

DEFIANCE SILVER CORP.

(an exploration stage company)

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED

SEPTEMBER 30, 2014

(expressed in Canadian dollars)

DEFIANCE SILVER CORP.

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

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

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

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

DEFIANCE SILVER CORP.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
As at September 30, 2014
(Canadian dollars)

	September 30, 2014	June 30, 2014
ASSETS		
Current assets		
Cash (Note 3)	\$ 420,549	\$ 685,317
Receivables (Note 4)	2,933	9,484
Advances and prepaid expenses	298	296
	<u>423,780</u>	<u>695,097</u>
Value added tax (Note 4)	136,438	117,423
Mineral property interests (Note 5)	<u>759,799</u>	<u>683,674</u>
	<u>\$ 1,320,017</u>	<u>\$ 1,496,194</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (Note 6)	\$ 246,040	\$ 266,891
Deferred income taxes	<u>36,000</u>	<u>36,000</u>
	<u>282,040</u>	<u>302,891</u>
Shareholders' equity		
Share capital (Note 7)	5,727,874	5,727,874
Share-based reserves	404,692	404,692
Deficit	<u>(5,094,589)</u>	<u>(4,939,263)</u>
	<u>1,037,977</u>	<u>1,193,303</u>
	<u>\$ 1,320,017</u>	<u>\$ 1,496,194</u>

Nature and continuance of operations (Note 1)
Subsequent event (Note 12)

On behalf of the Board:

"Darrell A. Rader"

Darrell A. Rader

"Ron Sowerby"

Ron Sowerby

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

DEFIANCE SILVER CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS & COMPREHENSIVE LOSS
For the three months ended September 30,
(Canadian dollars)

	2014	2013
Expenses		
Investor relations and promotion	\$ 2,040	\$ 25,351
Legal and audit	15,241	2,745
Management fees (<i>Note 8</i>)	77,844	76,613
Office and administration	43,553	23,957
Travel	14,348	6,429
Transfer agent and filing fees	783	1,760
	<u>(153,809)</u>	<u>(136,855)</u>
Interest income	1,384	217
Gain (loss) on foreign exchange	<u>(2,901)</u>	<u>(4,739)</u>
NET LOSS AND COMPREHENSIVE LOSS FOR THE PERIOD	\$ (155,326)	\$ (141,377)
Loss per common share - basic and diluted	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>
Weighted average number of common shares outstanding- basic and diluted	50,089,670	23,435,250

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

DEFIANCE SILVER CORP.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Canadian dollars)

	Number of Shares	Share Capital	Share Subscription Received	Share- based Reserves	Deficit	Total
Balance, June 30, 2013	21,797,750	\$4,108,131	\$ 13,000	\$ 404,692	\$(2,711,915)	\$1,813,908
Private placement	2,150,000	215,000	(13,000)	-	-	202,000
Share issue costs	-	(1,815)	-	-	-	(1,815)
Shares issued for property	150,000	15,000	-	-	-	15,000
Net loss for the period	-	-	-	-	(141,377)	(141,377)
Balance, September 30, 2013	24,097,750	4,336,316	-	404,692	(2,853,292)	1,887,716
Private placement	24,000,000	1,200,000	-	-	-	1,200,000
Share issue costs	-	(7,634)	-	-	-	(7,634)
Shares issued for settlement of debt	1,991,920	199,192	-	-	-	199,192
Net loss for the period	-	-	-	-	(2,085,971)	(2,085,971)
Balance, June 30, 2014	50,089,670	5,727,874	-	404,692	(4,939,263)	1,193,303
Net loss for the period	-	-	-	-	(155,326)	(155,326)
Balance, September 30, 2014	50,089,670	\$5,727,874	\$ -	\$ 404,692	\$(5,094,589)	\$1,037,977

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

DEFIANCE SILVER CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three months ended September 30,
(Canadian dollars)

	2014	2013
Operating Activities		
Net loss for the year	\$ (155,326)	\$ (141,377)
Adjustments for:		
Value added tax	(19,015)	-
Net changes in non-cash working capital items:		
Receivables	6,551	29,793
Advances and prepaid expenses	(2)	(46,989)
Accounts payable and accrued liabilities	(20,851)	14
Cash used in operating activities	<u>(188,643)</u>	<u>(158,559)</u>
Investing Activities		
Expenditures on mineral property interests	<u>(76,125)</u>	<u>(70,507)</u>
Cash used in investing activities	<u>(76,125)</u>	<u>(70,507)</u>
Financing Activities		
Share capital issued for cash (net of share issue costs)	<u>-</u>	<u>200,185</u>
Cash provided by financing activities	<u>-</u>	<u>200,185</u>
Increase (decrease) in cash	(264,768)	(28,881)
Cash – beginning of period	685,317	81,712
Cash – end of period	\$ 420,549	\$ 52,831

Supplemental disclosure with respect to cash flows (Note 10)

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

DEFIANCE SILVER CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Canadian Dollars)
September 30, 2014

1. NATURE AND CONTINUANCE OF OPERATIONS

Defiance Silver Corp (“the Company”) was incorporated on July 19, 2007 under the Business Corporations Act of the Province of British Columbia. The Company’s principal business is the acquisition, exploration and development of mineral properties. The Company’s registered and records office is at 595 Burrard St. Ste 2900, Vancouver, BC, V6C 2T6. The Company’s head office is at Suite 1610, 409 Granville Street, Vancouver, BC, V7X 1J5.

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

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

These consolidated financial statements were authorized by the Board of Directors of the Company on November 27, 2014.

2. BASIS OF PREPARATION

This condensed interim consolidated financial information for the three months ended September 30, 2014, has been prepared in accordance with IAS 34, ‘Interim Financial Reporting’. The condensed interim consolidated financial information should be read in conjunction with the annual financial statements for the year ended June 30, 2014, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

These unaudited condensed interim consolidated financial statements have been prepared using accounting policies consistent with those used in the Company’s annual financial statements for the year ended June 30, 2014.

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

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

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

Critical accounting judgments

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

- the accounting policies for mineral property interests;
- classification of financial instruments; and
- determination of functional currency.

DEFIANCE SILVER CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Canadian Dollars)
September 30, 2014

2. BASIS OF PREPARATION (cont'd...)

Basis of consolidation

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

Subsidiaries

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

The principal subsidiaries of the Company as of September 30, 2014 are as follows:

Name of subsidiary	Principal activity	Place of Incorporation	Ownership Interest Sept. 30, 2014	Ownership Interest June 30, 2014
Minera Santa Remy S.A. de CV	Mineral property exploration	Mexico	100%	100%
DefCap (BVI) Inc.	Holding company	British Virgin Islands	100%	100%

3. CASH

Cash consists of the following:

	September 30,	
	2014	June 30, 2014
Cash on deposit	\$ 43,467	\$ 33,428
Liquid short-term deposit	377,082	651,889
	<u>\$ 420,549</u>	<u>\$ 685,317</u>

4. RECEIVABLES

The Company's receivables arise mainly from refundable sales tax receivable from government taxation authorities in Canada and Mexico. These are broken down as follows:

	September 30,	
	2014	June 30, 2014
Goods and services tax ("GST")	\$ 2,933	\$ 9,484
Value added tax ("VAT")	-	-
	<u>\$ 2,933</u>	<u>\$ 9,484</u>

The Company has reclassified the Value added tax receivable from current to long term as the timing of the receipt cannot be determined.

DEFIANCE SILVER CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Canadian Dollars)
September 30, 2014

5. MINERAL PROPERTY INTERESTS

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

	Santa Gabriela Project	San Acacio Project	Minerva Property	Total
Acquisition costs				
Balance, June 30, 2013	\$ 1,455,880	\$ 267,729	\$ 9,574	\$ 1,733,183
Additions during the year	15,000	162,158	-	177,158
Balance, June 30, 2014	1,470,880	429,887	9,574	1,910,341
Additions during the year	-	57,629	-	57,629
Balance, September 30, 2014	1,470,880	487,516	9,574	1,967,970
Exploration costs				
Balance, June 30, 2013	102,086	124,152	13,674	239,912
Additions during the year:				
Claim fees	-	18,477	-	18,477
Consulting fees	26,558	24,904	-	51,462
Camp fees	4,560	11,019	-	15,579
Extraction fees	7,203	11,746	-	18,949
Geology & mapping fees	8,795	40,241	-	49,036
Balance, June 30, 2014	149,202	230,539	13,674	393,415
Additions during the year:				
Consulting fees	-	4,467	-	4,467
Camp fees	-	5,107	-	5,107
Extraction fees	-	4,545	-	4,545
Geology & mapping fees	-	4,377	-	4,377
	149,202	249,035	13,674	411,911
Impairment of properties	(1,620,082)	-	-	(1,620,082)
Balance, September 30, 2014	\$ -	\$ 736,551	\$ 23,248	\$ 759,799
Balance, June 30, 2014	\$ -	\$ 660,426	\$ 23,248	\$ 683,674

DEFIANCE SILVER CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Canadian Dollars)
September 30, 2014

5. MINERAL PROPERTY INTERESTS (cont'd...)

San Acacio Project

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

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

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

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

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

On July 25, 2012, the Company and the Vendors entered into an amending purchase agreement to extend the Final Payment. The terms of the amended purchase agreement are as follows:

- Payment of US\$150,000 for a 24 month extension from the date of signing the trust agreement (“First Extension Period); this payment was further extended subsequent to June 30, 2013;
- Payment of US\$225,000 for a 36 month extension from the date of signing the trust agreement (“Second Extension Period); and
- Final Payment for the Assets at the end of the selected extension period.

On September 27, 2012, the Company and the Vendors entered into the trust agreement with the initial 12 month option period set to expire on September 27, 2013. The payment terms were renegotiated subsequent to June 30, 2013.

During the year ended June 30, 2014, the Company renegotiated payment terms for the US\$150,000 payment due on September 27, 2013 under the San Acacio option agreement. The revised payment terms call for four quarterly payments of US\$37,500. On September 27, 2013, the Company made the initial quarterly payment of US\$37,500 due under the option to purchase agreement for the San Acacio mine.

On December 19, 2013 the Company renegotiated payment terms for the payment of US\$37,500 due on or before December 27, 2013. Under the new terms, the payment of US\$37,500 was due and was paid on January 30, 2014.

On September 26, 2014, the Company renegotiated its San Acacio silver project purchase agreement, extending its option by three years.

The new terms of the agreement are as follows (all amounts in U.S. dollars):

- The US\$225,000 property payment due on September 27, 2014, is payable in four equal installments of \$56,250 every three months commencing on September 27, 2014.
- A three-year extension of the option period to September 27, 2018, in exchange for yearly payments, a portion of which will be credited toward the final payment of US\$5,500,000

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

DEFIANCE SILVER CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Canadian Dollars)
September 30, 2014

5. MINERAL PROPERTY INTERESTS (cont'd...)

If the Company chooses to accelerate its payments, the balance payable will range between US\$2,500,000 and US\$4,300,000. At the discretion of the Company, any of the yearly payments due in 2015, 2016 and 2017 can be replaced by a payment of US\$1,000,000, all of which will be credited toward the final payment.

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

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

Minerva property

During the year ended June 30, 2012, the Company applied for a mining claim located in Coahuila State, Mexico, known as the Minerva property.

As of September 30, 2014 the application was still pending approval by the Mexican mining authorities.

Santa Gabriela Project

The Company entered into an option agreement ("Option Agreement") on September 9, 2011 (the "Execution Date") with IMPACT Silver Corp. ("IMPACT") for the acquisition of the Santa Gabriela mill in Zacatecas, Mexico. The Company and IMPACT are related by way of one common director. The Santa Gabriela mill consists of the Santa Gabriela (formerly Veta Grande) processing plant, and associated surface rights as well as a 100% interest in 10 mining claims.

Terms of the Option Agreement for the Company to exercise the option to purchase the assets from IMPACT include:

- Issuance of 2,680,500 shares of the Company to IMPACT (issued with a value of \$1,420,665);
- Payment of \$1,955,200 (not paid) on the earlier of (a) 24 months from the Execution Date; or (b) on the plant reaching commercial production. Commercial production is defined as the first day after the Mill has achieved a production rate averaging 160 tonnes per day over a 30 day period.

The Company signed a two-year extension ("Amended Agreement") to its option agreement with IMPACT on July 9, 2013. Under the terms of the Amended Agreement, the Company has an option of making two interim payments to extend the final closing date for making the purchase payment for up to two years to September 9th, 2015. The Company has the option to pay \$10,000 in cash or issue 150,000 common shares on or before September 9, 2013 to extend the term to September 9, 2014, and pay \$25,000 in cash or issue 350,000 common shares on or before September 9th, 2014 to extend the term to September 9, 2015.

During the year ended June 30, 2014, the Company issued 150,000 common shares to extend the term to September 9, 2014.

The Company cancelled its option effective January 22, 2014 and wrote off all costs associated with the Santa Gabriela Project.

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Payables and accrued liabilities for the Company are broken down as follows:

	September 30,	
	2014	June 30, 2014
Accrued liabilities	\$237,626	\$214,619
Trade payables	8,414	25,832
	\$246,040	\$377,451

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

DEFIANCE SILVER CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Canadian Dollars)
September 30, 2014

7. SHARE CAPITAL

Authorized

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

Private Placements

During the year ended June 30, 2014, the Company closed a private placement with the issuance of 2,150,000 units at a price of \$0.10 per Unit for gross proceeds of \$215,000 (\$13,000 received prior to June 30, 2013). Each Unit consists of one common share of the Company and one-half of one transferable share purchase warrant ("Warrant"). Each whole Warrant will entitle the holder to purchase one common share of the Company for a period of 24 months at a price of \$0.15 per share during the first year and at a price of \$0.20, thereafter. The Company incurred \$1,815 in share issue costs in connection with the private placement.

During the year ended June 30, 2014, the Company closed a private placement with the issuance of 24,000,000 units at a price of \$0.05 per Unit for gross proceeds of \$1,200,000. Each Unit consists of one common share of the Company and one Warrant. Each Warrant will entitle the holder to purchase one common share of the Company for a period of 24 months at a price of \$0.05 per share, provided however, the Company may accelerate the exercise period of the warrants under certain conditions. The Company incurred \$7,634 in share issue costs in connection with the private placement.

Escrow shares

At September 30, 2014, nil (June 30, 2014 - 3,841,500) common shares are held in escrow as the balance were released on September 27, 2014.

Stock options

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

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

	Number of Options	Weighted Average Exercise Price
Balance, June 30, 2013 and 2014	2,130,000	\$ 0.28
Expired	(405,000)	0.13
Balance, September 30 2014	1,725,000	\$ 0.32

DEFIANCE SILVER CORP.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Canadian Dollars)
September 30, 2014

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

Stock options (cont'd...)

The following incentive stock options were outstanding to directors, officers and employees at September 30, 2014:

Number of Options Exercisable and Outstanding	Exercise Price	Expiry Date
675,000	\$ 0.33	June 6, 2016
120,000	0.60	December 19, 2016
680,000	0.27	November 22, 2017
250,000	0.27	December 10, 2017
<u>1,725,000</u>		

Warrants

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

	Number of Warrants and Agent's Warrants	Weighted Average Exercise Price
Balance, June 30, 2013	5,933,250	0.38
Issued	25,075,000	0.05
Expired	(5,933,250)	0.38
Balance, June 30 and September 30, 2014	<u>25,075,000</u>	<u>\$ 0.05</u>

At September 30, 2014, the following warrants and Agent's warrants were outstanding:

Number of Warrants and Agent's Warrants	Exercise Price	Expiry Date
1,075,000	0.20	July 22, 2015
2,000,000	0.05	February 5, 2016
2,000,000	0.05	February 14, 2016
<u>20,000,000</u>	0.05	March 27, 2016
<u>25,075,000</u>		

DEFIANCE SILVER CORP.
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(Canadian Dollars)
September 30, 2014

8. RELATED PARTY TRANSACTIONS

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

As at September 30, 2014, accounts payable and accrued liabilities included \$17,100 (June 30, 2014 - \$17,727) payable to directors, officers and companies controlled or related to directors and/or officers. Amounts payable to related parties have no specific terms of repayment, are unsecured and do not bear interest.

The Company entered into the following transactions with related parties:

- a) Paid or accrued \$22,500 (2013 - \$26,250) in management fees to a company controlled by a director of the Company.
- b) Paid or accrued \$21,444 (2013 - \$15,763) in management fees to an officer of the Company.
- c) Paid or accrued \$9,900 (2013 - \$8,100) in management fees to a company controlled by a director of the Company.
- d) Paid or accrued \$7,500 (2013 - \$7,500) in management fees to an officer of the Company.
- e) Paid or accrued \$6,000 (2013 - \$6,000) in rent expense, included in office and administration, to a company related to a director.

9. SUPPLEMENTAL DISCLOSURES WITH RESPECT TO CASH FLOWS

There were no significant non-cash transactions for the three months year ended September 30, 2014.

The Company issued 150,000 common shares with a value of \$15,000 for mineral property interests during the three months year ended September 30, 2013.

10. SEGMENTED INFORMATION

The Company operates in one reportable operating segment, being the acquisition, exploration, and development of mineral properties in Mexico. All of the mineral property costs at September 30 and June 30, 2014 were for mineral property interests in Mexico.

11. FINANCIAL AND CAPITAL RISK MANAGEMENT

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

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data.

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

Credit risk

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

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

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

DEFIANCE SILVER CORP.
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(Canadian Dollars)
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11. FINANCIAL AND CAPITAL RISK MANAGEMENT (cont'd...)

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at September 30, 2014, the Company had cash of \$420,549 (June 30, 2014 - 685,317) to settle current liabilities of \$246,040 (June 30, 2014 - \$266,891).

Market risk

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

a) Interest rate risk

The Company has cash balances and interest-bearing investments. The interest earned on the investments approximates fair value rates, and the Company is not at a significant risk to fluctuating interest rates. The Company's current policy is to invest excess cash in investment-grade short-term deposit certificates issued by its financial institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. As at September 30, 2014, the Company had a total of \$375,000 (June 30, 2014-\$650,000) in investment-grade short-term deposit certificates.

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

b) Foreign currency risk

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

c) Price risk

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

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

Capital management

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

The Company currently is not subject to externally imposed capital requirements. There were no changes in the Company's approach to capital management.

12. SUBSEQUENT EVENT

Subsequent to September 30, 2014, the Company granted 2,020,000 incentive stock options to directors, officers and consultants. The options are exercisable on or before November 5, 2019, at a price of \$0.10.