feasibility and commercial viability. E&E costs include costs to establish an initial mineral resource and determine whether

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inferred mineral resources can be upgraded to measured and indicated mineral resources, and whether measured and indicated mineral resources can be converted to proven and probable reserves.

E&E costs consist of:

- gathering exploration data through topographical and geological studies;
- exploratory drilling, trenching and sampling;
- determining the volume and grade of the resource;
- test work on geology, metallurgy, mining, geotechnical and environmental; and
- conducting engineering, marketing and financial studies.

Costs in relation to these activities are expensed as incurred until such time that technical feasibility and commercial viability are demonstrable. At such time, mineral properties are assessed for impairment, and an impairment loss, if any, is recognized. Capitalized acquisition costs included in the Mineral Properties are transferred to capitalized costs within property, plant and equipment, or intangible assets, as appropriate. Determination of technical feasibility and commercial viability require management's judgment and assessment of legal, environmental, social and governmental factors.

The Company recognizes E&E costs as assets when acquired as part of a business combination, or asset purchase, or as a result of rights acquired relating to a mineral property. These assets are recognized at fair value or relative fair value if applicable. Acquired capitalized E&E consists of:

- interest in exploration properties, and
- amounts paid for acquired rights associated with exploration properties.

*(iv) Provisions*

A provision is recognized in the statements of financial position when the Company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are measured at the present value of the expected expenditures to settle the obligation, applying a risk-free interest rate. The increase in the provision due to a passage of time is recognized as accretion expense. The Company does not have any provisions as at June 30, 2014 other than the provision for decommissioning and restoration (Note 8) associated with its mineral properties.

The Company's decommissioning and restoration liability arise from its obligations to undertake site reclamation and remediation in connection with its mineral properties. The estimated costs of reclamation are based management's best estimates of costs to date. Future changes to any regulations and standards, as well as changes resulting from operations may result in actual reclamation costs differing from the estimate.

*(v) Financial instruments*

Financial instruments are classified into one of the following four categories: loans and receivables; fair value through profit or loss; held-to-maturity; and available-for-sale. Financial assets are initially measured at fair value. Subsequent measurement and recognition of the changes in fair value of financial instruments depends upon their initial classifications, as follows:

- Financial assets and financial liabilities at fair value through profit and loss include financial assets and financial liabilities that are held for trading or designated upon initial recognition as at fair value through profit and loss. These financial instruments are measured at fair value with changes in fair values recognized in the Condensed Interim Statement of Comprehensive Loss.
- Financial assets classified as available-for-sale are measured at fair value, with changes in fair values recognized as Other Comprehensive Income ("OCI") in the Interim Statement of Comprehensive Loss, except when there is

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- objective evidence that the asset is impaired, at which point the cumulative loss that had been previously recognized in OCI is recognized within the Condensed Interim Statement of Comprehensive Loss.
- Financial assets classified as held-to-maturity and loans and receivables are measured subsequent to initial recognition at amortized cost using the effective interest method.
- Financial liabilities, other than financial liabilities classified as fair value through profit and loss, are measured in subsequent periods at amortized cost using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or where appropriate, a short period, to the net carrying amount on initial recognition.

The Company has classified its financial instruments as follows:

<u>Asset/Liability</u>	<u>Classification</u>	<u>Measurement</u>
Cash	Fair Value through Profit and Loss	Fair Value
Short-term investments	Fair Value through Profit and Loss	Fair Value
Amounts receivable	Loans and Receivables	Amortized Cost
Accounts payable and accrued liabilities	Other Liabilities	Amortized Cost

The Company's cash consists of balances with banks. Short-term investments are investments with original maturities of greater than three months when acquired (Note 4).

The fair values of the Company's amounts receivable, and accounts payable and accrued liabilities approximate their carrying values because of the immediate or short-term to maturity of these financial instruments.

*(vi) Flow-through shares*

Under Canadian income tax legislation, a company is permitted to issue flow-through shares whereby the Company agrees to incur qualifying expenditures and renounce the related income tax deductions to the investors. The proceeds from issuance of these shares are allocated between the offering of shares and the sale of tax benefits. The allocation is made based on the difference between the quoted price of the existing shares and the amount the investor pays for the flow-through shares. A deferred premium liability is recognized for this difference. The Company renounces the deductions for tax purposes related to the eligible exploration and evaluation expenditures on the date the flow-through shares are issued. The premium liability is reduced on a pro-rata basis and recorded in other income based on the corresponding eligible expenditures that have been incurred.

Where the Company has unused tax benefits on loss carry forwards and tax pools in excess of book value available for deduction against which a valuation allowance has been provided, the Company reduces its valuation allowance to offset the increase in deferred tax liabilities resulting in an offsetting recovery of deferred income taxes being recognized through profit or loss in the reporting period.

*(vii) Share-based payments*

Equity-settled share-based payments to employees and others providing similar services are measured at the fair value of the equity instruments at the grant date. Details regarding the determination of the fair value of equity-settled share-based payment transactions are set out in Note 9.

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The fair value determined at the grant date of the equity-settled share-based payments is expensed to the Statement of Comprehensive Loss over the vesting period, if any, which is the period during which the employee becomes unconditionally entitled to equity instruments. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest, if any.

Equity-settled share-based payment transactions with parties other than employees, if any, are measured at the fair value of the goods or services received, except where that fair value cannot be estimated reliably, in which case they are measured at the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders the service.

*(viii) Loss per share*

Basic loss or earnings per share is calculated by dividing loss or earnings attributable to common shares by the weighted average number of shares outstanding during the period.

Diluted loss or earnings per share is calculated using the denominator of the basic loss or earnings calculation described above adjusted to include the potentially dilutive effect of outstanding stock options. The denominator is increased by the total number of additional common shares that would have been issued by the Company assuming exercise of all stock options with exercise prices below the average market price for the period.

*(ix) Income Taxes and Deferred Taxes*

The income tax expense or benefit for the period consists of two components: current and deferred. Income tax expense or benefit is recognized in the Interim Statement of Comprehensive Loss except to the extent it relates to a business combination or items recognized directly in equity.

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year. Current tax is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date in each of the jurisdictions and includes any adjustments for taxes payable or recovery in respect of prior periods.

Taxable profit or loss differs from profit or loss as reported in the Interim Statement of Comprehensive Loss because of items of income or expense that are taxable or deductible in other years, and items that are never taxable or deductible.

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences, loss carryforwards and tax credit carryforwards to the extent that it is probable that taxable profits will be available against which they can be utilized. To the extent that the Company does not consider it to be probable that taxable profits will be available against which deductible temporary differences, loss carryforwards, and tax credit carryforwards can be utilized, a deferred tax asset is not recognized.

Deferred tax assets and liabilities are not recognized if the temporary difference arises from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

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Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and 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 are recognized in profit or loss, except when they relate to items that are recognized in other comprehensive income or directly into equity, in which case, the current and deferred taxes are also recognized in other comprehensive income or directly in equity respectively.

(x) *Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Company*

At the date of authorization of these condensed interim financial statements, certain new standards, amendments and interpretations to existing standards have been published but are not yet effective, and have not been adopted early by the Company.

The Company anticipates that all of the relevant pronouncements will be adopted in the Company's accounting policy for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments and interpretations that are expected to be relevant to the Company's financial statements is provided below. Certain other new standards and interpretations have been issued but are not expected to have a material impact on the Company's condensed interim financial statements and are therefore not discussed below.

**IFRS 9 – Financial Instruments**

The IASB issued IFRS 9 "Financial Instruments" ("IFRS 9") which proposes to replace IAS 39 "Financial Instruments: recognition and measurement". The replacement standard has the following significant components: establishes two primary measurement categories for financial assets — amortized cost and fair value; establishes criteria for classification of financial assets within the measurement category based on business model and cash flow characteristics; and eliminates existing held to maturity, available-for-sale, and loans and receivable categories.

In November 2013, the IASB issued an amendment to IFRS 9 which includes a new hedge model that aligns accounting more closely with risk management, as well as enhancements to the disclosures about hedge accounting and risk management. Additionally as the impairment guidance in IFRS 9, as well as certain limited amendments to the classification and measurement requirements of IFRS 9 is not yet complete, the tentative required effective date to apply IFRS 9 is January 1, 2018. Entities may apply IFRS 9 before the IASB completes the amendments, but are not required to. The Company will evaluate the impact of the change to its financial statements based on the characteristics of its financial instruments at the time of adoption.

**3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS**

The preparation of the Company's financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. These financial statements include estimates, which, by their nature, are uncertain and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and future periods if the revision affects both current and future periods. These estimates are based on historical experience, current and future economic conditions, and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

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i) Significant Judgments in Applying Accounting Policies

The areas which require management to make significant judgments in applying the Company's accounting policies in determining carrying values include, but are not limited to:

a) *Impairment analysis – Mineral Properties*

The Company reviews its mineral properties for impairment based on results to date and when events and changes in circumstances indicate that the carrying value of the assets may not be recoverable. IFRS 6 - *Exploration for and evaluation of mineral resources* and IAS 36 – *Impairment of assets* ("IAS 36") requires the Company to make certain judgments in respect of such events and changes in circumstances, and in assessing their impact on the valuations of the affected assets. The Company's assessment is that as at June 30, 2014, there are no indicators of impairment in the carrying value of its mineral properties.

ii) Significant Accounting Estimates and Assumptions

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

a) *Impairment analysis – Mineral Properties*

The Company reviews its mineral properties for impairment based on results to date and when events and changes in circumstances indicate that the carrying value of the assets may not be recoverable. If indicators of impairment are identified, management will perform an impairment test in accordance with IAS 36. IAS 36 requires the Company to make certain judgments, assumptions, and estimates in determining the estimate of the net recoverable amount. Impairments are recognized when the carrying values exceed management's estimate of the net recoverable amounts associated with the affected assets. The values shown on the balance sheet for Mineral Properties represents the Company's assumption that the amounts are recoverable. As a result of the numerous variables associated with the Company's judgments and assumptions, the precision and accuracy of estimates of the recoverable amount is subject to significant uncertainties, and may change significantly as additional information becomes known.

b) *Stock options*

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

c) *Deferred taxes*

Deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and on unused losses carried forward, and are measured using the substantively enacted tax rates that are expected to be in effect when the differences are expected to reverse or losses are expected to be utilized. Deferred tax assets are recorded to recognize tax benefits only to the extent that, based on available evidence, including forecasts, it is probable that they will be realized. The Company has not recorded the benefit of any tax losses or deductible temporary differences.

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**4. FAIR VALUE MEASUREMENT**

For financial instruments recorded at fair value, the Company categorizes each of its fair value measurements in accordance with a fair value hierarchy. The fair value hierarchy establishes three levels to classify the inputs to valuation techniques used to measure fair value. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability (for example, interest rate and yield curves observable at commonly quoted intervals, forward pricing curves used to value currency and commodity contracts and volatility measurements used to value option contracts), or inputs that are derived principally from or corroborated by observable market data or other means. Level 3 inputs are unobservable (supported by little or no market activity).

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs.

The Company's financial assets as at June 30, 2014 and December 31, 2013 measured at fair value are summarized in the following table:

	June 30, 2014		
	Level 1	Level 2	Level 3
Cash	\$ 255,363	\$ -	\$ -
Short-term investments	-	6,682,044	-
	December 31, 2013		
	Level 1	Level 2	Level 3
Cash	\$ 2,663,300	\$ -	\$ -
Short-term investments	-	12,354,665	-

The short-term investments at June 30, 2014 and December 31, 2013 are cashable guaranteed investment certificates ("GICs") held with a major Canadian financial institution. GICs are measured using a discounted cash flow model, the future value of the GIC is discounted to the reporting period using the market interest rate.

The short-term investments at June 30, 2014 and December 31, 2013 were purchased with original maturities of less than one year. There is no restriction on the use of the short-term investments.

The fair values of the amounts receivable, and accounts payable and accrued liabilities approximate their carrying values due to the relatively short-term maturity of these financial instruments.

The carrying amounts by classification are:

	June 30, 2014	December 31, 2013
<b>Financial assets</b>		
<b>Fair Value Through Profit or Loss</b>		
Cash	\$ 255,363	\$ 2,663,300
Short-term investments	6,682,044	12,354,665
<b>Loans and receivables</b>		
Amounts receivable	243,081	97,778
<b>Financial liabilities</b>		
Financial liabilities measured at amortized cost		
Accounts payable and accrued liabilities	673,540	125,606

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**(Unaudited)**

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The Company's interest income on its bank balances carried at fair value is presented on the Statements of Comprehensive Loss in the interest income line.

*Financial Instruments Risks*

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

*Credit risk*

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

At June 30, 2014, the Company does not have any allowance for doubtful accounts, and does not consider that any such allowance is necessary.

All of the Company's cash and short-term investments are held with a major Canadian financial institution and thus the exposure to credit risk is considered insignificant. The short-term investments are in the form of GICs and are cashable in whole or in part, with interest, at any time to maturity. Management actively monitors the Company's exposure to credit risk under its financial instruments, including with respect to amounts receivable. The Company considers the risk of loss for its amounts receivable to be remote and significantly mitigated due to the financial strength of the party from whom the receivables are due - the Canadian government for harmonized sales tax ("HST") refunds receivable in the amount of \$243,081 (December 31, 2013 - \$97,778).

The Company's current policy is to invest excess cash in GICs. It periodically monitors the investments it makes and is satisfied with the credit ratings of its bank.

*Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its obligations associated with financial liabilities. The Company has a planning and budgeting process in place by which it anticipates and determines the funds required to support its operating requirements. The Company coordinates this planning and budgeting process with its financing activities through its capital management process. The Company's financial liabilities comprise its accounts payable and accrued liabilities, all of which are due within the next 12 month period. There are no operating lease commitments. The Company had a working capital of \$6,420,366 at June 30, 2014, including \$6,937,407 of cash and short-term investments; the Company has sufficient capital to finance its operations including exploration for the next twelve months.

*Interest rate sensitivity*

The Company has no significant exposure at June 30, 2014 to interest rate risk through its financial instruments. The short-term investments are at fixed rates of interest that do not fluctuate during the remaining term. The Company has no interest-bearing debt.

**5. RECLAMATION DEPOSIT**

At June 30, 2014, the Company provided a reclamation deposit of \$325,000 (December 31, 2013 - \$30,000) to the Mackenzie Valley Land and Water Board for its mining project to secure reclamation costs if the project is abandoned or closed (Note 8).



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**6. MINERAL PROPERTIES**

On March 12, 2012, Kennedy Diamonds and Mountain Province entered into an arrangement agreement (the "Arrangement") pursuant to which Mountain Province would transfer its interest in the Kennedy North Project, including permits, mining claims, rights and title, in the Northwest Territories in Canada, to Kennedy Diamonds in exchange for one common share of Kennedy Diamonds for every five common shares of Mountain Province outstanding, which would then be distributed to Mountain Province common shareholders.

The transactions contemplated by the Arrangement were completed on July 6, 2012. Kennedy Diamonds began trading on the TSX Venture Exchange on July 10, 2012 under the ticker symbol "KDI".

Upon completion of the Arrangement on July 6, 2012, the Company issued 16,143,111 Kennedy Diamonds shares to Mountain Province which were distributed, along with the one share held by Mountain Province, to the Mountain Province shareholders, and the Company recorded receipt of the rights to the Kennedy North Project and capitalized \$35,238 as acquired mineral properties. The Company also received \$3,000,000 of cash, as contemplated by the Arrangement.

At December 31, 2013, the Company acquired additional mining leases and capitalized \$149,999 as acquired mineral rights and claims. In addition, the Company staked grounds around the Kennedy North Project and capitalized \$51,590 to mineral properties.

The continuity of the Mineral Properties is as follows:

Balance, January 1, 2013	\$	<b>35,238</b>
Acquired mineral rights and claims		201,589
Change in expected decommissioning and restoration liability		112,227
Balance, December 31, 2013	\$	349,054
Acquired mineral rights and claims		-
Change in expected decommissioning and restoration liability		-
<b>Balance, June 30, 2014</b>	<b>\$</b>	<b>349,054</b>

**7. DEFERRED PREMIUM ON FLOW-THROUGH SHARES**

The premium paid for flow-through shares in excess of the fair value of common shares is initially recognized as a liability. The liability is reduced on a pro-rata basis and recorded in other income based on the corresponding eligible expenditures that have been incurred. The value of flow-through shares issued exceeded the fair value of the Company's common shares and therefore the deferred premium liability of \$1,176,874 on the flow-through shares was recognized. \$1,049,254 (June 30, 2013 -\$59,038) has been recognized in other income based on the corresponding eligible expenditures that have been incurred in the period.

**8. DECOMMISSIONING AND RESTORATION LIABILITY**

The decommissioning and restoration liability was calculated using the following assumptions as at June 30, 2014 and December 31, 2013:

	<b>June 30,</b>	December 31,
	<b>2014</b>	2013
Expected undiscounted cash flows	\$ 115,000	\$ 115,000
Discount rate	1.13%	1.13%
Periods	between 2014 and 2015	between 2014 and 2015

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The continuity of the decommissioning and restoration liability at June 30, 2014 and December 31, 2013 is follows:

		<b>June 30, 2014</b>		December 31, 2013
Balance, beginning of period	\$	<b>112,444</b>	\$	-
Change in estimate of discounted cash flows for the period		-		112,227
Accretion recorded in the period		<b>630</b>		217
Balance, end of the period	\$	<b>113,074</b>	\$	112,444

**9. SHAREHOLDERS' EQUITY**

*i. Authorized share capital*

Unlimited common shares, without par value. Each common share entitles the holder to one shareholder vote.

There is no other class of shares in the Company.

*ii. Share capital*

The number of shares issued and fully paid as at June 30, 2014 is 22,857,675. There are no shares issued but not fully paid.

On December 27, 2013, the Company issued 398,345 flow-through common shares at a price of \$5.75 per share, for aggregate gross proceeds of \$2,290,484. A finder's fee equal to 5 percent of the proceeds was paid to the underwriters. An amount of \$298,759 was recognized as the premium paid for flow-through shares in excess of the fair value of the common shares was recognized as a liability.

On October 25, 2013, the Company issued 910,000 flow-through common shares at a price of \$5.50 per share, for gross proceeds of \$5 million. The underwriters received a cash commission of 5 percent of the gross proceeds. An amount of \$682,500 was recognized as the premium paid for flow-through shares in excess of the fair value of the common shares was recognized as a liability.

On October 22, 2013, the Company issued 247,100 flow-through common shares at a price of \$5.50 per share and 1,608,621 non-flow-through common shares at a price of \$4.75 per share, for gross proceeds of \$9 million. An amount of \$185,325 was recognized as the premium paid for flow-through shares in excess of the fair value of the common shares was recognized as a liability.

On August 2013, the Company issued 34,300 flow-through common shares at a price of \$1.80 per share and 958,840 non-flow-through common shares at a price of \$1.50 per share, for gross proceeds of \$1.5 million. An amount of \$10,290 was recognized as the premium paid for flow-through shares in excess of the fair value of the common shares was initially recognized as a liability.

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iii. *Loss or earnings per share*

The following table sets forth the computation of basic and diluted loss or earnings per share:

	Three months ended June 30, 2014	Three months ended June 30, 2013	Six months ended June 30, 2014	Six months ended June 30, 2013
<b>Numerator</b>				
Net loss for the period	\$ (4,097,865)	\$ (2,358,262)	\$ (8,320,876)	\$ (3,017,630)
<b>Denominator</b>				
For basic - weighted average number of shares outstanding	22,857,675	18,700,469	22,857,675	18,700,469
Effect of dilutive securities	-	-	-	-
For diluted - adjusted weighted average number of shares outstanding	22,857,675	18,700,469	22,857,675	18,700,469
<b>Loss Per Share</b>				
Basic	\$ (0.18)	\$ (0.13)	\$ (0.36)	\$ (0.16)
Diluted	(0.18)	(0.13)	(0.36)	(0.16)

The calculation for the weighted average number of shares outstanding is based on the number of shares outstanding on a daily basis in the three and six months ended June 30, 2014 and June 30, 2013. Shares issuable on exercise of stock options totaling 1,050,000 on June 30, 2014 (650,000 - June 30, 2013) were not included in the computation of diluted loss per share because the effect would have been anti-dilutive.

iv. *Stock Options and Share-based Payments Reserve*

The Company, through its Board of Directors and shareholders, adopted a stock option plan (the "Plan") which, among other things, allows for the maximum number of shares that may be reserved for issuance under the Plan to be 10% of the Company's issued and outstanding shares at the time of the grant. The Board of Directors has the authority and discretion to grant stock option awards within the limits identified in the Plan, which includes provisions limiting the issuance of options to insiders and significant shareholders to maximums identified in the Plan.

The following table summarizes information about the stock options outstanding and exercisable at June 30, 2014 and December 31, 2013:

June 30, 2014		
	Number of options	Weighted average exercise price
Balance at beginning of period	750,000	1.27
Granted during the period	350,000	4.28
<b>Balance at end of the period</b>	<b>1,100,000</b>	<b>\$ 2.23</b>
<b>Options exercisable at the end of the period</b>	<b>1,050,000</b>	
December 31, 2013		
	Number of options	Weighted average exercise price
Balance at beginning of period	600,000	\$ 1.27
Granted during the period	150,000	1.30
Balance at end of the period	750,000	\$ 1.28
Options exercisable at the end of the period	650,000	

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The fair value of the 350,000 (150,000 - December 31, 2013) stock options granted in the six month period ended June 30, 2014 has been estimated on the date of grant using the Black-Scholes option pricing model, using the assumptions below, and total \$1,168,800 (\$151,250 – December 31, 2013). The options granted in the six month period ended June 30, 2014 vested immediately. The stock options granted in the year ended December 31, 2013 vested one third immediately, one third on the first anniversary of the grant date, and the balance vests on the second anniversary of the grant date. Expected volatility was calculated by reference to the weekly closing share price of similar companies in a similar stage of exploration for a period that reflects the expected life of the options (10 years).

	Period ended June 30, 2014	Year ended December 31, 2013
Exercise price	\$4.10 - 4.74	\$1.23 - 1.34
Expected volatility	73.00%	72.76%
Expected option life	10 years	10 years
Expected forfeiture	none	none
Expected dividend yield	0%	0%
Risk-free interest rate	2.45% - 2.52%	1.89% - 1.99%

The following tables reflect the Black-Scholes values, the number of stock options outstanding, the weighted average of options outstanding, and the exercise price of stock options outstanding at June 30, 2014 and December 31, 2013.

**At June 30, 2014**

Expiry Date	Black-Scholes Value	Number of Options	Exercise Price
November 6, 2022	\$ 587,400	600,000	1.27
January 31, 2023	103,700	100,000	1.34
March 17, 2023	47,550	50,000	1.23
February 13, 2024	799,000	250,000	4.10
March 9, 2024	\$ 369,800	100,000	4.74
	\$ 1,907,450	1,100,000	2.23

**At December 31, 2013**

Expiry Date	Black-Scholes Value	Number of Options	Exercise Price
November 6, 2022	\$ 587,400	600,000	1.27
January 31, 2023	103,700	100,000	1.34
March 17, 2023	47,550	50,000	1.23
	\$ 738,650	750,000	1.28

The weighted average remaining contractual life of the options outstanding at June 30, 2014 is 8.81 years (December 31, 2013 – 8.90 years).

**10. RELATED PARTIES**

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

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The Company's related parties include its key management, the Company's directors, and their close family members. Mountain Province and the Gahcho Kué Joint Venture, in which Mountain Province holds an interest, are also related parties since the Company and Mountain Province have common members of key management and certain directors. The Company is charged a monthly management fee by Mountain Province which includes an allocation for the services of key management.

None of the transactions with related parties incorporate special terms and conditions, and no guarantees were given or received. Related party transactions are recorded at their exchange amount, being the amount agreed to by the parties. Outstanding balances are generally settled in cash.

The Company had the following transactions and balances with its related parties including key management personnel, Mountain Province and the Gahcho Kué Joint Venture which includes the monthly management fee charged by Mountain Province, and reimbursement of expenses incurred on the Company's behalf by Mountain Province and the Gahcho Kué Joint Venture. The transactions with key management personnel are in the nature of remuneration.

	<b>Six months ended</b>		<b>Year ended</b>
	<b>June 30,</b>		<b>December 31,</b>
	<b>2014</b>		<b>2013</b>
<hr/>			
The total of the transactions:			
Management fee and reimburseable expenses charged by Mountain Province	\$ 45,000	\$	152,500
Remuneration of key management personnel	<b>1,293,741</b>		233,684

The remuneration expense of directors and other members of key management personnel for the six month period ended June 30, 2014 and the year ended December 31, 2013 were as follows:

	<b>Six months ended</b>		<b>Year ended</b>
	<b>June 30,</b>		<b>December 31,</b>
	<b>2014</b>		<b>2013</b>
<hr/>			
Consulting fees	\$ 106,066	\$	117,205
Share-based payments	<b>1,187,675</b>		116,479
	<b>\$ 1,293,741</b>	\$	<b>233,684</b>

**11. EXPLORATION AND EVALUATION EXPENSES**

	<b>Three months ended</b>		<b>Three months ended</b>		<b>Six months ended</b>		<b>Six months ended</b>
	<b>June 30, 2014</b>		<b>June 30, 2013</b>		<b>June 30, 2014</b>		<b>June 30, 2013</b>
Lease payments	\$ 9,069	\$	10,762	\$	14,781	\$	13,907
Geological consultants	<b>2,768,379</b>		1,287,874		<b>5,387,205</b>		1,620,173
Drilling	<b>1,779,449</b>		760,983		<b>2,507,397</b>		1,004,405
Laboratory analysis	-		123,338		-		123,338
	<b>\$ 4,556,897</b>	\$	<b>2,182,957</b>	\$	<b>7,909,383</b>	\$	<b>2,761,823</b>

**12. CAPITAL MANAGEMENT**

The capital of Kennady Diamonds consists of its Shareholders' Equity. The Company's objectives when managing capital are to safeguard Kennady Diamonds' ability to continue as a going concern in order to pursue the exploration and evaluation of its mineral properties and to maintain optimal returns to shareholders and benefits for other stakeholders. The Company

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manages its capital structure and makes adjustments to it, in order to have the funds available to support the exploration of its mineral properties. The Company's main property, Kennady North, is in the exploration stage, and as such the Company is dependent on external equity financing to fund its activities. 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 capital consists of:

	<b>June 30,</b>	December 31,
	<b>2014</b>	2013
Share capital	\$ 22,015,246	\$ 22,015,246
Share-based payments reserve	1,891,554	703,879
Deficit	<b>(16,925,454)</b>	<b>(8,604,578)</b>
	<b>\$ 6,981,346</b>	<b>\$ 14,114,547</b>

In order to carry out the planned management of the Company's properties and to pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed.

Management reviews its capital management approach on an on-going basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the six month period ended June 30, 2014.

### **13. SEGMENTED REPORTING**

The Company has determined that it has only one operating segment.