



LABRADOR IRON ORE
ROYALTY CORPORATION

2018

**ANNUAL
REPORT**

81 YEARS IN LABRADOR WEST

Corporate Profile

LABRADOR IRON ORE ROYALTY CORPORATION

Labrador Iron Ore Royalty Corporation (“LIORC”), a Canadian corporation, owns interests in Iron Ore Company of Canada (“IOC”) which operates a major iron mine near Labrador City, Newfoundland and Labrador on lands leased from LIORC. Directly and through its wholly-owned subsidiary, Hollinger-Hanna Limited (“Hollinger-Hanna”), LIORC owns a 15.10% equity interest in IOC and receives a 7% gross overriding royalty on all iron ore products produced from the leased lands, sold and shipped by IOC and a \$0.10 per tonne commission on sales of iron ore by IOC.

As at December 31, 2018, there were 64 million common shares issued and outstanding which are listed for trading on the Toronto Stock Exchange under the symbol LIF. Generally, LIORC pays cash dividends from its net income to the maximum extent possible, subject to the maintenance of appropriate levels of working capital. Currently, the holders of common shares receive quarterly dividends on the 25th day of the month following the end of each quarter. The common shares are qualified investments under the *Income Tax Act (Canada)* for deferred plans including registered retirement savings plans, registered retirement income funds and deferred profit sharing plans.

LIORC has a Board of eight Directors, an Audit Committee, a Compensation Committee and a Nominating Committee. The Compensation and Nominating Committees are composed of five independent Directors. The Audit Committee is composed of four independent Directors.

This information is prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and all amounts are shown in Canadian dollars unless otherwise indicated.

Shareholders’ Investment Highlights

| Years Ended December 31 | 2018 | 2017 |
|-------------------------------------|--|------------------------|
| | <i>(\$ in millions except per share information)</i> | |
| Revenue | 130.9 | 158.6 |
| Net Income | 128.5 | 157.3 |
| Cash Flow from Operations | 148.8 ⁽¹⁾ | 167.0 ⁽²⁾ |
| Net Income per Share | \$ 2.01 | \$ 2.46 |
| Cash Flow from Operations per Share | \$ 2.32 ⁽¹⁾ | \$ 2.61 ⁽²⁾ |
| Dividends Declared per Share | \$ 1.75 | \$ 2.65 |

(1) Includes IOC dividends totaling \$83.9 million or \$1.31 per Share.

(2) Includes IOC dividend totaling \$76.7 million or \$1.20 per Share.

Report To Shareholders

To the Holders of Common Shares of Labrador Iron Ore Royalty Corporation

The Directors of Labrador Iron Ore Royalty Corporation ("LIORC" or the "Corporation") present the Annual Report for the year ended December 31, 2018.

81 Years in Labrador West

Labrador Iron Ore Royalty Corporation has been involved in Labrador West for 81 years. Under a Statutory Agreement with Newfoundland made in 1938, a predecessor company, Labrador Mining and Exploration Limited, was granted extensive exploration and mining rights in Labrador West. LM&E found the iron ore bodies that now constitute the mine operated by Iron Ore Company of Canada. LM&E received grants of leases and licences under the Statutory Agreement. It also received a grant of surface rights to establish the town site that became Labrador City. LM&E sublet the leases to IOC and IOC, with major steel companies as original shareholders, built the infrastructure, mine, railway and port. Under the sublease, LIORC receives a 7% gross overriding royalty on iron ore products produced and sold by IOC.

Financial Performance

The Shareholders' cash flow from operations for the year ended December 31, 2018 was \$148.8 million or \$2.32 per share as compared to \$167.0 million or \$2.61 per share for 2017. The financial results for LIORC in 2018 were adversely affected by the nine-week labour strike from March 26 to May 29, 2018, which halted all iron ore production at IOC.

The Shareholders' consolidated net income for the year ended December 31, 2018 was \$128.5 million or \$2.01 per share compared to \$157.3 million or \$2.46 per share in 2017. Equity earnings from Iron Ore Company of Canada ("IOC") amounted to \$57.0 million compared to \$74.3 million in 2017. LIORC received dividends from IOC in 2018 totaling \$83.9 million or \$1.31 per share compared to \$76.7 million in 2017, or \$1.20 per share. Post the labour strike, IOC drew down its cash balance to pay the higher annual dividend. LIORC received an IOC dividend in the fourth quarter of 2018 in the amount of \$25.3 million or \$0.40 per share compared to \$19.3 million or \$0.30 per share in the fourth quarter of 2017. IOC's 2018 iron ore sales for calculating the royalty to LIORC totaled 15.10 million tonnes compared to 19.15 million tonnes in 2017. Royalty revenue decreased to \$128.8 million as compared to \$156.4 million in 2017 due to the labour strike in the second quarter of 2018.

The cash flow from operations, equity earnings and net income for the year were lower than last year mainly due to the reduced sales tonnages for concentrate and pellets caused by the labour strike. As in 2017, prices and premiums were higher than most forecasts, with the Chinese governments continuing to enforce measures to reduce pollution; these measures favoured higher quality products such as the concentrate for sale ("CFS") and pellets produced by IOC.

While the Platts index for 62% Fe, CFR China averaged US\$69 per tonne in 2018 compared to US\$71 per tonne in 2017, a 3% decline, the Platts index for 65% Fe, CFR China averaged US\$90 per tonne in 2018 compared to US\$87 per tonne in 2017, a 3% increase. Since the CFS sold by IOC is priced on the 65% Fe, CFR China benchmark, the stronger prices for the 65% Fe product somewhat offset the lower CFS sales tonnages in 2018. The monthly Atlantic Blast Furnace 65% Fe pellet premium index, as quoted by Platts, averaged US\$59 per tonne for 2018, and was 31% higher than in 2017. Blast Furnace pellet premiums were stable at approximately US\$58 per tonne for most of 2018 but increased to US\$62 per tonne in November and December 2018. The strong year-over-year increase in pellet premiums was supported by generally healthy margins for steel producers in 2018.

The average price realized by IOC for CFS and pellets, FOB Sept-Îles, net of selling costs and royalties was approximately C\$110 per tonne in 2018 compared to C\$108 per tonne in 2017. Increased freight rates and lower sales tonnages affected the average realized price FOB Sept-Îles in 2018. The premiums for 65% Fe concentrate and pellets continued to be supported by the environmental policies of the Chinese governments, which, as in 2017, caused Chinese steel producers to favour the usage of higher value-in-use iron ore, such as the concentrate and pellets produced by IOC. With strong pellet premiums in 2018, IOC again focused on maximizing pellet production to the extent possible, given the labour strike and the refurbishment of one pellet line in 2018, as compared to two lines in 2017. The sales tonnage of pellets in 2018, for calculating the royalty to LIORC, was 20% lower than in 2017. The CFS tonnage in 2018 was lower than in 2017 by 23%.

Iron Ore Company of Canada Operations

Production

Total concentrate production of 15.73 million tonnes in 2018 was 22% lower as compared to 2017 of 20.21 million tonnes, largely due to the labour strike in the second quarter of 2018. The Moss Pit (formerly known as Wabush 3) commenced production in the third quarter. Monthly concentrate production records were set in July and October of 2018. However, third quarter production was adversely affected by maintenance and the commissioning of a productivity improvement project on the spiral plant, which temporarily restricted throughput. Fourth quarter production at IOC was 4% higher than the corresponding period of 2017. The overall IOC saleable production (CFS plus pellets) was slightly below Rio Tinto's lower revised guidance, provided after the labour strike.

The unit operating costs for concentrate and pellets were higher than in 2017 due to the labour strike and the fixed costs incurred during the suspension of production. The total cash costs were lower in 2018 than in 2017 by 6%.

Haulage by the Quebec North Shore and Labrador Railway Company, Inc. ("QNS&L") for the iron ore concentrate from the Bloom Lake Mine, owned by Champion Iron Limited ("Champion"), began in March 2018, as scheduled by Champion. As reported by Champion, the dry metric tonnes of iron ore concentrate sold totaled 5.4 million tonnes in the nine months ending December 31, 2018.

Sales as Reported for the LIORC Royalty

Total iron ore tonnage sold by IOC (CFS plus pellets) of 15.10 million tonnes was 21% below the total sales tonnage in 2017. The pellet sales tonnage was 20% lower and CFS sales tonnage was 23% lower than in 2017. The reduced sales tonnages were the result of the reduced production tonnages, as explained above.

As noted above, pellet premiums were strong in 2018 and IOC maximized pellet production. Pellet sales were comparable in the second half of 2018 to the same period in 2017. Production and sales in both periods were affected by the refurbishment of a pellet line. IOC is focused on restoring the capacity of the pellet plant to 12.5 million tonnes per annum by improving maintenance and operating practices.

Capital Expenditures

Capital expenditures for IOC in 2018 were \$205 million in total as compared to \$265 million in 2017. The 2018 capital expenditures were essentially on budget and included the completion of the development of the Moss Pit in September, the refurbishment of the No. 4 Pellet Line, the track replacement program for 2018 for the QNS&L railway and dewatering for the Luce Pit.

Outlook

The collapse of the tailings dam and loss of human life at Vale's Corrego de Feijao mine in Brumadinho, Minas Gerais state, Brazil ("Brumadinho") on January 25, 2019 had a profound influence on the seaborne iron ore market. The full impacts are uncertain at present. The initial price response for the 62% Fe, CFR China benchmark index was a sharp increase to over US\$90 per tonne from US\$74 per tonne the day prior to the disaster. However, low profit margins for Chinese steelmakers at present could limit the duration of the price spike. The benchmark price for the 62% Fe, CFR China index declined in mid-February 2019 to US\$84 per tonne, as steelmakers looked to purchase less expensive, lower grade products and reduce port stocks in China.

Vale announced on January 29, 2019 plans to cut production of some 40 million tonnes per year, including the pellet feed needed for the production of 11 million tonnes per year of pellets. Additional Vale production cuts of 30 million tonnes per annum were announced in February 2019 as a result of a civil court order which Vale is appealing.

As reported by Platts on February 13, 2019, in response to the Vale supply cuts, the National Australia Bank raised its forecast for iron ore from US\$62 to US\$80 per tonne for 2019 and from US\$60 to US\$70 per tonne for 2020. The forecast decline over the two years is because of the expectation of softer growth in Chinese demand.

As at mid-February there was uncertainty in the Atlantic pellet market, as the Brumadinho disaster caused delays in the annual pellet negotiations between Vale and the European steelmakers. In late 2018 steelmakers were faced with falling margins which causes them to purchase less expensive, lower quality iron ore. In addition, just prior to the disaster, Vale had been negotiating to change the annual pricing of pellet contracts to be based on the 65% index as

opposed to the 62% index. The steelmakers judged that this would result in an increase in the cost of pellets and resisted the change. The Brumadinho disaster is expected to result in a decreased supply of pellets worldwide, and there are reports that Vale will fill Brazilian orders for pellets over other customers.

Prior to the Brumadinho disaster, the market was generally assuming the re-opening of the Samarco pellet plant in Brazil in 2020. This is now seen as highly unlikely. Some analysts are modelling a partial re-start of Samarco in 2021.

On February 2, 2019 Platts listed the February price index for the Atlantic Blast Furnace 65% Fe pellet premium at US\$67.50 per tonne, no change from the January 2019 price. Pellet producers were maximizing pellet production before the Brumadinho disaster, and therefore it is expected that pellet premiums will remain strong for the balance of 2019 at least, considering no likely Samarco production, the cuts to pellet production announced by Vale, and the limited ability of existing major producers to ramp up production. A potential brake on pellet price increases is the consideration that the margins for European steelmakers are relatively low at present.

Rio Tinto's guidance for 2019 is 11.3 million to 12.3 million tonnes for its 58.7% share of IOC's saleable production tonnage (CFS and pellets). This is 19.2 million to 20.9 million tonnes of saleable production on a 100% basis. With the strong pellet premiums, IOC is expected to continue to prioritize pellet production in 2019. The 2019 IOC objective is approximately 20 million tonnes of concentrate production with sales of up to 12.5 million tonnes of pellets and approximately 6 million tonnes of CFS.

The capital expenditures for 2019 at IOC are expected to be in the range of \$225 million to \$245 million, higher than the 2018 amount of \$205 million. The refurbishment of one induration machine in the pellet plant, a new rope shovel for the mine, productivity improvements in the concentrator and pellet plant, and additional locomotive capacity for the QNS&L railway are planned for 2019. IOC expects to earn revenue from hauling product from the Bloom Lake mine of Champion. The reported production capacity of the Bloom Lake is 7.5 million tonnes per annum of iron concentrate. Tacora Resources Inc. (Tacora) announced on November 27, 2018 that the financing for the re-start of the Scully Mine is complete. The concentrate produced by Tacora is to be hauled by the QNS&L.

The price of iron ore early in 2019 has exceeded forecasts. If the strong prices and premiums continue in 2019, the policies of the Chinese government on pollution are not materially relaxed, there are no major negative impacts from the China-US trade negotiations, IOC achieves the production guidance, and the Canadian dollar does not appreciate materially against the US dollar, the 2019 outlook for LIORC will be continued strong cash flows.

Responses to Shareholder Questions

On June 18, 2018 the Corporation announced in a press release that its Board of Directors had determined to call a special meeting of shareholders to seek approval of an amendment to LIORC's articles of incorporation to provide LIORC with the flexibility to invest in additional non-operating metal or mineral assets, including royalties and streams, and issue shares to finance such investments, for the specific purpose of allowing the Company to pursue a potentially compelling opportunity that it had been made aware of. That opportunity never materialized as anticipated and after extensive consultation with shareholders, in a press release dated February 6, 2019 it was stated that the directors wished to indicate that they have no intention of calling a special meeting on or before the upcoming Annual General Meeting, nor is a further special meeting currently contemplated. The directors also clarified that they have no intention of making an acquisition without shareholder approval.

The Corporation normally pays cash dividends from its net income to the maximum extent possible, subject to the maintenance of appropriate levels of working capital. It was noted in the February 6, 2019 press release that there have been times when the directors have determined that it is appropriate to draw down on its cash reserves and other times where it has been prudent to build cash reserves back up. The recent increase in the cash balance was based on the directors' view that it was prudent at that particular time to have some additional financial flexibility. On March 7, 2019 the directors determined that the cash balance be reduced to a more typical level with excess cash distributed to shareholders by means of a special dividend to be paid on April 25, 2019.

I would like to take this opportunity to thank our Shareholders for their interest and loyalty and my fellow Directors for their wisdom and support.

Respectfully submitted on behalf of the Directors of the Corporation,

William H. McNeil
President and Chief Executive Officer
March 7, 2019

Corporate Structure

LIORC is a Canadian corporation resulting from the conversion of the Labrador Iron Ore Royalty Income Fund (the “Fund”) under an Arrangement effective on July 1, 2010. LIORC is also the successor by amalgamation under the Arrangement of Labrador Mining Company Limited, formerly a wholly-owned subsidiary of the Fund.

LIORC, directly and through its wholly-owned subsidiary Hollinger-Hanna, holds a 15.10% equity interest in IOC and receives a 7% gross overriding royalty and a 10 cent per tonne commission on all iron ore products produced, sold and shipped by IOC. Generally, LIORC pays cash dividends from its net income to the maximum extent possible, subject to the maintenance of appropriate levels of working capital. The common shareholders receive quarterly dividends on the common shares on the 25th day of the month following the end of each quarter.

Eight Directors are responsible for the governance of the Corporation and also serve as directors of Hollinger-Hanna. The Directors, in addition to managing the affairs of the Corporation and Hollinger-Hanna, oversee the Corporation’s interests in IOC. The Compensation and Nominating Committees are composed of five independent Directors. The Audit Committee is composed of four independent Directors. Effective January 1, 2019, Suske Capital Inc., pursuant to an administration agreement, acts as the administrator of the Corporation and Hollinger-Hanna.

Taxation

The Corporation is a taxable corporation. Dividend income received from IOC and Hollinger-Hanna is received tax free while royalty income is subject to income tax and Newfoundland royalty tax. Expenses of the Corporation include administrative expenses. Hollinger-Hanna is a taxable corporation.

Income Taxes

Dividends to a shareholder that are paid within a particular year are to be included in the calculation of the shareholder’s taxable income for that year. All dividends paid in 2018 were “eligible dividends” under the Income Tax Act.

Review of Operations

Iron Ore Company of Canada

The income of the Corporation is entirely dependent on IOC as the only assets of the Corporation and its subsidiary are related to IOC and its operations. IOC is one of Canada’s largest iron ore producers, operating a mine, concentrator and pellet plant at Labrador City, Newfoundland and Labrador, and is among the top five producers of seaborne iron ore pellets in the world. It has been producing and processing iron ore concentrate and pellets since 1954. IOC is strategically situated to serve markets throughout the world from its year-round port facilities at Sept-Îles, Quebec.

IOC has ore reserves sufficient for approximately 24 years at current production rates with additional resources of a greater magnitude. It currently has the nominal capacity to extract around 55 million tonnes of crude ore annually. The crude ore is processed into iron ore concentrate and then either sold or converted into many different qualities of iron ore pellets to meet its customers’ needs. The iron ore concentrate and pellets are transported to IOC’s port facilities at Sept-Îles, Quebec via its wholly-owned QNS&L, a 418 kilometer rail line which links the mine and the port. From there, the products are shipped to markets throughout North America, Europe, the Middle East and the Asia-Pacific region.

IOC’s 2018 sales totaled 15.0 million tonnes, comprised of 8.4 million tonnes of iron ore pellets and 6.6 million tonnes of iron ore concentrate. Production in 2018 was 8.5 million tonnes of pellets and 6.7 million tonnes of CFS. IOC generated ore sales revenues (excluding third party ore sales) of \$1,815 million in 2018 (2017 - \$2,249 million).

Selected IOC Financial Information

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|-------------------------------------|-------------------------|-------|-------|-------|-------|
| | <i>(\$ in millions)</i> | | | | |
| Operating Revenues | 1,930 | 2,315 | 1,676 | 1,495 | 1,794 |
| Cash Flow from Operating Activities | 578 | 923 | 456 | 267 | 455 |
| Net Income | 383 | 499 | 170 | 21 | 273 |
| Capital Expenditures | 205 | 265 | 99 | 143 | 187 |

IOC Royalty

The Corporation holds certain leases and licenses covering approximately 18,200 hectares of land near Labrador City. IOC has leased certain portions of these lands from which it currently mines iron ore. In return, IOC pays the Corporation a 7% gross overriding royalty on all sales of iron ore products produced from these lands. A 20% tax on the royalty is payable to the Government of Newfoundland and Labrador. For the five years prior to 2018, the average royalty net of the 20% tax had been \$99.6 million per year and in 2018 the net royalty was \$103.0 million (2017 - \$125.1 million).

Because the royalty is “off-the-top”, it is not dependent on the profitability of IOC. However, it is affected by changes in sales volumes, iron ore prices and, because iron ore prices are denominated in US dollars, the United States - Canadian dollar exchange rate.

IOC Equity

In addition to the royalty interest, the Corporation directly and through its wholly owned subsidiary, Hollinger-Hanna, owns a 15.10% equity interest in IOC. The other shareholders of IOC are Rio Tinto Limited with 58.72% and Mitsubishi Corporation with 26.18%.

IOC Commissions

Hollinger-Hanna has the right to receive a payment of 10 cents per tonne on the products produced and sold by IOC. Pursuant to an agreement, IOC is obligated to make the payment to Hollinger-Hanna so long as Hollinger-Hanna is in existence and solvent. In 2018, Hollinger-Hanna received a total of \$1.5 million in commissions from IOC (2017 - \$1.9 million).

Quarterly Dividends

Dividends of \$1.75 per share including special dividends of \$0.75 per share were declared in 2018 (2017 – dividends of \$2.65 per share including special dividends of \$1.65). These dividends were allocated as follows:

| Period Ended | Payment Date | Dividend Income per Share | Total Dividend (\$ Million) |
|--|---------------|---------------------------|-----------------------------|
| Mar. 31, 2018 | Apr. 25, 2018 | \$0.25 | \$ 16.0 |
| Special Dividend | Apr. 25, 2018 | 0.10 | 6.4 |
| Jun. 30, 2018 | Jul. 25, 2018 | 0.25 | 16.0 |
| Sep. 30, 2018 | Oct. 25, 2018 | 0.25 | 16.0 |
| Special Dividend | Oct. 25, 2018 | 0.30 | 19.2 |
| Dec. 31, 2018 | Jan. 25, 2019 | 0.25 | 16.0 |
| Special Dividend | Jan. 25, 2019 | 0.35 | 22.4 |
| Dividend to Shareholders - 2018 | | \$1.75 | \$112.0 |
| Mar. 31, 2017 | Apr. 25, 2017 | \$0.25 | \$ 16.0 |
| Special Dividend | Apr. 25, 2017 | 0.25 | 16.0 |
| Jun. 30, 2017 | Jul. 25, 2017 | 0.25 | 16.0 |
| Special Dividend | Jul. 25, 2017 | 0.35 | 22.4 |

| | | | |
|------------------|---------------|------|------|
| Sep. 30, 2017 | Oct. 25, 2017 | 0.25 | 16.0 |
| Special Dividend | Oct. 25, 2017 | 0.75 | 48.0 |
| Dec. 31, 2017 | Jan. 25, 2018 | 0.25 | 16.0 |
| Special Dividend | Jan. 25, 2018 | 0.30 | 19.2 |

| | | |
|--|----------------|----------------|
| Dividend to Shareholders - 2017 | \$ 2.65 | \$169.6 |
|--|----------------|----------------|

The quarterly dividends are payable to all shareholders of record on the last day of each calendar quarter and are paid on the 25th day of the following month.

Management's Discussion and Analysis

The following is a discussion of the consolidated financial condition and results of operations of the Corporation for the years ended December 31, 2018 and 2017. This discussion should be read in conjunction with the consolidated financial statements of the Corporation and notes thereto for the years ended December 31, 2018 and 2017. This information is prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and all amounts are shown in Canadian dollars unless otherwise indicated.

The Corporation is a Canadian corporation resulting from the conversion of the Fund under an Arrangement effective on July 1, 2010. LIORC is also the successor by amalgamation under the Arrangement of Labrador Mining Company Limited, formerly a wholly-owned subsidiary of the Fund.

General

The Corporation is dependent on the operations of IOC. IOC's earnings and cash flows are affected by the volume and mix of iron ore products produced and sold, costs of production and the prices received. Iron ore demand and prices fluctuate and are affected by numerous factors which include demand for steel and steel products, the relative exchange rate of the US dollar, global and regional demand and production, political and economic conditions and production costs in major producing areas.

Liquidity and Capital Resources

The Corporation had \$80.5 million (2017 - \$40.5 million) in cash as at December 31, 2018 with total current assets of \$127.0 million (2017 - \$82.6 million). The Corporation had working capital of \$76.3 million (2017 - \$33.1 million). The Corporation's operating cash flow was \$148.8 million (2017 - \$167.0 million) and dividends paid during the year were \$108.8 million, resulting in cash balances increasing by \$40.0 million during 2018.

Cash balances consist of deposits in Canadian dollars and US dollars with Canadian chartered banks. Accounts receivable primarily consist of royalty payments from IOC. Royalty payments are received in U.S. dollars and converted to Canadian dollars on receipt, usually 25 days after the quarter end. The Corporation does not normally attempt to hedge this short term foreign currency exposure.

Operating cash flow of the Corporation is sourced entirely from IOC through the Corporation's 7% royalty, 10 cents commission per tonne and dividends from its 15.10% equity interest in IOC. The Corporation normally pays cash dividends from its net income to the maximum extent possible, subject to the maintenance of appropriate levels of working capital. As noted above, the Corporation increased its cash balance based on the directors' view that it was prudent at that particular time to have some additional financial flexibility. On March 7, 2019 the directors determined that the cash balance be reduced to a more typical level with excess cash distributed to shareholders by means of a special dividend to be paid on April 25, 2019.

The Corporation has a \$50 million revolving credit facility with a term ending September 18, 2021 with provision for annual one-year extensions. No amount is currently drawn under this facility leaving \$50 million available to provide for any capital required by IOC or requirements of the Corporation.

Operating Results

The following table summarizes the Corporation's 2018 operating results as compared to 2017 results (in '000's).

| Revenue | 2018 | 2017 |
|--|-------------------|-------------------|
| IOC royalties <i>(net of 20% Newfoundland royalty tax)</i> | \$103,047 | \$125,094 |
| IOC commissions | 1,486 | 1,885 |
| Other | 580 | 374 |
| | <u>105,113</u> | <u>127,353</u> |
| | | |
| Expenses | | |
| Administrative expenses | 3,503 | 2,938 |
| Income taxes expense – current | 30,521 | 37,283 |
| | <u>34,024</u> | <u>40,221</u> |
| Net Income before undernoted items | <u>71,089</u> | <u>87,132</u> |
| | | |
| Non cash revenue (expense) | | |
| Equity earnings in IOC | 56,987 | 74,300 |
| Deferred income taxes | 5,597 | 2,204 |
| Amortization | (5,186) | (6,352) |
| | <u>57,398</u> | <u>70,152</u> |
| | | |
| Net income for the year | 128,487 | 157,284 |
| Other comprehensive gain | 775 | 2,060 |
| Comprehensive income for the year | <u>\$ 129,262</u> | <u>\$ 159,344</u> |

A summary of IOC's sales for calculating the royalty to LIORC in millions of tonnes is as follows:

| | First Quarter 2018 | Second Quarter 2018 | Third Quarter 2018 | Fourth Quarter 2018 | Total Year 2018 | Total Year 2017 |
|-----------------------------|--------------------------|---------------------------|--------------------------|---------------------------|-----------------------|-----------------------|
| Pellets | 2.54 | 0.48 | 2.79 | 2.59 | 8.41 | 10.48 |
| Concentrates ⁽¹⁾ | 1.35 | 0.05 | 2.64 | 2.65 | 6.70 | 8.67 |
| Total ⁽²⁾ | <u>3.89</u> | <u>0.53</u> | <u>5.43</u> | <u>5.24</u> | <u>15.10</u> | <u>19.15</u> |

(1) Excludes third party ore sales.

(2) Totals may not add up due to rounding.

IOC's 2018 iron ore sales for calculating the royalty to LIORC totaled 15.10 million tonnes compared to 19.15 million tonnes in 2017. Royalty revenue decreased to \$128.8 million as compared to \$156.4 million in 2017. Equity earnings from IOC amounted to \$57.0 million compared to \$74.3 million in 2017. The lower royalty revenue and equity earnings achieved in 2018 as compared to 2017 was mainly due to the reduced sales tonnages for concentrate and pellets caused by the labour strike. As in 2017, prices and premiums were higher than most forecasts with the Chinese governments continuing to enforce measures to reduce pollution; these measures favoured higher quality products such as the concentrate for sale and pellets produced by IOC.

While the Platts index for 62% Fe, CFR China averaged US\$69 per tonne in 2018 compared to US\$71 per tonne in 2017, a 3% decline, the Platts index for 65% Fe, CFR China averaged US\$90 per tonne in 2018 compared to US\$87 per tonne in 2017, a 3% increase. Since the CFS sold by IOC is priced on the 65% Fe, CFR China benchmark, the stronger prices for the 65% Fe product somewhat offset the lower CFS sales tonnages in 2018. The monthly Atlantic Blast Furnace 65% Fe pellet premium index, as quoted by Platts, averaged US\$59 per tonne for 2018, and was 31% higher than in 2017. Blast Furnace pellet premiums were stable at approximately US\$58 per tonne for most of 2018 but increased to US\$62 per tonne in November and December 2018. The strong year-over-year increase in pellet premiums was supported by generally healthy margins for steel producers in 2018.

The average price realized by IOC for CFS and pellets, FOB Sept-Îles, net of selling costs and royalties was approximately C\$110 per tonne in 2018 compared to C\$108 per tonne in 2017. Increased freight rates and lower sales tonnages affected the average realized price FOB Sept-Îles in 2018. The premiums for 65% Fe concentrate and pellets continued to be supported by the environmental policies of the Chinese governments, which, as in 2017, caused Chinese steel producers to favour the usage of higher value-in-use iron ore, such as the concentrate and pellets produced by IOC. With strong pellet premiums in 2018, IOC again focused on maximizing pellet production to the extent possible, given the labour strike and the refurbishment of one pellet line in 2018, as compared to two lines in 2017. The sales tonnage of pellets in 2018, for calculating the royalty to LIORC, was 20% lower than in 2017. The CFS tonnage in 2018 was lower than in 2017 by 23%.

Capital expenditures for IOC in 2018 were \$205 million in total as compared to \$265 million in 2017. The 2018 capital expenditures were essentially on budget and included the completion of the development of the Moss Pit in September, the refurbishment of the No. 4 Pellet Line, the track replacement program for 2018 for the QNS&L railway and dewatering for the Luce Pit.

The Shareholders' consolidated net income for the year ended December 31, 2018 was \$128.5 million or \$2.01 per share compared to \$157.3 million or \$2.46 per share in 2017. Equity earnings from IOC amounted to \$57.0 million compared to \$74.3 million in 2017. The main cause of IOC's lower earnings for 2018 as compared to 2017 was the labour strike in the second quarter.

Administration expenses for the year ended December 31, 2018 totaling \$3.5 million include cash bonuses and grants of restricted share units accrued to date totaling \$0.3 million. Amortization expense for royalty and commission interests decreased \$1.1 million for the year ended December 31, 2018 due to the decrease in production as a result of the labour strike in the second quarter of 2018.

Fourth quarter 2018 CFS sales were basically flat year-over-year, but pellet sales were lower by 7% as a result of the refurbishment of the No. 4 pellet line, which required more downtime than expected. However, the achieved sales prices of CFS and pellets were improved, resulting in royalty income of \$45.9 million for the quarter as compared to \$40.0 million for the same period in 2017. Fourth quarter 2018 cash flow from operations was \$53.3 million or \$0.83 per share compared to 2017 of \$39.6 million or \$0.62 per share. LIORC received an IOC dividend in the fourth quarter of 2018 in the amount of \$25.3 million or \$0.40 per share (2017 - \$19.3 million or \$0.30 per share). Equity earnings from IOC amounted to \$17.8 million or \$0.28 per share in the fourth quarter 2018 compared to \$16.6 million or \$0.26 per share for the same period in 2017.

Selected Consolidated Financial Information

The following table sets out financial data from a Shareholder's perspective for the three years ended December 31, 2018, 2017 and 2016.

| <u>Description</u> | Years Ended December 31 | | |
|-------------------------------------|---|------------------------|-----------------------|
| | <u>2018</u> | <u>2017</u> | <u>2016</u> |
| | <i>(in millions except per share information)</i> | | |
| Revenue | \$130.9 | \$158.6 | \$115.1 |
| Net Income | \$128.5 | \$157.3 | \$78.2 |
| Net Income per Share | \$2.01 | \$2.46 | \$1.22 |
| Cash Flow from Operations | \$149.0 ⁽¹⁾ | \$167.0 ⁽²⁾ | \$63.5 ⁽³⁾ |
| Cash Flow from Operations per Share | \$2.32 ⁽¹⁾ | \$2.61 ⁽²⁾ | \$0.99 ⁽³⁾ |
| Total Assets | \$763.6 | \$750.0 | \$737.0 |
| Dividends Declared per Share | \$1.75 | \$2.65 | \$1.00 |
| Number of Common Shares outstanding | 64.0 | 64.0 | 64.0 |

(1) Includes IOC dividends totaling \$83.9 million or \$1.31 per Share.

(2) Includes IOC dividend totaling \$76.7 million or \$1.20 per Share.

(3) Includes IOC dividend totaling \$15.1 million or \$0.23 per Share.

The following table sets out quarterly revenue, net income, cash flow and dividend data for 2018 and 2017. Due to seasonal weather patterns the first and fourth quarters generally have lower production and sales. Royalty revenues and equity earnings in IOC track iron ore spot prices, which can be very volatile. Dividends, included in cash flow, are declared and paid by IOC irregularly according to the availability of cash. There were limited sales in the second quarter of 2018 due to the labour strike.

| | <u>Revenue</u> | <u>Net Income</u> | <u>Net Income per Share</u> | <u>Cash Flow</u> | <u>Cash Flow from Operations per Share</u> | <u>Adjusted Cash Flow per Share ⁽¹⁾</u> | <u>Dividends Declared per Share</u> |
|----------------|---|-----------------------|-------------------------------------|-----------------------|--|--|---|
| | <i>(in millions except per share information)</i> | | | | | | |
| <u>2018</u> | | | | | | | |
| First Quarter | \$34.3 | \$30.3 | \$0.47 | \$20.3 | \$0.32 | \$0.29 | \$0.35 |
| Second Quarter | \$5.2 | \$(3.3) | \$(0.05) | \$15.5 | \$0.24 | \$0.04 | \$0.25 |
| Third Quarter | \$44.6 | \$58.1 | \$0.91 | \$59.7 ⁽²⁾ | \$0.93 ⁽²⁾ | \$1.30 ⁽²⁾ | \$0.55 |
| Fourth Quarter | \$46.8 | \$43.4 | \$0.68 | \$53.3 ⁽³⁾ | \$0.83 ⁽³⁾ | \$0.79 ⁽³⁾ | \$0.60 |

2017

| | | | | | | | |
|----------------|--------|--------|--------|-----------------------|-----------------------|-----------------------|--------|
| First Quarter | \$43.4 | \$42.9 | \$0.67 | \$28.2 ⁽⁴⁾ | \$0.44 ⁽⁴⁾ | \$0.53 ⁽⁴⁾ | \$0.50 |
| Second Quarter | \$34.2 | \$32.3 | \$0.50 | \$45.6 ⁽⁵⁾ | \$0.71 ⁽⁵⁾ | \$0.53 ⁽⁵⁾ | \$0.60 |
| Third Quarter | \$40.4 | \$43.8 | \$0.69 | \$53.6 ⁽⁶⁾ | \$0.84 ⁽⁶⁾ | \$0.85 ⁽⁶⁾ | \$1.00 |
| Fourth Quarter | \$40.6 | \$38.3 | \$0.60 | \$39.6 ⁽⁷⁾ | \$0.62 ⁽⁷⁾ | \$0.65 ⁽⁷⁾ | \$0.55 |

- (1) "Adjusted cash flow" (see below)
- (2) Includes \$58.6 million IOC dividend.
- (3) Includes \$25.3 million IOC dividend.
- (4) Includes \$10.0 million IOC dividend.
- (5) Includes \$15.2 million IOC dividend.
- (6) Includes \$32.2 million IOC dividend.
- (7) Includes \$19.3 million IOC dividend.

Standardized Cash Flow and Adjusted Cash Flow

For the Corporation, standardized cash flow is the same as cash flow from operating activities as recorded in the Corporation's cash flow statements as the Corporation does not incur capital expenditures or have any restrictions on dividends. Standardized cash flow per share was \$2.32 for 2018 (2017 - \$2.61). Cumulative standardized cash flow from inception of the Corporation is \$27.47 per share and total cash distributions since inception are \$26.34 per share, for a payout ratio of 96%.

The Corporation also reports "Adjusted cash flow" which is defined as cash flow from operating activities after adjustments for changes in amounts receivable, accounts payable and income taxes recoverable and payable. It is not a recognized measure under IFRS. The Directors believe that adjusted cash flow is a useful analytical measure as it better reflects cash available for distributions to Shareholders.

The following reconciles standardized cash flow from operating activities to adjusted cash flow (in '000's).

| | 2018 | 2017 |
|---|-----------|-----------|
| Standardized cash flow from operating activities | \$148,797 | \$166,960 |
| Changes in amounts receivable, accounts and interest payable and income taxes recoverable and payable | 6,377 | (3,116) |
| Adjusted cash flow | \$155,174 | \$163,844 |
| Adjusted cash flow per share | \$2.42 | \$2.56 |

Disclosure Controls and Internal Control over Financial Reporting

The President and CEO and the CFO are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the Corporation. Two directors serve as directors of IOC and IOC provides monthly reports on its operations to them. The Corporation also relies on financial information provided by IOC, including its audited financial statements, and other material information provided to the President and CEO, the Executive Vice President and Secretary and the CFO by officers of IOC. IOC is a private corporation, and its financial statements are not publicly available.

The Directors are informed of all material information relating to the Corporation and its subsidiary by the officers of the Corporation on a timely basis and approve all core disclosure documents including the Management Information Circular, the annual and interim financial statements and related Management's Discussion and Analyses, the Annual Information Form, any prospectuses and all press releases. An evaluation of the design and operating effectiveness of the Corporation's disclosure controls and procedures was conducted under the supervision of the CEO and CFO. Based on their evaluation, they concluded that the Corporation's disclosure controls and procedures were effective in ensuring that all material information relating to the Corporation was accumulated and communicated for the year ended December 31, 2018.

The President and CEO and the CFO have designed internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. An evaluation of the design and operating effectiveness of the Corporation's internal control over financial reporting was conducted under the supervision of the CEO and CFO. Based on their evaluation, they concluded that the Corporation's internal control over financial reporting was effective and that there were no material weaknesses therein for the year ended December 31, 2018.

The preparation of financial statements requires the Corporation's management to make estimates and assumptions that affect the reported amounts of the assets, liabilities, revenue and expenses reported each period. Each of these estimates varies with respect to the level of judgment involved and the potential impact on the Corporation's reported financial results. Estimates are deemed critical when the Corporation's financial condition, change in financial condition or results of operations would be materially impacted by a different estimate or a change in estimate from period to period. By their nature, these estimates are subject to measurement uncertainty, and changes in these estimates may affect the consolidated financial statements of future periods.

No material change in the Corporation's internal control over financial reporting occurred during the year ended December 31, 2018.

Outlook

The collapse of the tailings dam and loss of human life at Vale's Corrego de Feijao mine in Brumadinho, Minas Gerais state, Brazil ("Brumadinho") on January 25, 2019 had a profound influence on the seaborne iron ore market. The full impacts are uncertain at present. The initial price response for the 62% Fe, CFR China benchmark index was a sharp increase to over US\$90 per tonne from US\$74 per tonne the day prior to the disaster. However, low profit margins for Chinese steelmakers at present could limit the duration of the price spike. The benchmark price for the 62% Fe, CFR China index declined in mid-February 2019 to US\$84 per tonne, as steelmakers looked to purchase less expensive, lower grade products and reduce port stocks in China.

Vale announced on January 29, 2019 plans to cut production of some 40 million tonnes per year, including the pellet feed needed for the production of 11 million tonnes per year of pellets. Additional Vale production cuts of 30 million tonnes per annum were announced in February 2019 as a result of a civil court order which Vale is appealing.

As reported by Platts on February 13, 2019, in response to the Vale supply cuts, the National Australia Bank raised its forecast for iron ore from US\$62 to US\$80 per tonne for 2019 and from US\$60 to US\$70 per tonne for 2020. The forecast decline over the two years is because of the expectation of softer growth in Chinese demand.

As at mid-February there was uncertainty in the Atlantic pellet market, as the Brumadinho disaster caused delays in the annual pellet negotiations between Vale and the European steelmakers. In late 2018 steelmakers were faced with falling margins which causes them to purchase less expensive, lower quality iron ore. In addition, just prior to the disaster, Vale had been negotiating to change the annual pricing of pellet contracts to be based on the 65% index as opposed to the 62% index. The steelmakers judged that

this would result in an increase in the cost of pellets and resisted the change. The Brumadinho disaster is expected to result in a decreased supply of pellets worldwide, and there are reports that Vale will fill Brazilian orders for pellets over other customers.

Prior to the Brumadinho disaster, the market was generally assuming the re-opening of the Samarco pellet plant in Brazil in 2020. This is now seen as highly unlikely. Some analysts are modelling a partial re-start of Samarco in 2021.

On February 2, 2019 Platts listed the February price index for the Atlantic Blast Furnace 65% Fe pellet premium at US\$67.50 per tonne, no change from the January 2019 price. Pellet producers were maximizing pellet production before the Brumadinho disaster, and therefore it is expected that pellet premiums will remain strong for the balance of 2019 at least, considering no likely Samarco production, the cuts to pellet production announced by Vale, and the limited ability of existing major producers to ramp up production. A potential brake on pellet price increases is the consideration that the margins for European steelmakers are relatively low at present.

Rio Tinto's guidance for 2019 is 11.3 million to 12.3 million tonnes for its 58.7% share of IOC's saleable production tonnage (CFS and pellets). This is 19.2 million to 20.9 million tonnes of saleable production on a 100% basis. With the strong pellet premiums, IOC is expected to continue to prioritize pellet production in 2019. The 2019 IOC objective is approximately 20 million tonnes of concentrate production with sales of up to 12.5 million tonnes of pellets and approximately 6 million tonnes of CFS.

The capital expenditures for 2019 at IOC are expected to be in the range of \$225 million to 245 million, higher than the 2018 amount of \$205 million. The refurbishment of one induration machine in the pellet plant, a new rope shovel for the mine, productivity improvements in the concentrator and pellet plant, and additional locomotive capacity for the QNS&L railway are planned for 2019. IOC expects to earn revenue from hauling product from the Bloom Lake mine of Champion. The reported production capacity of the Bloom Lake is 7.5 million tonnes per annum of iron concentrate. Tacora Resources Inc. (Tacora) announced on November 27, 2018 that the financing for the re-start of the Scully Mine is complete. The concentrate produced by Tacora is to be hauled by the QNS&L.

The price of iron ore early in 2019 has exceeded forecasts. If the strong prices and premiums continue in 2019, the policies of the Chinese government on pollution are not materially relaxed, there are no major negative impacts from the China-US trade negotiations, IOC achieves the production guidance, and the Canadian dollar does not appreciate materially against the US dollar, the 2019 outlook for LIORC will be continued strong cash flows.

Forward-Looking Statements

This report may contain "forward-looking" statements that involve risks, uncertainties and other factors that may cause the actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Words such as "may", "will", "expect", "believe", "plan", "intend", "should", "would", "anticipate" and other similar terminology are intended to identify forward-looking statements. These statements reflect current assumptions and expectations regarding future events and operating performance as of the date of this report. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. A number of factors could cause actual results to vary significantly, including iron ore price and volume volatility, exchange rates, the performance of IOC, market conditions in the steel industry, mining risks and insurance, relationships with aboriginal groups, changes affecting IOC's customers, competition from other iron ore producers, estimates of reserves and resources and government regulation and taxation. A discussion of these factors is contained in LIORC's annual information form dated March 7, 2019 under the heading, "Risk Factors". Although the forward-looking statements contained in this report are based upon what management of LIORC believes are reasonable

assumptions, LIORC cannot assure investors that actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of this report and LIORC assumes no obligation, except as required by law, to update any forward-looking statements to reflect new events or circumstances. This report should be viewed in conjunction with LIORC's other publicly available filings, copies of which can be obtained electronically on SEDAR at www.sedar.com.

Additional information

Additional information relating to the Corporation, including the Annual Information Form, is on SEDAR at www.sedar.com. Additional information is also available on the Corporation's website at www.labradorironore.com.

William H. McNeil,
President and Chief Executive Officer
Toronto, Ontario
March 7, 2019

Management's Report

The consolidated financial statements are the responsibility of the management of Labrador Iron Ore Royalty Corporation (the "Corporation"). They have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, using management's best estimates and judgements, where appropriate.

Management is responsible for the reliability and integrity of the consolidated financial statements, the notes to the consolidated financial statements and other financial information contained in this report. In the preparation of these consolidated financial statements, estimates are sometimes necessary because a precise determination of certain assets and liabilities is dependent on future events. Management believes such estimates have been based on careful judgements and have been properly reflected in the accompanying consolidated financial statements.

Management is also responsible for maintaining a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that accounting systems provide timely, accurate and reliable financial information. The Directors are responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control.

PricewaterhouseCoopers LLP, the independent auditors, have audited the Corporation's consolidated financial statements in accordance with Canadian generally accepted auditing standards and have provided an independent professional opinion.

(Signed)
William H. McNeil
President and Chief Executive Officer

(Signed)
Alan R. Thomas
Chief Financial Officer

Toronto, Ontario
March 7, 2019



Independent auditor's report

To the Shareholders of Labrador Iron Ore Royalty Corporation

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Labrador Iron Ore Royalty Corporation 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 as issued by the International Accounting Standards Board (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 and comprehensive income for the years then ended;
- the consolidated statements of cash flows for the years then ended;
- the consolidated statements of changes in equity for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

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.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report.

PricewaterhouseCoopers LLP
PwC Tower, 18 York Street, Suite 2600, Toronto, Ontario, Canada M5J 0B2
T: +1 416 863 1133, F: +1 416 365 8215



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.

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.

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 Dean Braunsteiner.

(Signed) "PricewaterhouseCoopers LLP"

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Ontario
March 7, 2019

LABRADOR IRON ORE ROYALTY CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

| <i>(in thousands of Canadian dollars)</i> | As at | |
|---|-------------------|-------------------|
| | December 31, | |
| | 2018 | 2017 |
| Assets | | |
| Current Assets | | |
| Cash and short-term investments (note 14) | \$ 80,495 | \$ 40,498 |
| Amounts receivable (note 4) | 46,548 | 42,092 |
| Total Current Assets | <u>127,043</u> | <u>82,590</u> |
| Non-Current Assets | | |
| Iron Ore Company of Canada ("IOC") royalty and commission interests (note 5) | 253,846 | 259,032 |
| Investment in IOC (note 6) | 382,704 | 408,691 |
| Total Non-Current Assets | <u>636,550</u> | <u>667,723</u> |
| Total Assets | <u>\$ 763,593</u> | <u>\$ 750,313</u> |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities | | |
| Accounts payable | \$ 9,969 | \$ 8,601 |
| Dividend payable (note 7) | 38,400 | 35,200 |
| Taxes payable | 2,613 | 5,703 |
| Total Current Liabilities | <u>50,982</u> | <u>49,504</u> |
| Non-Current Liabilities | | |
| Deferred income taxes (note 9) | 121,760 | 127,220 |
| Total Liabilities | <u>172,742</u> | <u>176,724</u> |
| Shareholders' Equity | | |
| Share capital (note 10) | 317,708 | 317,708 |
| Retained earnings | 280,759 | 264,272 |
| Accumulated other comprehensive loss (note 11) | (7,616) | (8,391) |
| | <u>590,851</u> | <u>573,589</u> |
| Total Liabilities and Shareholders' Equity | <u>\$ 763,593</u> | <u>\$ 750,313</u> |

See accompanying notes to consolidated financial statements.

Approved by the Directors,

(Signed)
William H. McNeil
Director

(Signed)
Patricia M. Volker
Director

LABRADOR IRON ORE ROYALTY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME

| | For the Year Ended December 31, | |
|---|------------------------------------|-------------------|
| | 2018 | 2017 |
| <i>(in thousands of Canadian dollars except for per share information)</i> | | |
| Revenue | | |
| IOC royalties | \$ 128,809 | \$ 156,367 |
| IOC commissions | 1,486 | 1,885 |
| Interest and other income | 580 | 374 |
| | <u>130,875</u> | <u>158,626</u> |
| Expenses | | |
| Newfoundland royalty taxes | 25,762 | 31,273 |
| Amortization of royalty and commission interests | 5,186 | 6,352 |
| Administrative expenses | 3,503 | 2,938 |
| | <u>34,451</u> | <u>40,563</u> |
| Income before equity earnings and income taxes | 96,424 | 118,063 |
| Equity earnings in IOC (note 6) | 56,987 | 74,300 |
| Income before income taxes | <u>153,411</u> | <u>192,363</u> |
| Provision for income taxes (note 9) | | |
| Current | 30,521 | 37,283 |
| Deferred | (5,597) | (2,204) |
| | <u>24,924</u> | <u>35,079</u> |
| Net income for the year | 128,487 | 157,284 |
| Other comprehensive income | | |
| Share of other comprehensive income of IOC that will not be reclassified subsequently to profit or loss (net of income taxes of 2018 - \$137; 2017 - \$364) (note 11) | 775 | 2,060 |
| Comprehensive income for the year | <u>\$ 129,262</u> | <u>\$ 159,344</u> |
| Net income per share (note 10) | <u>\$ 2.01</u> | <u>\$ 2.46</u> |

See accompanying notes to consolidated financial statements.

LABRADOR IRON ORE ROYALTY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For the Year Ended | |
|---|--------------------|------------------|
| | December 31, | |
| <i>(in thousands of Canadian dollars)</i> | 2018 | 2017 |
| Net inflow (outflow) of cash related to the following activities | | |
| Operating | | |
| Net income for the year | \$ 128,487 | \$ 157,284 |
| Items not affecting cash: | | |
| Equity earnings in IOC | (56,987) | (74,300) |
| Current income taxes | 30,521 | 37,283 |
| Deferred income taxes | (5,597) | (2,204) |
| Amortization of royalty and commission interests | 5,186 | 6,352 |
| Common share dividend from IOC | 83,886 | 76,713 |
| Change in amounts receivable | (4,456) | (3,605) |
| Change in accounts payable | 1,368 | 528 |
| Income taxes paid | (33,611) | (31,090) |
| Cash flow from operating activities | <u>148,797</u> | <u>166,961</u> |
| Financing | | |
| Dividends paid to shareholders | (108,800) | (150,400) |
| Cash flow used in financing activities | <u>(108,800)</u> | <u>(150,400)</u> |
| Increase in cash, during the year | 39,997 | 16,561 |
| Cash, beginning of year | <u>40,498</u> | <u>23,937</u> |
| Cash, end of year | <u>\$ 80,495</u> | <u>\$ 40,498</u> |

See accompanying notes to consolidated financial statements.

LABRADOR IRON ORE ROYALTY CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

| <i>(in thousands of Canadian dollars)</i> | Share capital | Retained earnings | Accumulated other comprehensive loss | Total |
|---|--------------------------|------------------------------|---|-------------------|
| Balance as at December 31, 2016 | \$ 317,708 | \$ 276,588 | \$ (10,451) | \$ 583,845 |
| Net income for the year | - | 157,284 | - | 157,284 |
| Dividends declared to shareholders | - | (169,600) | - | (169,600) |
| Share of other comprehensive loss from investment in IOC (net of taxes) | - | - | 2,060 | 2,060 |
| Balance as at December 31, 2017 | <u>\$ 317,708</u> | <u>\$ 264,272</u> | <u>\$ (8,391)</u> | <u>\$ 573,589</u> |
| Balance as at December 31, 2017 | \$ 317,708 | \$ 264,272 | \$ (8,391) | \$ 573,589 |
| Net income for the year | - | 128,487 | - | 128,487 |
| Dividends declared to shareholders | - | (112,000) | - | (112,000) |
| Share of other comprehensive income from investment in IOC (net of taxes) | - | - | 775 | 775 |
| Balance as at December 31, 2018 | <u>\$ 317,708</u> | <u>\$ 280,759</u> | <u>\$ (7,616)</u> | <u>\$ 590,851</u> |

See accompanying notes to consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars)

1. CORPORATE INFORMATION

Labrador Iron Ore Royalty Corporation (the “Corporation”) directly and through its wholly-owned subsidiary, Hollinger-Hanna Limited (“Hollinger-Hanna”), holds a 15.10% equity interest in Iron Ore Company of Canada (“IOC”), a 7% gross overriding royalty on all iron ore products produced, sold and shipped by IOC, a \$0.10 per tonne commission interest on sales of iron ore by IOC and certain lease interests and, accordingly, is economically dependent on IOC. The Corporation and Hollinger-Hanna were established under the laws of the Canada Business Corporations Act. The Corporation is listed on the Toronto Stock Exchange under the symbol LIF. The registered office of the Corporation is 235 Water Street, P.O. Box 610, St. John’s, Newfoundland and Labrador, A1C 5L3.

These consolidated financial statements were authorized for issuance by the Board of Directors of the Corporation on March 7, 2019.

2. BASIS OF PRESENTATION

These consolidated financial statements of the Corporation have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The consolidated financial statements are prepared on a going concern basis, under the historical cost convention. All financial information is presented in Canadian dollars, except as otherwise noted. The Corporation adopted IFRS 9, *Financial Instruments* and IFRS 15, *Revenue with Contracts with Customers* on January 1, 2018 and accordingly, certain accounting policies described in Note 3 have changed in preparing these financial statements. There has been no material impact to the financial statements on adoption of IFRS 9 and 15. The additional disclosures required by IFRS 9 are outlined in Note 16.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of consolidation

These consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiary, Hollinger-Hanna. All inter-company transactions, balances, income and expenses are eliminated in full on consolidation.

(b) Financial assets and liabilities

The Corporation has applied the resulting changes in accounting policies for financial instruments retrospectively; however in accordance with the transitional provisions in IFRS 9, comparative figures have not been restated.

(i) Recognition

The Corporation initially recognizes deposits, receivables and liabilities on the date that they were originated. All other financial assets and liabilities are recognized initially on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument.

All financial assets and liabilities are initially measured at fair value and in the case of a financial asset or liability not at fair value through profit or loss, plus or minus transaction costs that are directly attributable to its acquisition or issue.

The Corporation derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in a transferred financial asset that is created or retained by the Corporation is recognized as a separate asset or liability.

The Corporation derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

Financial assets and liabilities are offset and the net amount presented in the statements of financial position when, and only when, the Corporation has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously

ii) Classification and fair value measurement

IFRS 9 contains three principal classification categories for financial assets: measured at amortized cost, fair value through other comprehensive income (“FVOCI”) and fair value through profit or loss. The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. The standard eliminates the previous IAS 39 categories of held to maturity, loans and receivables and available for sale. The adoption of IFRS 9 has not had a significant effect on the Corporation’s accounting policies for financial assets and financial liabilities – see Note 16.

Financial assets

A financial asset is classified as subsequently measured at amortized cost if it meets the following criteria:

- ‘hold-to-collect’ business model test – the asset is held within a business model whose objective is to hold the financial asset in order to collect contractual cash flows; and
- ‘SPPI’ contractual cash flow characteristics test – the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest (“SPPI”) on the principal outstanding on a specified date.

The Corporation’s business model is to hold financial assets to collect contractual cash flows and the cash flows pass the SPPI test and accordingly, all financial assets are measured at amortized cost.

Financial liabilities

The Corporation classifies all financial liabilities, not otherwise held for trading, as subsequently measured at amortized cost.

(c) Investment in associate

The Corporation has a 15.1% equity and voting interest in its associate, IOC, and exercises significant influence over IOC through its direct ownership interest, combined with its representation on the board of directors, participation in policy-making and approval processes, and the mineral sublease under which IOC conducts its operations near Labrador City, Newfoundland and Labrador. This investment is accounted for using the equity method.

The Corporation recognizes its share of earnings (loss) net of tax in the consolidated statements of income and comprehensive income which is adjusted against the carrying amount of its investment in IOC.

Unrealized gains and losses on transactions between the Corporation and IOC are eliminated to the extent of the Corporation's interest in this entity. Unrealized losses are eliminated only to the extent that there is no evidence of impairment.

The excess of the cost of the investment in IOC over the underlying book value at the date of acquisition is amortized on the unit-of-production method based on actual production in the current year and estimated production of iron ore over the life of mine at IOC. The rate of amortization is based on estimates of total proven and probable reserves and a portion of mineral resources, which may differ from actual.

(d) Revenue recognition

The Corporation has adopted IFRS 15 using the modified retrospective approach.

Royalty and commission revenue are based on iron ore sold and shipped by IOC and are measured at the fair value of the consideration received or receivable. The Corporation recognizes revenue from these sales when control over the iron ore transfers to the customer.

Royalty and commission revenue are recognized in an amount that reflects the consideration which the Corporation is entitled under the mineral sublease and for which collectability is reasonably assured.

(e) IOC royalty and commission interests

The royalty and commission interests are carried at cost less accumulated amortization. Amortization is recognized on the unit-of-production method based on actual production in the current year and estimated production of iron ore over the life of mine at IOC. The rate of amortization is based on estimates of total proven and probable reserves along with a portion of mineral resources, which may differ from actual.

(f) Asset impairment

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model applies to financial assets measured at amortized cost, contract assets and debt investments at FVOCI, but not to investments in equity instruments. Under IFRS 9, credit losses are recognized earlier than under IAS 39. There have been no allowances made to financial assets for credit losses on transition to IFRS 9 because the Corporation determined that the expected credit losses on its financial assets were nominal.

For other assets, including its investment in IOC and IOC royalty and commission interests, at each balance sheet date, the Corporation assesses whether there is any indication that such assets are impaired. Impairment is recognized if the recoverable amount, determined as the higher of the estimated fair value less costs of disposal or the value in use, is less than the carrying value.

Fair value less costs of disposal is best evidenced if obtained from an active market or binding sale agreement. Where neither exists, the fair value is based on the best estimates available to reflect the amount that could be received from an arm's length transaction.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the relevant asset for which the estimates of future cash flows have not been adjusted. The projections of future cash flows take into account the relevant operating plans and management's best estimate of the most probable set of conditions anticipated to prevail.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the lesser of the revised estimate of recoverable amount and the carrying amount that would have been recorded had no impairment loss been recognized previously.

(g) Income taxes

The Corporation and Hollinger-Hanna are taxable corporations.

Current income taxes are measured at the amount expected to be paid to tax authorities, based on taxable profit for the period, net of recoveries using enacted tax rates at the balance sheet date. Taxable income differs from income as reported in the consolidated statements of income and comprehensive income because of items of income or expense that are taxable or deductible in other periods and items that are never taxable or deductible. Deferred income tax liabilities are recognized using the liability method on taxable temporary differences between the tax bases and carrying amounts of assets and liabilities. Deferred income tax assets are recognized for all deductible temporary differences to the extent that it is probable that deductions can be utilized. Deferred income tax assets and liabilities are measured at tax rates that are expected to apply to the year when the asset is realized or the liability settled, using enacted or substantively enacted tax rates at the statement of financial position date. Deferred income taxes are presented as non-current.

(h) Restricted share units

Restricted share units (“RSU”) awarded to employees are recognized as compensation expense in the Consolidated Statement of Income (Loss) over the vesting period based on the number of RSUs expected to vest including the impact of expected forfeitures. RSUs are settled in cash and, as a result, are classified as a liability. The liability for vested RSUs are re-measured to fair value at each reporting date while they remain outstanding, with any changes in fair value recognized in compensation expense in the period.

(i) Foreign currency transactions

The Canadian dollar is the functional and presentation currency of the Corporation and Hollinger-Hanna. Amounts receivable and payable denominated in U.S. dollars are translated at exchange rates in effect at the balance sheet date and revenues and expenses denominated in U.S. dollars are translated at exchange rates in effect at the transaction date.

(j) Segment reporting

The Corporation manages its business under a single operating segment, consisting of its investment in IOC and its IOC royalty and commission interests. All of the Corporation’s assets and revenues are attributable to this single segment. The operating segment is reported in a manner consistent with the internal reporting provided to the President and Chief Executive Officer who fulfills the role of the chief operating decision-maker.

(k) Critical judgments and estimates

The preparation of financial statements requires the Corporation’s management to make estimates and assumptions that affect the reported amounts of the assets, liabilities, revenue and expenses reported each period. Each of these estimates varies with respect to the level of judgment involved and the potential impact on the Corporation’s reported financial results. Estimates are deemed critical when the Corporation’s financial condition, change in financial condition or results of operations would be materially impacted by a different estimate or a change in estimate from period to period. By their nature, these estimates are subject to measurement uncertainty, and changes in these estimates may affect the consolidated financial statements of future periods.

Critical judgments in applying accounting policies

Determination of significant influence over investment in IOC

The Corporation owns 15.1% of IOC. Judgment is needed to assess whether this interest meets the definition of significant influence and should be accounted for under the equity method. Management makes this determination based on its legal ownership interest, board representation and through an analysis

of the Corporation's participation in IOC's policy making process and mineral sub-lease agreements under which IOC conducts its operations.

Income taxes

The Corporation applies judgment in determining the tax rate to calculate deferred income taxes based upon temporary differences between the assets and liabilities that are reported in its consolidated financial statements and their tax bases as determined under applicable tax legislation. The Corporation records deferred income tax assets when it determines that it is probable that such assets will be realized. The future realization of deferred tax assets can be affected by many factors, including current and future economic conditions, expected royalties and commissions and can either be increased or decreased where, in the view of management, such change is warranted.

Critical accounting estimates and assumptions

Ore reserves and resources

Reserves are estimates of the amount of product that can be economically and legally extracted from IOC's mining properties. Reserve and resource estimates are an integral component in the determination of the commercial viability of the investment in IOC, the IOC royalty and commission interest, amortization calculations and impairment analyses. In calculating reserves and resources, estimates and assumptions are required about a range of geological, technical and economic factors, including quantities, grades, production techniques, production decline rates, recovery rates, production costs, commodity demand, commodity prices and exchange rates. In addition, future changes in regulatory environments, including government levies or changes in the Corporation's rights to exploit the resource imposed over the producing life of the reserves and resources may also significantly impact estimates.

Asset impairment

The Corporation's investment in IOC and the IOC royalty and commission interests are tested for impairment if there is an indicator of impairment. Where an indicator of impairment exists, a formal estimate of the recoverable amount, which is considered to be the higher of the fair value less costs of disposal and value in use, is made. These assessments require the use of estimates and assumptions such as long-term commodity prices, discount rates, future capital requirements, and operating performance. Fair value is determined as the amount that would be obtained from the sale of the asset(s) in an arm's-length transaction between knowledgeable and willing parties. Value in use for mineral assets is generally determined as the present values of estimated future cash flows arising from the continued use of the assets. These cash flows are discounted by an appropriate pre-tax discount rate to determine the estimated value in use. Projections inherently require assumptions and judgments to be made about each of the factors affecting future cash flows. Changes in any of these assumptions or judgments could result in a significant difference in the recoverable amount. Management considers the investment in IOC and the IOC royalty and commission interests to be a single combined cash generating unit.

(I) Future accounting policies

Future changes in accounting standards which may impact the consolidated financial statements for future periods pertain to the adoption of IFRS 16 Leases. The mandatory effective date of this standard is on January 1, 2019 and the Corporation will adopt the new standard on this date. The Corporation has conducted its assessment of the impact on its own leases and its investment in IOC. Based on work performed to date, the Corporation does not expect that the standard will have a material impact on its consolidated financial statements.

4. AMOUNTS RECEIVABLE

Amounts receivable consist of the following:

| | December 31 | |
|-----------------|------------------|------------------|
| | 2018 | 2017 |
| IOC royalties | \$ 46,241 | \$ 41,834 |
| IOC commissions | 178 | 225 |
| Other | 129 | 33 |
| | <u>\$ 46,548</u> | <u>\$ 42,092</u> |

5. IOC ROYALTY AND COMMISSION INTERESTS

| | December 31 | |
|---|-------------------|-------------------|
| | 2018 | 2017 |
| 7% Overriding royalty interest, at cost | \$ 351,617 | \$ 351,617 |
| Commission interest, at cost | 13,661 | 13,661 |
| Accumulated amortization | (111,432) | (106,246) |
| | <u>\$ 253,846</u> | <u>\$ 259,032</u> |

6. INVESTMENT IN IOC

The Corporation holds, directly and through Hollinger-Hanna, all of the Series B and Series C common shares of IOC, representing a 15.10% equity interest in the company as at December 31, 2018 and 2017. The Series B and Series C common shares have identical voting rights to all other issued and outstanding common shares of IOC.

| | 2018 | 2017 |
|--------------------------------------|-------------------|-------------------|
| Investment in IOC, beginning of year | \$ 408,691 | \$ 408,680 |
| Equity earnings in IOC | 56,987 | 74,300 |
| Other comprehensive income of IOC | 912 | 2,424 |
| Common share dividend received | (83,886) | (76,713) |
| Investment in IOC, end of year | <u>\$ 382,704</u> | <u>\$ 408,691</u> |

The Corporation's ability to exercise significant influence over IOC is achieved through its legal ownership interest, combined with its representation on the board of directors, participation in policy-making processes and in approval processes, and the mineral sublease agreement under which IOC conducts its operations near Labrador City, Newfoundland and Labrador.

The net excess of cost of the Investment in IOC over the net book value of underlying net assets amounts to \$43,416 (2017 - \$44,303) and is being amortized to net income on the units-of- production method based on actual production in the current year and estimated production of iron ore over the life of mine at IOC.

A summary of the financial information of IOC is as follows:

| | 2018 | 2017 |
|--|-------------|-------------|
| Common share dividends received from IOC | \$ 83,886 | \$ 76,713 |
| Amounts per IOC's financial statements: | | |
| Current assets | \$ 646,192 | \$ 881,489 |
| Non-current assets | 3,073,608 | 3,015,042 |
| Current liabilities | 559,393 | 607,748 |
| Non-current liabilities | 932,034 | 892,007 |
| Revenue | 1,930,456 | 2,314,700 |
| Net income | 383,273 | 499,244 |
| Other comprehensive income | 6,040 | 16,055 |
| Comprehensive income | 389,313 | 515,299 |

Reconciliation of IOC's net assets to LIORC's investment per Statements of Financial Position:

| | 2018 | 2017 |
|--|-------------|-------------|
| IOC net assets, beginning of year | 2,396,776 | 2,389,778 |
| Net income of IOC | 383,273 | 499,244 |
| Share based transactions with other shareholders | (2,180) | (268) |
| Other comprehensive income of IOC | 6,040 | 16,055 |
| Common share dividends declared and paid | (555,536) | (508,033) |
| IOC net assets, end of year | 2,228,373 | 2,396,776 |
| Ownership interest | 15.1% | 15.1% |
| Share of net assets | 336,484 | 361,913 |
| Adjustments: | | |
| Excess cost over net book value | 43,416 | 44,303 |
| Other | 2,804 | 2,475 |
| Carrying value - Investment in IOC | 382,704 | 408,691 |

Commitments

LIORC has no commitments from its investment in IOC that would give rise to future outflow of cash.

Contingent Liability

IOC is the defendant in a lawsuit by two Quebec Innu communities, claiming damages of \$900,000 relating to aboriginal rights and titles on the land where IOC operates. At this stage, IOC's management does not consider the risk of a material financial impact of this action to be probable.

7. DIVIDENDS TO SHAREHOLDERS

A regular dividend of \$0.25 and a special dividend of \$0.35 per common share, being an aggregate dividend of \$38,400, was declared by the Directors of the Corporation payable to shareholders of record on December 31, 2018 and paid on January 25, 2019.

Total dividends to shareholders as declared by the Directors of the Corporation in 2018 were \$112,000 or \$1.75 per share (2017 - \$169,000 or \$2.65 per share).

On March 7, 2019 dividends of \$1.05 per common share, comprised of a regular dividend of \$0.25 and a special dividend of \$0.80 per common share, for a total of \$67,200 were declared by the Directors of the Corporation payable to shareholders of record at the close of business on March 31, 2019 and to be paid on April 25, 2019.

8. DEBT

The Corporation has a \$50,000 revolving senior secured credit facility to September 18, 2021 with provision for annual one-year extensions. The credit facility provides for various forms of advances at the option of the Corporation. Various interest options are available for these revolving credits and a standby fee is payable on the unadvanced portion of the facility. The facility is secured by an assignment of the Corporation's and Hollinger-Hanna's interests in the IOC common shares, the IOC royalty and commission interests, and other assets of the Corporation and requires that the Corporation maintain certain financial ratios.

As at December 31, 2018, no amount was drawn on the credit facility (2017 – nil) leaving \$50,000 available to provide for any investment in IOC or other Corporation requirements.

9. INCOME TAXES

The provision for income taxes in the statements of income and comprehensive income differs from the amount computed by applying the combined Canadian federal and provincial tax rate to the Corporation's income before income taxes. The reasons for the difference and the related tax effects are as follows:

| | <u>2018</u> | <u>2017</u> |
|---|------------------|------------------|
| Income before income taxes | \$ 153,411 | \$ 192,363 |
| Income taxes at combined federal and provincial statutory tax rates of 30.0% | 46,023 | 57,709 |
| Increase (decrease) in income taxes resulting from: | | |
| Undistributed equity earnings in investment in IOC | (8,548) | (11,145) |
| Equity earnings distributed as dividends | (12,583) | (11,507) |
| Other | 32 | 22 |
| Income tax expense | <u>\$ 24,924</u> | <u>\$ 35,079</u> |

The deferred tax liability is comprised of the following:

| | <u>Opening Balance</u> | <u>Recognized in net income</u> | <u>Recognized in other comprehensive income</u> | <u>Closing Balance</u> |
|---|----------------------------|-------------------------------------|---|----------------------------|
| December 31, 2017 | | | | |
| Difference in tax and book value of assets | \$ 129,794 | \$ (2,273) | \$ 364 | \$ 127,885 |
| Tax benefit of deductible temporary differences | (734) | 69 | - | (665) |
| Net deferred income tax liability | <u>\$ 129,060</u> | <u>\$ (2,204)</u> | <u>\$ 364</u> | <u>\$ 127,220</u> |
| December 31, 2018 | | | | |
| Difference in tax and book value of assets | \$ 127,885 | (\$5,591) | \$ 137 | \$ 122,431 |
| Tax benefit of deductible temporary differences | (665) | (6) | - | (671) |
| Net deferred income tax liability | <u>\$ 127,220</u> | <u>\$ (5,597)</u> | <u>\$ 137</u> | <u>\$ 121,760</u> |

14. FINANCIAL INSTRUMENT RISK MANAGEMENT

Commodity price risk

The Corporation is dependent on royalty income, commissions and dividends received from IOC. IOC's earnings and cash flows are affected by the volume of iron ore products sold, the price of those products, operating costs, and currency movements. The demand for and price of iron ore fluctuate as a result of numerous factors outside the control of the Corporation and IOC. Such factors include, but are not limited to, the demand for steel and steel products, global and regional demand, political and economic conditions, and production conditions and costs in major producing regions.

Based on gross royalties for the year ended December 31, 2018, an increase or decrease in sale price of iron ore by 5% with all other variables held constant could have a favourable or unfavourable impact of approximately \$3,607 (2017 - \$4,400), respectively, on net income.

Currency risk

The Corporation derives dividends and royalty income from IOC denominated in US dollars. From time to time the Corporation may enter into financial agreements with banks and other financial institutions to reduce the underlying risks associated with this foreign currency denominated income. As at December 31, 2018 and 2017, there were no foreign exchange contracts outstanding.

Based on financial instrument balances as at December 31, 2018, a strengthening or weakening of the Canadian dollar to the U.S. dollar by 1% with all other variables held constant could have an unfavourable or favourable impact of approximately \$259 (2017 - \$240), respectively, on net income.

Based on gross royalties for the year ended December 31, 2018, a strengthening or weakening of the Canadian dollar to the U.S. dollar by 1% with all other variables held constant could have an unfavourable or favourable impact of approximately \$749 (2017 - \$860), respectively, on net income.

Liquidity risk

Liquidity risk is the risk of loss from not having access to sufficient funds to meet both expected and unexpected cash demands. The Corporation manages its exposure to liquidity risk through prudent management of its statement of financial position, including maintaining sufficient cash balances and access to undrawn credit facilities. Management monitors and reviews both actual and forecasted cash-flows.

As at December 31, 2018 the Corporation held \$55,237 in cash and cash equivalents (2017 - \$40,498) and \$25,258 in bankers acceptance instruments (2017 - nil), which were redeemed on February 7, 2019 and held in cash. All of the Corporation's financial liabilities are due within one year.

Credit risk

The Corporation is exposed to credit risk with respect to amounts receivable from IOC, with whom there is no history of credit losses or uncollectability. The Corporation is economically dependent on IOC. The Corporation maintains all of its cash with financial institutions having a minimum debt rating of A.

15. KEY MANAGEMENT PERSONNEL COMPENSATION

Key management personnel are the President and Chief Executive Officer, Executive Vice Presidents, the Chief Financial Officer, the Secretary and directors. Their remuneration for the year ended December 31, 2018 was comprised of salaries, RSUs accrued to date and fees totaling \$1,439 (2017 - \$1,261). The compensation expense recorded in 2017 did not reflect the restricted share unit plan that was implemented in March 2018.

16. TRANSITION TO IFRS 9 FINANCIAL INSTRUMENTS

The following table shows the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the Corporation's financial assets and financial liabilities as at January 1, 2018.

| | Measurement Category | | Carrying Amount - December 31, 2017 | | |
|-------------------------------|----------------------|----------------|-------------------------------------|-----------|------------|
| | IAS 39 | IFRS 9 | IAS 39 | IFRS 9 | Difference |
| Current Financial Assets | | | | | |
| Cash | Amortised cost | Amortised cost | \$ 40,498 | \$ 40,498 | - |
| Amounts receivable | Amortised cost | Amortised cost | 42,092 | 42,092 | - |
| Current Financial Liabilities | | | | | |
| Accounts payable | Amortised cost | Amortised cost | \$ 8,601 | \$ 8,601 | - |
| Dividend payable | Amortised cost | Amortised cost | 35,200 | 35,200 | - |
| Taxes payable | Amortised cost | Amortised cost | 5,703 | 5,703 | - |

17. SHARE-BASED PAYMENTS

On March 15, 2018, the Corporation adopted a restricted share unit plan ("Plan") for its employees that uses notional units that are valued based on the Corporation's common share price on the Toronto Stock Exchange. The RSUs accumulate dividend equivalents in the form of additional units based on the dividends paid on the Corporation's common shares. The Plan is settled in cash and, as a result, is classified as a liability. Fluctuations in the Corporation's share price change the value of the RSUs, which affects the Corporation's compensation expense.

Under the Plan, selected employees receive an award of RSUs which vest in three equal installments on each of the first, second and third anniversary of the award date. Upon vesting all RSUs are paid in cash to the employee. The share-based payment expense is recognized evenly over the vesting period. As at December 31, 2018, there were 8,606 RSUs awarded and outstanding. For the year ended December 31, 2018, compensation expense of \$108 was accrued in connection with the RSUs, respectively.

| | |
|---|---|
| Corporate Information | |
| Administration and Investor Relations | Registrar & Transfer Agent |
| PO Box 957, STN Adelaide Toronto, Ontario M5C 2K3 Telephone : (416) 863-7133 | Computershare Investor Services Inc. 100 University Avenue Toronto, Ontario M5J 2Y1 |
| | |
| Directors | Legal Counsel |
| William H. McNeil President and Chief Executive Officer Labrador Iron Ore Royalty Corporation | McCarthy Tétrault LLP Toronto, Ontario |
| | Auditors |
| William J. Corcoran⁽¹⁾ Company Director | PricewaterhouseCoopers LLP Toronto, Ontario |
| | |
| Mark J. Fuller⁽¹⁾ President and CEO of Ontario Pension Board | Stock Exchange Listing The Toronto Stock Exchange |
| | |
| Duncan N.R. Jackman⁽¹⁾ Chairman, President and CEO of E-L Financial Corporation Limited | Symbol LIF |
| | |
| James C. McCartney Retired Partner, McCarthy Tétrault LLP | Website www.labradorironore.com |
| | |
| John F. Tuer⁽²⁾ Company Director | E-mail investor.relations@labradorironore.com |
| | |
| Sandra L. Rosch Executive Vice President, Labrador Iron Ore Royalty Corporation | |
| | |
| Patricia M. Volker⁽¹⁾ Company Director | |
| | |
| Officers | |
| William J. Corcoran Non- Executive Chairman of the Board | Sandra L. Rosch Executive Vice President |
| William H. McNeil President and Chief Executive Officer | Alan R. Thomas Chief Financial Officer |
| James C. McCartney Executive Vice President | Robert O. Hansen Secretary |

(1) Member of Audit, Nominating and Compensation Committees

(2) Member of Nominating and Compensation Committees