PROPHECY RESOURCE CORP.
(Formerly Red Hill Energy Inc.)

Consolidated Financial Statements
December 31, 2010 and 2009
(Expressed in Canadian Dollars)

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of Prophecy Resource Corp. (formerly Red Hill Energy Inc.) are the responsibility of the Company's management. The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and reflect management's best estimates and judgment based on information currently available.

Management has developed and maintains a system of internal control to ensure that the Company's assets are protected from loss or improper use, transactions are authorized and properly recorded, and financial records are reliable.

The Board of Directors is responsible for ensuring management fulfills its responsibilities for financial reporting and internal control through an audit committee, which is comprised primarily of non-management directors. The audit committee reviews the results of the audit and the annual consolidated financial statements prior to their submission to the Board of Directors for approval.

The consolidated financial statements have been audited by Smythe Ratcliffe LLP, Chartered Accountants and their report outlines the scope of their examination and gives their opinion on the consolidated financial statements.

"John Lee"	*"Irina Plavutska"*
………………………………………	………………………………………
John Lee, President	Irina Plavutska, Interim CFO

Vancouver, British Columbia
April 26, 2011

SmytheRatcliffe
CHARTERED ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF PROPHECY RESOURCE CORP.
(formerly Red Hill Energy Inc.)

We have audited the accompanying consolidated financial statements of Prophecy Resource Corp. (formerly Red Hill Energy Inc.), which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of operations and comprehensive loss, shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles 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.

Auditors' Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Prophecy Resource Corp. as at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Smythe Ratcliffe LLP

Chartered Accountants

Vancouver, British Columbia
April 26, 2011

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Vancouver, BC V6C 2G8

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PROPHECY RESOURCE CORP.
(Formerly Red Hill Energy Inc.)
Consolidated Balance Sheets
December 31
(Expressed in Canadian Dollars)

	2010	2009
Assets		
Current		
Cash and cash equivalents	$ 39,324,151	$ 139,312
Receivables and deposits	414,926	2,928
Prepaid expenses	82,513	-
Investment (note 4)	3,295,385	-
	43,116,975	142,240
Property and Equipment (note 6)	91,706	77,927
Reclamation Deposits	6,500	6,850
Mineral Properties (note 7)	74,377,177	15,933,591
	$ 117,592,358	$ 16,160,608
Liabilities		
Current		
Accounts payable and accrued liabilities	$ 2,221,951	$ 52,105
Loans payable (note 8)	5,083,334	-
	7,305,285	52,105
Asset Retirement Obligation (note 7(j))	80,000	-
Future Income Taxes (note 9)	8,606,656	-
	15,991,941	52,105
Shareholders' Equity		
Share Capital (note 10)	125,458,376	33,896,787
Contributed Surplus (note 10)	5,407,447	3,582,419
Accumulated Other Comprehensive Loss	(512,616)	-
Deficit	(28,752,790)	(21,370,703)
	101,600,417	16,108,503
	$ 117,592,358	$ 16,160,608

Commitments (note 14)
Subsequent events (note 16)

Approved on behalf of the Board:

"John Lee"
…………………………………………………… Director
John Lee

"Greg Hall"
…………………………………………………… Director
Greg Hall

See notes to consolidated financial statements.

PROPHECY RESOURCE CORP.
(Formerly Red Hill Energy Inc.)
Consolidated Statements of Operations and Comprehensive Loss
Years Ended December 31
(Expressed in Canadian Dollars)

	2010	2009
General and Administrative Expenses		
Consulting and management fees	$ 1,278,392	$ 407,960
Stock-based compensation (note 10(c))	1,142,330	585,632
Advertising and promotion	693,778	110,164
Professional fees	447,512	89,859
Travel and accommodation	367,511	134,103
Stock exchange and shareholder services	254,658	45,819
Salary and benefits	252,703	230,869
Office and administration	196,958	124,201
Insurance	6,038	15,300
Director fees	-	27,878
Amortization	19,458	24,710
Loss Before Other Items	(4,659,338)	(1,796,495)
Other Items		
Foreign exchange gain (loss)	23,726	(25,837)
Interest income	9,399	2,687
Mineral property written-off	-	(85,443)
Gain on acquisition of joint venture interest	-	5,347
Loss on disposal of property and equipment	(1,739)	(3,544)
Interest expense (note 8)	(414,594)	-
Loss on early debt settlement	(729,295)	-
	(1,112,503)	(106,790)
Net Loss for Year	(5,771,841)	(1,903,285)
Unrealized Loss on Available-for-Sale Security (note 4)	(512,616)	-
Comprehensive Loss for Year	$ (6,284,457)	$ (1,903,285)
Loss Per Share, basic and diluted	$ (0.06)	$ (0.04)
Weighted Average Number of Shares Outstanding	100,639,942	52,173,846

See notes to consolidated financial statements.

PROPHECY RESOURCE CORP.
(Formerly Red Hill Energy Inc.)
Consolidated Statements of Shareholders' Equity
Years Ended December 31
(Expressed in Canadian Dollars)

	Number of Shares	Amount	Contributed Surplus	Accumulated Other Comprehensive Loss	Deficit	Total Shareholders' Equity
Balance, December 31, 2008	51,509,874	$ 33,002,987	$ 2,905,947	$ -	$ (19,376,578)	$ 16,532,356
Private placement, net of share issuance costs	1,650,000	613,800	-	-	-	613,800
Shares issued for mineral properties	700,000	280,000	-	-	-	280,000
Stock-based compensation	-	-	585,632	-	-	585,632
Net loss for year	-	-	-	-	(1,903,285)	(1,903,285)
Warrant modification	-	-	90,840	-	(90,840)	-
Balance, December 31, 2009	53,859,874	33,896,787	3,582,419	-	(21,370,703)	16,108,503
Private placement, net of share issuance costs	23,470,169	10,762,957	133,847	-	-	10,896,804
Shares reduced upon spin-off	(5,265,840)	-	-	-	-	-
Shares issued upon acquisition of Prophecy Holdings Corp.	36,178,285	27,495,497	73,404	-	-	27,568,901
Shares issued upon acquisition of Northern Platinum Ltd.	14,170,815	7,085,408	448,253	-	-	7,533,661
Shares issued for mineral properties	5,760,000	3,658,400	-	-	-	3,658,400
Shares issued as financing fees	1,000,000	490,000	-	-	-	490,000
Prospectus offering, net of share issuance costs	49,475,000	38,426,910	573,300	-	-	38,426,910
Options exercised	2,610,000	1,121,383	-	-	-	1,694,683
Warrants exercised	3,722,896	1,766,134	-	-	-	1,766,134
Stock-based compensation	-	-	1,351,124	-	-	1,351,124
Reclassification of contributed surplus on exercise of options	-	754,900	(754,900)	-	-	-
Net loss for year	-	-	-	-	(5,771,841)	(5,771,841)
Distribution to shareholders on spin-off	-	-	-	-	(1,610,246)	(1,610,246)
Unrealized loss on available-for-sale security	-	-	-	(512,616)	-	(512,616)
Balance, December 31, 2010	184,981,199	$ 125,458,376	$ 5,407,447	$ (512,616)	$ (28,752,790)	$ 101,600,417

See notes to consolidated financial statements.

PROPHECY RESOURCE CORP.
(Formerly Red Hill Energy Inc.)
Consolidated Statements of Cash Flows
Years Ended December 31
(Expressed in Canadian Dollars)

	2010	2009
Operating Activities		
Net loss for year	$ (5,771,841)	$ (1,903,285)
Items not involving cash		
Amortization	19,458	24,710
Stock-based compensation	1,142,330	585,632
Unrealized foreign exchange gain	956	5,104
Gain on acquisition of joint venture interest	-	(5,347)
Interest expense	573,334	-
Mineral property written off	-	85,443
Loss on disposal of property and equipment	1,739	3,544
	(4,034,024)	(1,204,199)
Changes in non-cash working capital		
Receivables and deposits	(275,386)	17,700
Prepaid expenses	(82,513)	-
Accounts payable and accrued liabilities	(524,639)	(15,023)
	(882,538)	2,677
Cash Used in Operating Activities	(4,916,562)	(1,201,522)
Investing Activities		
Cash received upon acquisition of Prophecy Holdings Corp. and Northern Platinum Ltd., net transaction costs	3,923,501	-
Reclamation deposits	6,850	-
Acquisition of property and equipment	(34,976)	(22,816)
Acquisition of joint venture interest	-	4,904
Mineral property expenditures	(12,769,549)	(639,283)
Purchase of investment	(3,808,001)	-
Cash Used in Investing Activities	(12,682,175)	(657,195)
Financing Activities		
Proceeds from loans payable	5,000,000	-
Shares issued, net of share issuance costs	52,784,532	613,800
Dividend distribution to shareholders on spin-off	(1,000,000)	-
Cash Provided by Financing Activities	56,784,532	613,800
Foreign Exchange Effect on Cash	(956)	(5,104)
Net Increase (Decrease) in Cash	39,184,839	(1,250,021)
Cash and Cash Equivalents, Beginning of Year	139,312	1,389,333
Cash and Cash Equivalents, End of Year	$ 39,324,151	$ 139,312

Supplemental Cash Flow Information (note 15)

See notes to consolidated financial statements.

1. NATURE OF OPERATIONS

Prophecy Resource Corp. (formerly Red Hill Energy Inc.) ("Prophecy" or the "Company") is incorporated under the laws of the province of British Columbia, Canada, and engaged in the acquisition, exploration and development of energy, nickel and platinum group metals projects.

The Company is in the development phase of its energy resource projects ("coal projects") in Mongolia and is exploring nickel and platinum group metals projects in Canada. The underlying value and recoverability of the amounts shown for mineral properties, and property and equipment are dependent upon the existence of economically recoverable mineral reserves, receipt of appropriate permits, the ability of the Company to obtain the necessary financing to complete the development of its projects, and future profitable production from, or the proceeds from the disposition of its mineral properties.

The Company has not yet generated any revenue and has incurred losses since inception. Management will need to generate additional financing in order to meet its planned business objectives. There is no assurance that the Company will be able to raise additional financing. The Company's mine operations at Ulaan Ovoo have not been fully commissioned and until the Company can sustain production and sale of its minerals it will remain in the development phase.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are stated in Canadian dollars, which is the Company's functional and reporting currency. The consolidated financial statements include the accounts of the Company and its wholly-owned integrated Mongolian subsidiaries, Chandgana Coal LLC, UGL Enterprises LLC, Red Hill Mongolia LLC, and East Energy Development LLC, and its Canadian subsidiaries, Northern Platinum Ltd. ("Northern") and Prophecy Holdings Corp. ("Prophecy Holdings"). All material intercompany balances and transactions have been eliminated.

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of estimates include the rates of amortization for property and equipment, recoverability of mineral property interests, valuation of asset retirement obligations ("ARO") and accrued liabilities, assumptions used in the determination of the fair value of assets on acquisition and of the fair value of stock-based compensation, and determination of the valuation allowance for future income tax assets. Management believes the estimates are reasonable; however, actual results could differ from those estimates and could impact future results of operations and cash flows.

(Expressed in Canadian Dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Business combinations and related sections

In January 2009, the Canadian Institute of Chartered Accountants ("CICA") issued Section 1582, "Business Combinations", to replace Section 1581. The new standard effectively harmonized the business combinations standard under Canadian GAAP with International Financial Reporting Standards ("IFRS"). The new standard revised guidance on the determination of the carrying amounts of the assets acquired and liabilities assumed, goodwill and accounting for non-controlling interests at the time of a business combination.

The CICA concurrently issued Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-Controlling Interests", which replace Section 1600, "Consolidated Financial Statements". Section 1601 provides revised guidance on the preparation of consolidated financial statements and Section 1602 addresses accounting for non-controlling interests in consolidated financial statements subsequent to a business combination.

Effective January 1, 2010, the Company early adopted these standards on a prospective basis, which did not have a material impact on the consolidated financial statements for the year ended December 31, 2010.

(c) Cash equivalents

Cash equivalents consist of highly liquid, short-term investments with original maturities of three months or less when purchased and are readily convertible to known amounts of cash.

(d) Amortization

Amortization of property and equipment is recorded on a declining-balance basis at the following annual rates:

Furniture and equipment	- 20%
Vehicle	- 30%
Computer equipment	- 45%

Leasehold improvements are amortized on a straight-line basis over 5 years.

Additions during the year are amortized at one-half the annual rates.

(e) Mineral properties and mine development costs

The Company capitalizes all costs related to investments in mineral properties on a property-by property basis. Such costs include acquisition costs and exploration expenditures, net of any recoveries received. Costs are deferred until such time as the extent of mineralization has been determined and mineral property interests are either developed, the property is sold or the Company's mineral rights are allowed to lapse.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Mineral properties and mine development costs (continued)

During the development of a mine, prior to the commencement of production, costs incurred to remove overburden and other mine waste materials in order to access the resource body ("stripping costs") are capitalized to the related property and depleted over the productive life of the mine using the unit-of-production method. During the production phase of a mine, stripping costs are accounted for as variable production costs and included in the cost of inventory produced during the period except for stripping costs incurred to provide access to reserves that will be produced in future periods and would not otherwise have been accessible, which are capitalized to the cost of mineral property interests and depleted on a unit-of-production method over the reserves that directly benefit from the stripping activity.

All capitalized costs are reviewed, on a property-by-property basis, to consider whether there are any conditions that may indicate impairment. Mineral property interests are reviewed at least annually or when otherwise appropriate for impairment or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When the carrying value of a property exceeds its net recoverable amount (as estimated by quantifiable evidence of an economic geological resource or reserve or by reference to option or joint venture expenditure commitments) or when, in the Company's assessment, it would be unable to sell the property for an amount greater than the deferred costs, the property is written down for the impairment in value.

From time to time the Company may acquire or dispose of a mineral property interest pursuant to the terms of an option agreement. As such options are exercisable entirely at the discretion of the optionee; the amount payable or receivable is not recorded at the time of the agreement. Option payments are recorded as property costs or recoveries when the payments are made or received. Recoveries in excess of property costs are reflected in income.

Capitalized costs will be depleted over the useful lives of the interests upon commencement of commercial production or written off if the interests are abandoned or the applicable mineral rights are allowed to lapse.

(f) Impairment of long-lived assets

The Company monitors the recoverability of long-lived assets, including property and equipment, based on factors such as current market value, future asset utilization, business climate and future undiscounted cash flows expected to result from the use of the related assets. The impairment loss is recorded in the period when it is determined that the carrying amount of the asset may not be recoverable.

(g) Revenue recognition

The Company recognizes interest income on its cash and cash equivalents on an accrual basis at the stated rates over the term to maturity.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Stock-based compensation

The Company accounts for stock-based compensation using a fair value based method with respect to all stock-based payments, to directors, employees and non-employees. For directors, officers and employees, the fair value for the options is measured at the date of grant using the Black-Scholes pricing model and expensed in the consolidated statements of operations over the vesting period of the options granted. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is completed or the date the performance commitment is reached or the date at which the equity instruments are granted if they are fully vested and non-forfeitable using the Black-Scholes option pricing method. Forfeitures are accounted for as they occur.

The Company has applied graded vesting to recognize stock-based compensation to directors, officers and employees this year. Previously, the Company recognized stock-based compensation on a straight-line basis over the vesting period of the options granted. No retroactive adjustment is necessary as all previously granted options have fully vested.

Upon the exercise of the stock option, consideration received and the related amount transferred from contributed surplus are recorded as share capital.

(i) Loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the period. The Company uses the treasury stock method to compute the dilutive effect of options and warrants. Under this method the dilutive effect on earnings per share is calculated presuming the exercise of outstanding options and warrants. It assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the period. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

(j) Foreign currency translation

All foreign subsidiaries are considered to be integrated foreign operations and their financial statements are translated to Canadian dollars under the temporal method. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities at historical exchange rates. Revenues and expenses (except for amortization, which is translated at the same rate as the related assets), are translated at the exchange rate on the transaction date. Realized and unrealized foreign exchange gains and losses are included in earnings.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Income taxes

The Company uses the asset and liability method to account for income taxes. Future income taxes are recognized for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax basis on the balance sheet date plus tax losses. Future income tax assets and liabilities are measured using the tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantively enacted. The amount of future income tax assets recognized is limited to the amount of the benefit that is more likely than not to be realized.

(l) Asset retirement obligations

The Company recognizes an estimate of the liability associated with an ARO in the financial statements at the time the liability is incurred. The estimated fair value of the ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The liability amount is increased each reporting period due to the passage of time and the amount of accretion will be charged to operations in the period. The ARO can also increase or decrease due to changes in the estimates of timing of cash flows or changes in the original estimated undiscounted costs. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the liability recorded.

(m) Unit offerings

Proceeds received on the issuance of units, consisting of common shares and warrants, are allocated first to common shares based on the market trading price of the common shares at the time the units are priced, and any excess is allocated to warrants.

(n) Flow-through shares

Flow-through shares entitle a company that incurs certain resource expenditures in Canada to renounce them for tax purposes allowing the expenditures to be deducted for income tax purposes by the investors who purchased the flow-through shares. The proceeds from shares issued under flow-through share financing agreements are credited to share capital and the tax benefits of the exploration expenditures incurred under these agreements are renounced to the purchaser of the flow-through shares. The tax impact to the Company of the renouncement is recorded on the date that the renunciation is filed with taxation authorities, through a decrease in share capital and the recognition of a future tax liability.

When flow-through expenditures are renounced, a portion of the future income tax assets that were not previously recognized, due to the recording of a valuation allowance, are recognized as a recovery of future income taxes in the statements of operations.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(o) Financial instruments

All financial instruments must be classified as either loans and receivables, held-to-maturity, held-for-trading, available-for-sale or other financial liabilities. Financial assets and liabilities classified as held-for-trading are measured at fair value with gains and losses recognized in operations. Financial assets classified as held-to-maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method. Financial instruments classified as available-for-sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) and reported in shareholders' equity. Any financial instrument may be designated as held-for-trading upon initial recognition. When a decline in the fair value of an available-for-sale financial asset has been recognized in comprehensive income, and there is objective evidence that impairment is other than temporary, the cumulative loss that had been previously recognized in accumulated other comprehensive income is removed from accumulated other comprehensive income and recognized in operations even though the financial asset has not been de-recognized.

Transaction costs that are directly attributable to the acquisition or issue of financial instruments that are classified as other than held-for-trading, which are expensed as incurred, are included in the initial carrying value of such instruments.

(p) Future accounting change

IFRS

In February 2008, the Canadian Accounting Standards Board confirmed that publicly accountable enterprises will be required to adopt IFRS for fiscal years beginning on or after January 1, 2011. The Company's first IFRS financial statements will be its interim financial statements for the first quarter of 2011 with an opening balance sheet date of January 1, 2011, which will require restatement of comparative information presented. The Company has evaluated the impact of the conversion on the Company's consolidated financial statements and is quantifying the effects.

3. ACQUISITIONS

In April 2010, the Company completed the acquisition of Prophecy Holdings through a plan of arrangement ("Arrangement"). As part of the Arrangement, the Company transferred $1,000,000 cash and its non-coal assets, principally the Red Lithium Property near Clayton Valley, Nevada, the Thor Rare Earth Property ("ThorRee") in Nevada, and the Banbury Property in British Columbia, to Elissa Resources Ltd. ("Elissa"), in exchange for Elissa's common shares. The Company exchanged each of the common shares for 0.92 of a new common share and 0.25 of an Elissa common share. The result was to reduce the number of common shares outstanding by 5,265,840 and recognize a distribution of an asset. Each outstanding stock option and warrant is exercisable to acquire one new common share of the Company. As consideration for the acquisition, a total of 36,178,285 common shares were issued to Prophecy Holdings' shareholders, and 3,500,000 options and 11,336,109 warrants were issued to replace the old

(Expressed in Canadian Dollars)

3. ACQUISITIONS (Continued)

options and warrants of Prophecy Holdings on a one-to-one basis. This transaction has been accounted for as an acquisition of assets. The excess of the consideration given over the fair value of the assets and liabilities acquired has been allocated to mineral properties. The allocation of the consideration given and net assets acquired of this transaction is summarized as follows:

Fair value of common shares issued	$	27,495,497
Fair value of replacement options and warrants		73,404
Transaction costs		174,999
Purchase price	$	27,743,900
Cash and cash equivalents	$	4,213,364
Receivables		24,565
Reclamation deposit		6,500
Mineral properties		30,935,357
Accounts payable and accrued liabilities		(591,823)
Future income tax liabilities		(6,844,063)
Net assets acquired	$	27,743,900

In September 2010, the Company completed the acquisition of Northern through a plan of Arrangement. Pursuant to the Arrangement, each common share of Northern was exchanged for 0.50 common share and 0.10 warrant of the Company, and each option and warrant of Northern was exchanged for 0.50 option and warrant of the Company, respectively. Upon closing the Arrangement, the Company issued a total of 13,874,819 common shares and, 1,300,000 options and 6,079,715 warrants acquired to replace the common shares, options and warrants of Northern. The Company also issued 295,996 common shares as finder's fees for this transaction. This transaction has been accounted for as an acquisition of assets. The allocation of the consideration given and net assets acquired are summarized as follows:

Fair value of common shares issued	$	6,937,410
Fair value of replacement options and warrants		448,253
Transaction costs		263,937
Purchase price	$	7,649,600
Cash and cash equivalents	$	1,075
Receivables		112,047
Mineral properties		9,853,625
Accounts payable and accrued liabilities		(614,845)
Future income tax liabilities		(1,702,302)
Net assets acquired	$	7,649,600

4. INVESTMENT

In May 2010, the Company and Victory Nickel Inc. ("Victory Nickel") agreed to reciprocal private placements enabling Victory Nickel to acquire approximately 9.9% equity interest in the Company in accordance with the terms of an Equity Participation Agreement dated October 20, 2009. Victory Nickel subscribed for 7,000,000 shares of the Company at a price of $0.544 per share, while the Company purchased 36,615,385 common shares in Victory Nickel, which represented approximately 9.8% equity interest in Victory Nickel, for gross proceeds of $3,808,001. This investment is classified as an available-for-sale financial instrument.

As of December 31, 2010, the fair value of the investment in Victory Nickel was $3,295,385. An unrealized loss of $512,616 was recorded as other comprehensive loss.

5. CAPITAL MANAGEMENT

The Company considers its capital structure to consist of share capital, stock options and warrants. The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition and exploration of mineral properties. The Board of Directors does not establish quantitative returns on capital criteria for management.

The Company has some properties that are in the exploration stage and, as such, the Company is dependent on the external financing to fund those properties. In order to carry out the planned exploration and development and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed. In addition, the Company has one property in the development stage that will generate sufficient funds to support ongoing operations. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the year ended December 31, 2010. The Company is not subject to externally imposed capital requirements.

The Company's investment policy is to invest its surplus cash in highly liquid short-term interest-bearing investments with maturities of 90 days or less from the original date of acquisition, all held with major Canadian financial institutions.

(Expressed in Canadian Dollars)

6. PROPERTY AND EQUIPMENT

				2010		
		Cost		Accumulated Amortization		Net
Furniture and equipment	$	118,317	$	63,394	$	54,923
Vehicle		47,475		26,973		20,502
Computer equipment		35,214		23,551		11,663
Leasehold improvements		7,244		2,626		4,618
	$	208,250	$	116,544	$	91,706

				2009		
		Cost		Accumulated Amortization		Net
Furniture and equipment	$	92,565	$	54,044	$	38,521
Vehicle		47,475		19,471		28,004
Computer equipment		25,522		19,915		5,607
Leasehold improvements		7,244		1,449		5,795
	$	172,806	$	94,879	$	77,927

(Expressed in Canadian Dollars)

7. MINERAL PROPERTIES

The Company's investment in and expenditures on mineral properties for the years ended December 31, 2010 and 2009 are as follows:

	Ulaan Ovoo	Chandgana Tal	Chandgana Khavtgai	Lynn Lake	Okeover, Kanichee	Titan	Wellgreen	Uranium	Red Lithium	ThorRee	Banbury	Total
	(note 7(a))	(note 7(b))	(note 7(c))	(note 7(d))	(note 7(e))	(note 7(f))	(note 7(g))	(note 7(h))	(note 7(i))	(note 7(i))	(note 7(i))	
Balance, December 31, 2008	$12,619,128	$1,279,337	$1,144,830	$ -	$ -	$ -	$ -	$74,844	$ -	$ -	$ 1	$15,118,140
Acquisition costs	-	-	-	-	-	-	-	-	290,000	155,000	-	445,000
Deferred exploration costs												
Licenses, leases and Power Plant Application	28,710	2,907	13,258	-	-	-	-	10,599	27,460	31,635	-	114,569
Geological core, engineering and consulting	276,445	-	17,335	-	-	-	-	-	18,995	2,545	-	315,320
Drilling	25,153	-	-	-	-	-	-	-	3,152	-	-	28,305
Transportation and shipping	1,891	-	98	-	-	-	-	-	-	-	-	1,989
Camp and general	(1,110)	-	(3,179)	-	-	-	-	-	-	-	-	(4,289)
	331,089	2,907	27,512	-	-	-	-	10,599	49,607	34,180	-	455,894
Impairment charges	-	-	-	-	-	-	-	(85,443)	-	-	-	(85,443)
Balance, December 31 2009	12,950,217	1,282,244	1,172,342	-	-	-	-	-	339,607	189,180	1	15,933,591
Acquisition costs	1,570,000	-	-	29,805,964	1,246,890	307,274	14,172,024	-	-	-	-	47,102,152
Deferred exploration costs												
Licenses, leases and Power Plant Application	35,460	1,450	322,305	6,395	-	-	31,912	-	-	-	-	397,522
Geological core, engineering and consulting	1,031,479	15,091	191,722	331,356	80,738	64,630	251,062	-	-	81,458 -		2,047,536
Drilling	25,129	-	267,080	419,402	-	-	49,876	-	-	-	-	761,487
Transportation and shipping	522,346	-	-	-	-	-	-	-	-	-	-	522,346
Road and bridge construction	2,925,587	-	-	-	-	-	-	-	-	-	-	2,925,587
Mine development	4,671,075	-	-	-	-	-	-	-	-	-	-	4,671,075
Personnel	116,097	1,502	19,948	-	-	-	33,333	-	-	-	-	170,880
Camp and general	328,577	34,153	112,743	55,763	-	-	31,625	-	-	-	-	562,861
	9,655,750	52,196	913,798	812,916	80,738	64,630	397,808	-	-	81,458	-	12,059,294
Recoveries	(107,614)	-	-	-	-	-	-	-	-	-	-	(107,614)
Disposal on spin-off	-	-	-	-	-	-	-	-	(339,607)	(270,638)	(1)	(610,246)
Balance, December 31, 2010	$ 9,548,136	$1,334,440	$2,086,140	$30,618,880	$1,327,628	$371,904	$14,569,832	$ -	$ -	$ -	$ -	$74,377,177

7. **MINERAL PROPERTIES** (Continued)

(a) Ulaan Ovoo property

In November 2005, the Company entered into a letter of intent with Ochir LLC that sets out the terms to acquire a 100% interest in the Ulaan Ovoo coal property. The Ulaan Ovoo property is located in Selenge province, Mongolia. It is held by the vendor under a transferable, 55-year mining license with a 45-year option for extension granted by the Government of Mongolia. The purchase price for the 100% interest, together with all equipment, buildings and other facilities assembled and constructed at the property is US$9,600,000. Under the terms of the agreement, the Vendor retained a 2% net smelter return royalty ("NSR").

In November 2006, the Company entered into an agreement with a private Mongolian corporation to purchase 100% title and interest in five mineral licenses including licenses that are contiguous and entirely surrounding the Ulaan Ovoo property. The aggregate purchase price for the licenses was US$400,000. Under the terms of the agreement the vendor retained a 2% NSR. A finder's fee of 58,500 shares was issued to a third party on the acquisition.

In March 2010, the Company was granted an option to purchase the 2% NSR on the Ulaan Ovoo property by cash payment of US$130,000 and issuance of 2,000,000 common shares of the Company. In April 2010, the Company exercised the option and a total of $1,570,000 was capitalized as acquisition costs of the property.

On November 9, 2010, the Company has received its mine permit from the Mongolian Ministry of Mineral Resources and Energy ("MMMRE") for the Ulaan Ovoo coal project.

(b) Chandgana Tal property

In March 2006, the Company acquired a 100% interest in the Chandgana Tal property, a coal exploration property consisting of two exploration licenses located in the northeast part of the Nyalga coal basin, approximately 290 kilometres east of Ulaan Bataar, Mongolia, by cash payment of US$400,000 and issuance of 250,000 shares of the Company valued at $1.20 per share. A total of $814,334, which included a finder's fee of 50,000 shares of the Company issued to a third party, was capitalized as acquisition costs of the Chandgana Tal property.

In March 2011, the Company has obtained its mine permit from the MMMRE for the Chandgana Tal coal project.

(c) Changdana Khavtgai property

In 2007, the Company acquired a 100% interest in the Chandgana Khavtgai property, a coal exploration property consisting of one license and located in the northeast part of the Nyalga coal basin by cash payment of US$570,000. A total of $589,053 was capitalized as acquisition costs of the Chandgana Khavtgai property.

7. MINERAL PROPERTIES (Continued)

(d) Lynn Lake property

The Lynn Lake property, a nickel project located in northern Manitoba, Canada, was acquired through the acquisition of Prophecy Holdings in April 2010 (see note 3).

On October 20, 2009, Prophecy Holdings entered into an option agreement with Victory Nickel. Pursuant to the option agreement, Prophecy has the right to earn a 100% interest in Lynn Lake by paying Victory Nickel an aggregate of $4,000,000 over approximately four and one-half years by incurring an aggregate of $3,000,000 exploration expenditures at Lynn Lake over a three-year period, and by issuing of 2,419,548 shares to Victory Nickel (issued). The option agreement also provided Victory Nickel with a right to participate in future financings or acquisitions on a pro-rata basis so that Victory Nickel may maintain its 10% interest in the number of outstanding shares of the Company (see note 4).

Pursuant to the option agreement, the schedule of cash payment to Victory Nickel is as follows:

(i) $300,000 within five business days after the approval from the TSX Venture Exchange (paid);
(ii) $300,000 on January 9, 2010 (paid);
(iii) $400,000 within 180 days of the option agreement (paid);
(iv) $1,000,000 on or before March 1, 2011 ($400,000 was paid during the year ended December 31, 2010; $600,000 was paid on February 28, 2011);
(v) $1,000,000 on or before March 1, 2012; and
(vi) $1,000,000 on or before March 1, 2013.

The schedule of expenditures to be incurred at Lynn Lake is as follows:

(vii) $500,000 on or before November 1, 2010 (incurred);
(viii) an aggregate of $1,500,000 on or before November 1, 2011; and
(ix) an aggregate of $3,000,000 on or before November 1, 2012.

(e) Okeover property

The 60% interest in the Okeover property, a copper-molybdenum project in the Vancouver Mining Division of southwestern British Columbia, Canada, was acquired through the acquisition of Prophecy Holdings in April 2010 (see note 3).

(f) Titan property

The 80% interest in Titan property, a vanadium-titanium-iron project located in Ontario, Canada, was acquired through the acquisition of Prophecy Holdings in April 2010 (see note 3).

7. MINERAL PROPERTIES (Continued)

(f) Titan property (Continued)

In January 2010, Prophecy Holdings entered into an option agreement with Randsburg International Gold Corp. ("Randsburg") whereby Prophecy Holdings has the right to acquire an 80% interest in Titan by paying Randsburg an aggregate of $500,000, of which $200,000 was paid, and incurring exploration expenditures of $200,000 by December 31, 2010. Pursuant to the option agreement, Randsburg has the option to sell the remaining 20% interest in the Titan property to the Company for $150,000 cash and 400,000 shares of the Company. The Titan property is subject to a 3% NSR that may be purchased for $20,000.

(g) Wellgreen property

The Wellgreen property, a nickel-copper and platinum group metals project located in southwestern Yukon Territory, Canada, was acquired through the acquisition of Northern in September 2010 (see note 3).

In June 2010, the Company entered into a Back-In Assignment Agreement (the "Assignment Agreement') with Belleterre Quebec Mines ("Belleterre"), a private company controlled by a Northern shareholder and former director. Pursuant to the Assignment Agreement, Belleterre assigns its rights, title and interest in and to the Assignment Agreement to Prophecy for consideration of $4,200,000 payable as follows:

- $2,100,000 in cash (paid); and
- $2,100,000 payable through the issuance of 3,560,000 common shares and 712,000 warrants (issued). Each warrant entitles the holder to acquire one common share at $0.80, expiring October 8, 2011. The Company issued 200,000 common shares as a finder's fee valued at $118,000.

Pursuant to the Assignment Agreement, Belleterre was granted a back-in right to a 50% interest in Wellgreen at any time up to and including completion of a positive feasibility study at Wellgreen by paying to the Company, at the time of backing-in, 50% of the amount of expenditures incurred by the Company at Wellgreen. As a result, the Company acquired a 100% interest in Wellgreen.

The property is subject to annual lease payments and property taxes of $3,811 payable to the Territorial Treasurer of the Yukon.

(h) Mongolia Uranium project

The Company owns a 100% interest in the Mongolia Uranium Project, which was written off during the year ended December 31, 2009 due to unsuccessful exploration results.

(i) Red Lithium, ThorRee and Banbury properties

Under the Arrangement between the Company and Prophecy Holdings, the Red Lithium, ThorRee and Banbury properties were transferred, before the closing of the Arrangement, to Elissa in exchange for Elissa's common shares, which were distributed to the shareholders of Red Hill pursuant to the plan of arrangement (see note 3).

(Expressed in Canadian Dollars)

7. MINERAL PROPERTIES (Continued)

(j) Asset retirement obligation

The Company's ARO consists of reclamation and closure costs for mine development and exploration activities. Although the ultimate amount of reclamation costs to be incurred cannot be predicted with certainty, the total undiscounted amount of estimated cash flows required to settle the Company's estimated obligations is $179,000. The present value of AROs is $80,000 (2009 - $nil) and is expected to be settled over the next ten years. This amount has been disclosed using a credit and inflation adjusted risk-free rate of 12.2%.

At December 31, 2010, the ARO relates to reclamation and closure costs of the Company's Ulaan Ovoo property in Mongolia.

	2010	2009
Asset retirement obligation, beginning of year	$ -	$ -
Additions	80,000	-
Asset retirement obligation, end of year	$ 80,000	$ -

(k) Title to mineral properties

Although the Company has taken steps to verify title to the properties on which it is conducting exploration and in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property title may be subject to unregistered prior agreements and non-compliance with regulatory requirements.

(l) Realization of assets

The investment in and expenditures on mineral property interests comprise a significant portion of the Company's assets. Realization of the Company's investment in these assets is dependent upon the establishment of legal ownership, the attainment of successful production from properties or from the proceeds of their disposal. Resource exploration and development is highly speculative and involves inherent risks. While the rewards if an ore body is discovered can be substantial, few properties that are explored are ultimately developed into producing mines. There can be no assurance that current exploration programs will result in the discovery of economically viable quantities of ore. The amounts shown for acquisition costs and deferred exploration expenditures represent costs incurred to date and do not necessarily reflect present or future values.

(m) Environmental

The Company is subject to the laws and regulations relating to environmental matters in all jurisdictions in which it operates, including provisions relating to property reclamation, discharge of hazardous material and other matters. The Company may also be held liable should environmental problems be discovered that were caused by former owners and operators of its properties and properties in which it has previously had an interest. The Company conducts its mineral exploration activities in compliance with applicable

(Expressed in Canadian Dollars)

7. MINERAL PROPERTIES (Continued)

(m) Environment (Continued)

environmental protection legislation. The Company is not aware of any existing environmental problems related to any of its current or former properties that may result in material liability to the Company.

Environmental legislation is becoming increasingly stringent and costs and expenses of regulatory compliance are increasing. The impact of new and future environmental legislation on the Company's operations may cause additional expenses and restrictions. If the restrictions adversely affect the scope of exploration and development on the mineral properties, the potential for production on the property may be diminished or negated.

8. LOANS PAYABLE

In August 2010, the Company arranged a secured debt facility of up to $10,000,000 (the “Loan”) with Waterton Global Value, L.P. (“Waterton”). Subject to certain draw-down conditions, the Loan may be drawn in three tranches as follows: (a) $2,000,000 on the closing date, which occurred as at September 1, 2010; (b) $3,000,000 upon completion of the acquisition of Northern; and (c) $5,000,000 at such time as the Company completes an off-take agreement for the Ulaan Ovoo property.

The Loan is due by August 31, 2011 and bears interest at 10% per annum payable monthly. A structuring fee of $50,000 and 1% of the third tranche (if drawn down) is payable in cash. In conjunction with the closing of the Loan, the Company issued 1,000,000 common shares valued at $490,000 to Waterton. In the event the third tranche of the Loan is drawn, the Company shall issue a further 1,000,000 common shares to Waterton. Macquarie Capital Markets Canada Ltd. (“Macquarie”) acted as the financial advisor to the Company with respect to the loan, and a total of $300,000 finder’s fee was paid to Macquarie.

As at December 31, 2010, the Company had drawn down $5,000,000 of the Loan and recorded $1,143,889 interest expense. The common shares issued and finders’ fee have been accounted for as interest and financing costs and expensed during the year ended December 31, 2010. The outstanding balance of the loans payable as at December 31, 2010 is summarized as follows:

		2010
Loan payable	$	5,000,000
Accrued financing fees		83,334
Outstanding amount payable	$	5,083,334

In December 2010, the Company agreed to repay the loan outstanding and, on January 11, 2011 the Company repaid the outstanding loan balance plus early termination financing fees equal to two months’ interest payment of $83,334 pursuant to the Credit Agreement. The effective interest rate on the loan is 35%.

(Expressed in Canadian Dollars)

9. INCOME TAXES

The Company has non-capital losses that may be carried forward to apply against future taxable income for Canadian income tax purposes. The losses expire as follows:

Available to	Amount
2014	$ 395,000
2015	688,000
2026	686,000
2027	942,000
2028	1,129,000
2029	1,447,000
2030	4,119,000
	$ 9,406,000

Significant components of the Company's future tax assets and liabilities, after applying enacted corporate income tax rates, are as follows:

	2010	**2009**
Future income tax liabilities		
Book value over tax value of mineral property interests	$ (8,179,682)	$ -
Future income tax assets:		
Non-capital loss carry-forwards for Canadian tax purposes	2,737,949	1,534,332
Tax value over book value of property and equipment	164,791	51,310
Tax value over book value of share issue costs	725,359	71,064
Tax value over book value of investment	64,077	-
Tax value over book value of mineral property interests	-	1,948,282
	(4,487,506)	3,604,988
Valuation allowance	(4,119,150)	(3,604,988)
Net future income tax liability	$ (8,606,656)	$ -

The valuation allowance reflects the Company's estimate that the tax assets, more likely than not, will not be realized.

(Expressed in Canadian Dollars)

9. INCOME TAXES (Continued)

The reconciliation of income tax attributable to continuing operations computed at the statutory tax rate of 28.5% (2009 - 30%) to income tax recovery is:

	2010	2009
Income tax recovery at Canadian statutory rates	$ (1,644,975)	$ (570,985)
Non-deductible expenses	387,339	190,502
Adjustment due to effective rate attributable to income taxes of other countries	38,570	16,358
Effect of change in valuation allowance	1,577,814	223,573
Effect of change in timing differences	(616,386)	97,962
Effect of change in tax rate	257,638	42,590
	$ -	$ -

10. SHARE CAPITAL

(a) Authorized

Unlimited number of common shares without par value

(b) Equity financing

During the year ended December 31, 2010, the Company had the following share capital transactions:

(i) In February 2010, the Company issued 6,500,000 units for gross proceeds of $1,950,000. Each unit is comprised of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of $0.45 per share during the warrant term. The warrants are subject to forcible conversion within 30 days of delivery of notice from the Company, in the event the shares of the Company close at over $0.65 for 10 consecutive trading days. Finder's fees of $71,872 were incurred on a portion of the financing and recorded as share issuance costs.

10. SHARE CAPITAL (Continued)

(b) Equity financing (Continued)

(ii) In March 2010, the Company issued 5,463,158 units for gross proceeds of $3,113,945. Each unit is comprised of one common share and one share purchase warrant. Each share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of $0.71 during the warrant term. The warrants are subject to forcible conversion within 30 days of delivery of notice from the Company, in the event the shares of the Company close at $1.06 for 10 consecutive trading days. Finders' fees of $217,980 and 382,421 warrants, with a fair value of $133,847, exercisable for a period of two years from closing at $0.76 per unit, were incurred on a portion of the financing and recorded as share issuance costs.

(iii) In April 2010, the Company issued 675,500 units for gross proceeds of $398,545. Each unit is comprised of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of $0.80 during the warrant term. The warrants are subject to forcible conversion within 30 days of delivery of notice from the Company, in the event the shares of the Company close at $1.10 for 20 consecutive trading days.

(iv) In May 2010, the Company closed a reciprocal private placement with Victory Nickel whereby Victory Nickel subscribed for 7,000,000 shares of the Company at a price of $0.544 per share (note 4).

(v) In October 2010, the Company issued 3,831,511 flow-through units for gross proceeds of $2,030,701. Each unit is comprised of one flow-through common share and one share purchase warrant. Each warrant entitles the holder to acquire one additional common share for a period of two years at a price of $0.66. Finder's fees of $114,535 were incurred on a portion of the financing and recorded as share issuance costs.

(vi) In December, 2010, the Company issued 49,475,000 common shares for gross proceeds of $42,053,750. Finder's fees of $3,053,540 and 1,800,000 warrants, with a fair value of $573,300, exercisable for a period of one year from closing at $0.91 per unit, were incurred on a portion of the financing and recorded as share issuance costs.

During the year ended December 31, 2009, the Company had the following share capital transactions:

(vii) On September 1, 2009, the Company closed a $660,000 private placement. Under the placement, the Company issued 1,650,000 units, each unit is comprised of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of $0.60. A finder's fee of $46,200, equal to 7% of the proceeds placed, was paid.

(Expressed in Canadian Dollars)

10. SHARE CAPITAL (Continued)

(b) Equity financing (Continued)

(viii) Issued 350,000 common shares at a price of $0.40 per share pursuant to a property option agreement for Red Lithium dated September 4, 2009.

(ix) Issued 350,000 common shares at a price of $0.40 per share pursuant to a property option agreement for ThorRee dated November 23, 2009.

(c) Stock options

The Company has established a stock option plan for its directors, officers, employees and consultants under which the Company may grant options to acquire a maximum number of common shares equal to 20% of the total issued and outstanding common shares of the Company. In December 2010, the Company granted 3,692,505 options in excess of the limits of the Company's stock option plan. These option grants are not effective until receipt of regulatory and shareholder approval at the Company's next annual general meeting.

The following is a summary of the option transactions:

	2010		2009	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	3,980,000	$ 0.37	3,720,000	$ 0.78
Granted	17,685,500	$ 0.77	385,000	$ 0.37
Repriced – old			(3,675,000)	$ 0.78
Repriced - new			3,675,000	$ 0.37
Options reduced as per spin-off (note 3)	(318,400)	$ 0.37	-	-
Conversion as per acquisition of Prophecy Holdings (note 3)	3,500,000	$ 0.40	-	-
Conversion as per acquisition of Northern (note 3)	1,300,000	$ 0.67	-	-
Exercised	(2,610,000)	$ 0.40	(80,000)	$ 0.37
Cancelled	(510,000)	$ 0.64	-	-
Outstanding, end of year	23,027,100	$ 0.69	3,980,000	$ 0.37
Exercisable, end of year	5,817,100		3,980,000	

(Expressed in Canadian Dollars)

10. SHARE CAPITAL (Continued)

(c) Stock options (Continued)

On January 23, 2009, the Company cancelled and re-issued 3,675,000 stock options with certain directors, employees and consultant. The incremental fair value of this option modification in the amount of $479,273 has been expensed and was estimated using the Black-Scholes option pricing model with the following weighted average assumption: risk-free interest rate of 1.39%, dividend yield of nil, volatility of 79.98% and an expected life of 2.45 years.

During the year ended December 31, 2010, a total of 17,685,500 options with a term of five years were granted to directors, officers, employees and consultants at exercise prices ranging from $0.54 to $0.85; the options vest over a two-year period.

The following is the summary of assumptions used to estimate the fair value of each option granted using the Black-Scholes option pricing model:

	2010	2009
Risk-free interest rate	2.58%	1.83%
Expected life of options in years	4.8 years	5 years
Expected volatility	77%	79.36%
Expected dividend yield	Nil	Nil

The Company granted stock options that were in excess of their stock option plan during the year ended December 31, 2010. Accordingly, only 1,307,495 of the 2,050,000 options expiring December 24, 2015 were subject to Black-Scholes valuation; 2,950,000 options expiring December 24, 2015 were not valued.

The weighted average grant date fair value of options granted during the year ended December 31, 2010 was $0.94 per share.

(Expressed in Canadian Dollars)

10. SHARE CAPITAL (Continued)

(c) Stock options (Continued)

For the year ended December 31, 2010, a total of $1,351,124 (2009 - $585,632) stock-based compensation expense was recorded as follows:

Consolidated Statements of Operations	**2010**	**2009**
Nature of expense		
Directors' fees	$ 255,231	$ 341,700
Advertising and promotion	457,651	21,100
Salaries	38,787	38,852
Consulting fees	390,661	183,980
	$ 1,142,330	$ 585,632
Consolidated Balance Sheets	**2010**	**2009**
Ulaan Oovo exploration	$ 75,006	$ -
Lynn Lake exploration	20,354	-
Wellgreen exploration	113,434	-
	$ 208,794	$ -
Total stock-based compensation	$ 1,351,124	$ 585,632

As of December 31, 2010, the following director, officer, employee and consultant options were outstanding:

Exercise Price	Number of Options Outstanding	Expiry Date
$ 0.25	50,000	February 14, 2012
$ 0.25	1,287,500	October 29, 2014
$ 0.38	200,000	November 30, 2014
$ 0.40	1,719,600	January 23, 2014
$ 0.40	600,000	January 29, 2014
$ 0.54	1,000,000	September 21, 2015
$ 0.54	250,000	October 1, 2015
$ 0.55	350,000	March 15, 2015
$ 0.60	550,000	July 17, 2014
$ 0.60	115,000	September 21, 2014
$ 0.67	1,980,000	May 10, 2015
$ 0.67	175,000	October 15, 2015
$ 0.77	9,000,000	December 10, 2015
$ 0.77	2,050,000	December 24, 2015
$ 0.80	500,000	April 30, 2014
$ 0.80	100,000	September 21, 2015
$ 0.93	2,950,000	December 24, 2015
$ 1.03	150,000	March 24, 2015
	23,027,100	

(Expressed in Canadian Dollars)

10. SHARE CAPITAL (Continued)

(c) Stock options (Continued)

As at December 31, 2009, the following director, officer, employee and consultant options were outstanding:

Exercise Price	Number of Options Outstanding	Expiry Date
$ 0.37	3,880,000	January 23, 2014
$ 0.36	100,000	February 3, 2014
	3,980,000	

(d) Share purchase warrants

	2010		2009	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Outstanding, beginning of year	7,815,000	$ 1.09	6,990,000	$ 1.15
Issued	15,776,840	$ 0.69	825,000	$ 0.60
Warrants reduced on spin-off (note 3)	(1,352,846)	$ 0.67	-	-
Conversion as per acquisition of Prophecy Holdings (note 3)	11,336,109	$ 0.55	-	-
Conversion as per acquisition of Northern (note 3)	6,079,715	$ 0.69	-	-
Exercised	(3,722,897)	$ 0.47	-	-
Expired	(6,430,800)	$1.15	-	-
Outstanding, end of year	29,501,121	$ 1.25	7,815,000	$ 1.09

(Expressed in Canadian Dollars)

10. SHARE CAPITAL (Continued)

(d) Share purchase warrants (Continued)

As at December 31, 2010, the following warrants were outstanding:

Exercise Price	Number of Warrants Outstanding	Expiry Date
$ 0.10	3,250,000	December 31, 2011
$ 0.40	745,750	December 31, 2011
$ 0.40	449,302	January 25, 2012
$ 0.40	125,000	June 5, 2011
$ 0.40	25,000	December 31, 2011
$ 0.46	100,000	September 4, 2011
$ 0.49	2,418,221	February 17, 2012
$ 0.50	1,711,533	December 31, 2011
$ 0.60	687,500	June 5, 2011
$ 0.60	237,500	August 18, 2011
$ 0.60	137,500	December 31, 2011
$ 0.60	323,750	December 21, 2011
$ 0.60	62,500	December 22, 2011
$ 0.65	759,000	September 1, 2011
$ 0.66	3,831,511	October 28, 2012
$ 0.70	550,000	September 4, 2011
$ 0.77	5,377,932	March 31, 2012
$ 0.80	3,040,458	March 31, 2012
$ 0.80	337,750	April 21, 2012
$ 0.80	2,818,914	March 23, 2012
$ 0.80	712,000	October 8, 2011
$ 0.85	1,800,000	December 24, 2011
	29,501,121	

As at December 31, 2009, the following warrants were outstanding:

Exercise Price	Number of Warrants Outstanding	Expiry Date
$ 1.25	3,750,000	April 3, 2010
$ 1.25	1,215,000	May 31, 2010
$ 0.90	2,025,000	July 4, 2010
$ 0.60	825,000	September 1, 2011
	7,815,000	

On February 23, 2009, the Company extended the expiry dates of 3,750,000 warrants from April 3, 2009 to April 3, 2010, and 1,215,000 warrants from May 31, 2009 to May 31, 2010. These warrants were originally issued pursuant to private placements in 2007 as part of equity offerings. The warrant amendments resulted in an incremental fair value of $90,840 credited to contributed surplus and included in the Company's deficit. The incremental value was estimated using the Black-Scholes option pricing model.

(Expressed in Canadian Dollars)

11. RELATED PARTY TRANSACTIONS

Details of the transactions between the Company and related parties not disclosed elsewhere in the financial statements are as follows:

	2010	2009
Armada Investments Ltd. (a)	$ 134,440	$ 106,325
S. Paul Simpson Law Corp. (b)	414,109	22,370
Consulting fees (c)	577,363	82,234
	$ 1,125,912	$ 210,929

(a) During the year ended December 31, 2010, the Company paid $134,440 (2009 - $106,325) to Armada Investments Ltd, a private company controlled by a common director of the Company, for office rent, accounting and management services provided.

(b) During the year ended December 31, 2010, the Company paid $414,109 (2009 - $22,370) to S. Paul Simpson Law Corp., a law corporation controlled by a former director of the Company, for legal services provided.

(c) During the year ended December 31, 2010, the Company paid consulting fees of $577,363 (2009 - $82,234) to companies controlled by a former director, a former officer of the Company, and to private companies controlled by a director and officer of the Company, for management and financing services provided.

Transactions with related parties are measured at the exchange amount, which is the amount of consideration established and agreed to by the parties.

12. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The Company classified its cash and cash equivalents as held-for-trading; amounts receivable as loans and receivables; investment as available-for-sale; and accounts payable and accrued liabilities and loans payable as other financial liabilities. The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and loan payable approximate their fair values due to the short-term maturity of these financial instruments. The fair values of amounts due from related parties have not been disclosed, as their fair values cannot be reliably measured since the parties are not at arm's length.

CICA Handbook Section 3862 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value of financial instruments as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities;

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

Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

(Expressed in Canadian Dollars)

12. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (Continued)

The following table sets forth the Company's financial assets and liabilities measured at fair value by level within the fair value hierarchy:

	Level 1	Level 2	Level 3	Total
Financial assets				
Investments	$ 3,295,385	$ -	$ -	3,295,385
	$ 3,295,385	$ -	$ -	$ 3,295,385

(a) Liquidity risk

Liquidity risk is the risk that an entity will be unable to meet its financial obligations as they fall due. The Company manages liquidity risk by preparing cash flow forecasts of upcoming cash requirements. As at December 31, 2010, the Company has cash and cash equivalents of $39,324,151 (2009 - $139,312) and financial liabilities of $7,305,285 (2009 - $52,105), which have contractual maturities of 90 days or less, with the exception of the loan payable, which is due August 2011.

(b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is exposed to credit risk primarily associated to cash and cash equivalents, receivables and deposits. The Company manages credit risk, in respect of cash and cash equivalents, by purchasing highly liquid, short-term investment-grade securities held at a major Canadian financial institution in accordance with the Company's investment policy. The carrying amount of assets included on the balance sheets represents the maximum credit exposure. Concentration of credit risk exists with respect to the Company's cash and cash equivalents, as substantially all amounts are held with a single Canadian financial institution.

12. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT (Continued)

(c) Market risk

The significant market risks to which the Company is exposed are interest rate risk, foreign currency risk and other price risk.

(i) Interest rate risk

Interest risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. The Company's cash equivalents primarily include highly liquid investments that earn interest at market rates that are fixed to maturity or at variable interest rates. The Company also drew on credit facility bearing an annual coupon rate of 10%. Due to the short-term nature of these financial instruments, fluctuations in market rates do not have a significant impact on the fair values or cash flows of the financial instruments as of December 31, 2010. The Company manages interest rate risk by maintaining an investment policy that focuses primarily on preservation of capital and liquidity.

(ii) Foreign currency risk

The Company is exposed to foreign currency risk to the extent that monetary assets and liabilities held by the Company are not denominated in Canadian dollars.

The Company has exploration and development projects in Mongolia and undertakes transactions in various foreign currencies. The Company is therefore exposed to foreign currency risk arising from transactions denominated in a foreign currency and the translation of financial instruments denominated in US dollars and Mongolia tugrug into its functional and reporting currency, the Canadian dollar.

Based on the above net exposures as at December 31, 2010, with other variables unchanged, a 4% (2009 - 17%) strengthening (weakening) of the US dollar against the Canadian dollar would not have a material impact on earnings; with other variables unchanged, a 10% (2009 - 10%) strengthening (weakening) of the Mongolian tugrug against the Canadian dollar would not have a material impact on net loss.

(iii) Other price risk

The Company holds an investment in marketable securities that fluctuates in value. Based upon the Company's investment position as at December 31, 2010, a 10% increase (decrease) in the market price of the investment held would have resulted in an increase (decrease) to other comprehensive income of approximately $329,538 (2009 - $nil).

(Expressed in Canadian Dollars)

13. SEGMENT INFORMATION

The Company operates in one operating segment, being the acquisition, exploration, and development of mineral properties. Based on the internal reporting structure and the nature of the Company's activities, projects within the same geographic area are not identified for segment reporting purposes. Corporate head office provides support to the mining and exploration activities with respect to financial and technical supports and its information is included in the Canada category.

	2010			
	Canada	Mongolia	United States	Total
Property and equipment	$ 52,061	$ 39,645	$ -	$ 91,706
Mineral properties	$ 46,888,246	$ 27,488,932	$ -	$ 74,377,178
Investment	$ 3,295,385	$ -	$ -	$ 3,295,385

	2009			
	Canada	Mongolia	United States	Total
Property and equipment	$ 20,805	$ 57,122	$ -	$ 77,927
Mineral properties	$ -	$ 15,404,803	$ 528,788	$ 15,933,591

14. COMMITMENTS

Commitments, not disclosed elsewhere in these financial statements, are as follows.

On February 4, 2011, the Company entered into a new office rental agreement expiring April 30, 2016 with total rental expense of $312,417 over the next five years as follows:

2011	$ 61,712
2012	61,712
2013	61,712
2014	63,641
2015	63,640
	$ 312,417

Pursuant to the flow-through renunciation filed with the Canada Revenue Agency for December 31, 2010, the Company is required to incur additional exploration expenditures of $2,030,701 by December 31, 2011.

(Expressed in Canadian Dollars)

15. SUPPLEMENTAL CASH FLOW INFORMATION

	2010	2009
Supplementary Information		
Interest paid	$ 300,000	$ -
Income taxes paid	$ -	$ -
Non-Cash Financing and Investing Activities		
Shares issued for mineral properties	$ 3,658,400	$ 280,000
Non-cash share issue costs	$ 3,448,075	$ -
Mineral property expenditures included in accounts payable	$ 1,550,654	$ 2,545
Shares issued as financing fees	$ 490,000	$ -
Shares issued on acquisitions	$ 34,580,905	$ -

16. SUBSEQUENT EVENTS

(a) On April 4, 2011, the Company signed a definitive arrangement agreement (the "Arrangement Agreement") to sell Prophecy's Wellgreen and Lynn Lake projects to Pacific Coast Nickel Corp. ("PCNC").

Pursuant to the Arrangement Agreement, the transaction will be implemented by way of a plan of arrangement under the Business Corporations Act (British Columbia) (the "Arrangement"), whereby Prophecy will sell the assets comprising the Wellgreen and Lynn Lake projects, as well as $2,000,000 cash, in exchange for the issuance of 450,000,000 common shares of PCNC (the "PCNC Shares"); 225,000,000 PCNC Shares will be retained by Prophecy and 225,000,000 PCNC Shares will be distributed or reserved for distribution to holders of Prophecy shares. Prophecy may also grant up to 500,000 options prior to the effective time of the Arrangement.

Upon completion of the Arrangement, Prophecy and its shareholders will hold approximately 88.97% of the issued and outstanding shares of PCNC. Following the completion of the Arrangement, Prophecy will change its name to "Prophecy Coal Corp." and PCNC will consolidate its share capital on a 10:1 basis and be renamed as "Prophecy Platinum Corp.".

(b) Subsequent to December 31, 2010, a total of 120,000 options exercisable at $0.80 per option, 50,000 options exercisable at $0.93 per option and 130,000 options exercisable at $0.98 per option with a life of five years, were granted to employees and consultants. Subsequent to December 31, 2010, a total of 736,600 options were exercised for proceeds of $313,015.

(c) On January 4, 2011, the Company announced accelerated expiry of approximately 3,355,585 share purchase warrants, which were issued in various private placements; 1,711,533 warrants are exercisable to purchase common shares of the Company at a price of $0.50 per share until December 31, 2011; 915,750 warrants are exercisable to purchase one common share of the Company at a price of $0.40 per share until December 31, 2011; and 728,302 warrants are exercisable to purchase one common share of the Company at a price of $0.40 until January 25, 2012.

Subsequent to December 31, 2010, a total of 4,207,465 warrants were exercised for proceeds of $2,116,347.

PROPHECY RESOURCE CORP.
(Formerly – Red Hill Energy Inc.)
Management's Discussion and Analysis of Financial Condition and Results of Operations
For the Year Ended December 31, 2010
(Expressed in Canadian dollars)

This Management's Discussion and Analysis ("MD&A") provides a review of the significant developments and issues that influenced the Company during year ended December 31, 2010. It should be read in conjunction with the audited consolidated financial statements of Prophecy Resource Corp. (Formerly – Red Hill Energy Inc.) ("Prophecy" or the "Company") for the year ended December 31, 2010, and the audited consolidated financial statements of the Company for the year ended December 31, 2009.

This MD&A contains information up to and including April 26, 2011.

Additional information relating to Prophecy is available on SEDAR at www.sedar.com and on Prophecy's website at www.prophecyresource.com.

Except for statements of historical fact relating to the Company, certain information contained herein constitutes forward-looking statements. This MD&A contains forward-looking statements which reflect management's expectations regarding Prophecy's future growth, results of operations, performance, business prospects and opportunities. Words such as "expects", "anticipates", "intends", "plans", "believes", "estimates", or similar expressions, are forward-looking statements within the meaning of securities laws. Forward-looking statements include, without limitation, the information concerning possible or assumed future results of operations of Prophecy. These statements are not historical facts but instead represent only Prophecy's expectations, estimates and projections regarding future events. These statements are not guarantees of future performance and involve assumptions and risks and uncertainties that are difficult to predict. Therefore, actual results may differ materially from what is expressed, implied or forecasted in such forward-looking statements. In addition to the factors that Prophecy currently believes to be material such as, but not limited to, its ability to obtain adequate working capital, its ability to secure purchase contracts relating to its various operations, the cyclical nature of the industry within which it operates and price fluctuations in the demand and supply of the products it produces, its reliance on joint venture partners, authorized intermediaries, key customers, suppliers and third party service providers, its ability to operate its production facilities on a profitable basis, changes in currency exchange rates and interest rates, evaluation of its provision for income and related taxes and the Mongolian economic, political and social conditions and government policy, as well as other factors, such as general, economic and business conditions and opportunities available to or pursued by Prophecy, which are not currently viewed as material but could cause actual results to differ materially from those described in the forward-looking statements. Although Prophecy has attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors and risks that cause actions, events or results not anticipated, estimated or intended. Accordingly, readers should not place any undue reliance on forward-looking statements as such information may not be appropriate for other purposes.

Prophecy maintains a forward-looking statement database which is reviewed by management on a regular basis to ensure that no material change has occurred with respect to such forecasts. The Company will publicly disclose such material changes to its forward-looking statements as soon as they are known to management.

1. FISCAL YEAR 2010 HIGHLIGHTS AND SIGNIFICANT EVENTS

- In January 2010, the Company appoints Mr. Greg Hall as a Director.

- In February 2010, the Company completed a private placement of an aggregate 6,500,000 units at a price of $0.30 per unit for aggregate gross proceeds to the Company of $1,950,000. Each unit is comprised of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of $0.45 per share during the warrant term. The warrants are subject to forcible conversion within 30 days of delivery of notice from the Company, in the event the shares of the Company close at over $0.65 for 10 consecutive trading days. The units issued under the placement are subject to a hold period that expired on June 18, 2010. Finder's fees of $71,872 were incurred on a portion of the financing.

- In March 2010, the Company completed a private placement of an aggregate 5,463,158 units at a price $0.57 per unit for an aggregate gross proceeds to the Company of $ 3,113,945. Each unit is comprised of one common share and one share purchase warrant. Each share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of $0.71 per share during the warrant term. The warrants are subject to forcible conversion within 30 days of delivery of notice from the Company, in the event the shares of the Company close at $1.06 for 10 consecutive trading days. The units issued under the placement are subject to a hold period that expired on August 1, 2010. Finders' fees of $217,980 and 382,421 warrants, with a fair value of $133,847, exercisable for a period of two years from closing at $0.76 per unit were incurred on a portion of the financing.

- In April 2010, Red Hill Energy completed the arrangement of a friendly transaction to combine with Prophecy Resource Corp. through an all share transaction, and changed its name to Prophecy Resource Corp.

- In April 2010, the Company acquired the following properties:
  - Lynn Lake from Victory Nickel Inc,;
  - Titan Vanadium from Randsburg Gold Corp.;
  - Lynn Gabbros from VMS Ventures Inc.

- In April 2010, the Company completed a private placement, post arrangement, of an aggregate 675,500 units at a price $0.59 per unit for an aggregate gross proceeds to the Company of $ 398,545. Each unit is comprised of one common share and one half of a share purchase warrant. Each share purchase warrant entitles the holder to acquire one additional common share for a price of $0.80 per until April 21, 2012. In the event that the closing price of the Company on the market is at least $1.10 for 20 consecutive trading days at any time following four month from the date of closing, the Company may reduce the remaining exercise period of the warrants to not less than 30 days from the date of providing notice of such reduced exercise period.

1. FISCAL YEAR 2010 HIGHLIGHTS AND SIGNIFICANT EVENTS (CONTINUED)

- In May 2010, the Company completed reciprocal private placement. Prophecy subscribed for 36,615,385 common shares in Victory Nickel at a price of $0.104 per common share for gross proceeds of $3,808,000. In turn, Victory Nickel subscribed for 7,000,000 Prophecy common shares at a price of $0.544 per common share for gross proceeds of $3,808,000. The transaction resulted in Victory Nickel owning a 9.9% interest in Prophecy and Prophecy acquiring a 9.8% interest in Victory Nickel. The Company common shares issued to Victory Nickel were subject to a four month hold period expiring on September 29, 2010.

- In May 2010, the Company appoints Mr. Paul Venter as a Director.

- In August 2010, the Company secured a debt facility of $10,000,000 to advance Ulaan Ovoo project with Waterton Global Value, L.P. ("Waterton"). A total of $300,000 finder's fee was paid to Macquarie Capital Markets Canada Ltd. that acted as the financial advisor to the Company with respect to the loan. In conjunction with the closing of the Loan, the Company issued 1,000,000 common shares to Waterton.

- In September 2010, the Company acquired 100% interest of Wellgreen Property, a nickel-copper and platinum group metals project through the acquisition of Northern Platinum Ltd.

- In October 2010, the Company completed the non-brokered flow through private placement. A total of 3,831,511 flow through units were placed at a price of $0.53 per Unit generating gross proceeds of $2,030,701. Each unit consisted of one flow though common share and one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share at a price of $0.66 until October 28, 2012. All of the securities issued under this placement are subject to a hold period expiring on March 1, 2011. Finder's fees of $114,535 were incurred on a portion of the financing.

- In November 2010, the Company announces receiving of the final permit to commence mining operations at its Ulaan Ovoo coal mining project in Mongolia.

- In November 2010, the Company reports that Detailed Environmental Impact Assessment ("DEIA") pertaining to the construction of a pit-mouth 600MW coal fired power plant by Prophecy's 1.2-billion-tonne Chandgana Coal Project has been approved by the Mongolian Ministry of Nature and the Environment.

- In December 2010, the Company completed a short-form Prospectus public placement of an aggregate 49,475,000 units at a price of $0.85 per unit for aggregate gross proceeds to the Company of $42,053,750 (net $39,000,210). Finders' fees of $3,053,540 and 1,800,000 share purchase warrants with a fair value of $573,300 exercisable for a period of one year from closing at $0.91 per unit were incurred on a portion of financing.

1. FISCAL YEAR 2010 HIGHLIGHTS AND SIGNIFICANT EVENTS (CONTINUED)

- Recorded net loss of $5.77 million, or loss of $0.06 per share.

Subsequent to year-end:

- In January, 2011, the Company and Pacific Coast Nickel Corp. ("PCNC") entered into an agreement whereby PCNC will acquire Prophecy's Nickel PGM projects by issuing common shares to the Company. Pursuant to the Agreement, PCNC will acquire the Wellgreen and Lynn Lake nickel projects by issuing up to 450 million common shares of PCNC to Prophecy. Following completion of the transaction, which is expected in Q2 2011, the Company will own approximately 90% of PCNC (85% fully diluted). PCNC will consolidate its share capital with 10 common shares being converted to 1 common share basis.

  Following the completion of the transaction, the Company expects to change its name to "Prophecy Coal Corp." and PCNC will be renamed as "Prophecy Platinum Corp."

- In March 2011, the Company appoints Mr. Paul Venter as VP Energy Operations, Mr. Christiaan H.B.Van Eeden as VP Mining Operations, Mr. Enkbaatar Ochirbal as VP Mongolia Country Manager, Ms. Irina Plavutska as Interim CFO, Mr. Joseph W. Li as General Manager and Corporate Secretary, and announced the resignation of Mr. Derek Liu as CFO

- In March 2011, the Company has obtained Full Mining License for its 141 million tonne Chandgana Tal Coal deposit in Mongolia.

- In March 2011, the Company has announced that Mr. Chuluunbaatar, President and Chairman of the Monnis Group of Companies, Mongolia ("Monnis") has been appointed to Prophecy's Board of Directors.

- In March 2011, the Company made strategic investment in Compliance Energy Corporation ("CEC") by acquiring 5,000,000 common shares of CEC, representing approximately 8% of CEC's outstanding shares by means of non-brokered private placement. The investment represents the Company's first foray into the metallurgical coal market to complement its coal resources in Mongolia.

- In April 2011, the Company has announced the appointment of Mr. Jivko Savov, Deputy CEO of En+Group, as a non-executive director.

- In April 2011, the Company signed the definitive arrangement agreement with PCNC to sell the Company's Wellgreen and Lynn Lake Nickel projects.

2. BUSINESS OVERVIEW

Prophecy Resource Corp. (formerly – Red Hill Energy Inc.) ("Prophecy" or the "Company") is an internationally diversified company incorporated under the laws of the province of British Columbia, Canada, and engaged in the acquisition, exploration and development of coal properties in Mongolia, nickel, and platinum group metals projects in Canada, specifically in the Yukon Territory and the Provinces of Manitoba, Ontario and British Columbia. The Company is a publicly listed company and its outstanding Common shares are listed for trading on the TSX Venture Exchange ("TSXV") under symbol "PCY", OTC-QX under symbol "PRPCF", and Frankfurt Stock Exchange under symbol "1P2".

The Company's head office is at Suite 2060-777 Hornby Street, Vancouver, BC, V6Z 1T4 and a registered office at Suite 2080-777 Hornby Street, Vancouver, British Columbia, Canada, V6Z 1T4.

2.1 Business Combination between the Company and PHI

On April 16, 2010, the Company completed a plan of arrangement with old Prophecy Resource Corp. (old PCY" or "PHI") and Elissa Resources Ltd. ("Elissa") (the "RH Plan of Arrangement"). As the first step in the RH Plan of Arrangement, the Company transferred $1,000,000 and its non-coal assets, principally the Red Lithium property in Nevada, the Thor Rare Earth property in Nevada and the Banbury property in British Columbia, to Elissa Resources Ltd. in exchange for the issuance Elissa common shares to shareholders of the Company.

The Company then created a new class of common share, being the currently outstanding common shares of the Company. Each one old common share of the Company was exchanged for 0.92 new common shares of the Company and 0.25 Elissa common shares, and each common share of old PCY was exchanged for one new common share of the Company. In addition, each stock option and warrant of the Company was amended to entitle the holder to receive 0.92 common shares and each old PCY stock option or warrant was exchanged for an option or warrant to acquire one common share. The common shares of PHI were voluntarily delisted from the Toronto Stock Exchange, and PHI became a wholly owned subsidiary of the Company.

Following the RH Plan of Arrangement, the Company changed its name to "Prophecy Resource Corp." A total of 36,178,285 common shares, 3,500,000 options, and 11,336,109 warrants were issued to replace the old common shares, options, and warrants of PHI on a one-to-one basis.

(Expressed in Canadian dollars)

2. BUSINESS OVERVIEW (CONTINUED)

The preliminary allocation of the consideration given and net assets received of this transaction is summarized as follows:

Fair value of common shares issued	27,495,497
Fair value of replacement options and warrants	73,404
Transation costs	174,999
Purchase Price	**$27,743,900**
Cash and cash equivalents	$4,213,364
Receivables	24,565
Reclamation deposit	6,500
Mineral properties	30,935,357
Accounts payable and accrued liabilities	(591,823)
Future income tax liabilities	(6,844,063)
Net assets acquired	**$27,743,900**

2.2 Acquisition of Northern Platinum Ltd. And Consolidation of Ownership of Wellgreen Property

On September 23, 2010, the Company acquired all of the issued and outstanding securities of Northern Platinum Ltd. ("Northern") pursuant to a court approved statutory plan of arrangement under the Business Company Act (British Columbia) involving the Company, Northern and its security holders (the "Northern Transaction"). Northern amalgamated with a wholly owned subsidiary of Prophecy and all of the security holders of Northern exchanged their Northern securities for securities of the Company.

For each one share of Northern held, a Northern shareholder received 0.50 of a common share of the Company and 0.10 of a warrant (an "Arrangement Warrant") of the Company. Pursuant to the Arrangement, Northern then issued to all of its shareholders an option to acquire 0.20 of a Northern share at a price of $0.40 per share for a period of 18 months (a "Northern Arrangement Option") and each Northern Arrangement Option was exchanged for 0.50 of an Arrangement Warrant of the Company. Each whole Arrangement Warrant entitles the holder to acquire one additional common share of the Company at an exercise price of $0.80 per share until March 23, 2012.

Holders of convertible securities of Northern received convertible securities of the Company such that each former Northern security was exchanged for convertible securities of the Company exercisable for that number of shares that is equal to the number of Northern Shares that would otherwise have been issuable hereunder multiplied by 0.50 with the exercise price of such convertible security of the Company being adjusted to equal the exercise price of the applicable Northern convertible security divided by 0.50..

Northern became a wholly owned subsidiary of the Company and its common shares were delisted from the TSX Venture Exchange. Upon closing the Arrangement, the Company issued a total of 13,874,819 shares, 1.3 million options, and 6,007,090 warrants to replace the common shares, options and warrants of Northern.

(Expressed in Canadian dollars)

2. BUSINESS OVERVIEW (CONTINUED)

The Company also issued a total of 495,996 common shares to O&M Partners Inc. as finder's fees for this transaction. The preliminary allocation of the consideration given and net assets received of this transaction is summarized as follows:

Fair value of common shares issued	6,937,410
Fair value of replacement options and warrants	448,253
Transation costs	263,937
Purchase Price	**$7,649,600**
Cash and cash equivalents	$1,075
Receivables	112,047
Mineral properties	9,853,625
Accounts payable and accrued liabilities	(614,845)
Future income tax liabilities	(1,702,302)
Net assets acquired	**$7,649,600**

In connection with the Northern Transaction, the Company signed a definitive agreement dated June 4, 2010 with Belleterre Quebec Mines Ltd. of Quebec, Canada ("Belleterre") to acquire its 50% back-in right ("Back-in") on Northern's Wellgreen project. As consideration for the Back-In, the Company paid $2.1 million cash and issued 3.56 million common shares to Belleterre. Additionally, the Company issued 712,000 warrants to Belleterre. The warrants issued to Belleterre expire on October 8, 2011 and have an exercise price of $0.80.

2.3 Resource Properties

The Company resource properties are include: Ulaan Ovoo coal (Mongolia), Chandgana Khavtgai and Chandgana Tal coal (Mongolia), Wellgreen nickel (Yukon, Canada), Lynn Lake nickel (Manitoba, Canada), Okeover copper-molybdenum (British Columbia, Canada), and Titan vanadium/iron (Ontario, Canada).

Ulaan Ovoo Coal Property

The Company announced on August 26, 2010 that Leighton Asia Limited ("Leighton") has established the required infrastructure and deployed all necessary equipment and manpower (on schedule) to execute the mining operations at the Ulaan Ovoo property.

In October 2010, the Company provided 10,000 tonnes of coal as a trial run to power stations in Darkhan and Erdenet, Mongolia's largest cities behind its capital Ulaanbaatar.

2. BUSINESS OVERVIEW (CONTINUED)

On November 9, 2010, the Company received the final permit to commence mining operations at Ulaan Ovoo.

In December 2010, at the Ministry's request, the Company commenced preproduction mining and trucked coal shipments to Sukhbaatar rail station, ready to be transported to Darkhan power plant.

During the year ended December 2010, the Company incurred development expenditures of approximately $9,4 million at Ulaan Ovoo and exercised an option to acquire the 2% net smelter returns royalty on Ulaan Ovoo by cash payment of US$130,000 and issuance 2.0 million shares of the Company.

Operation Statistics: By March 31, 2011, Leighton has removed and stockpiled approximately 1,289,300 BCM of topsoil and overburden thereby accessing some 333,760 tons of in-situ coal ready to be mined. The Company is working with Leighton to optimize mine plans for 2011 and on an incurred cost basis.

Having secured a rail siding at Sukhbaatar covering an area of 23,770 sq meters, the Company has commenced the trucking of domestic quality coal from Ulaan Ovoo to the Sukhbaatar railway siding.

Equipment: In January 2011, the Company purchased its entire auxiliary equipment and mining fleet on site consisting of one CAT 385C Excavator, one CAT D8R Dozer, 3 three Cat 773D Dump trucks, one CAT 160 H Grader, and one CAT 928G Loader plus additional miscellaneous equipment. This purchase has eliminated the high costs associated with equipment leasing and rental.
In addition to the on-site equipment buyout, Prophecy has ordered the following mining and transport units with delivery dates between March and June of 2011.

1 (one) CAT 390 Excavator,
3 (three) CAT 773D Dump Trucks
1 (one) CAT D8R Dozer and
1 (one) CAT 160K Grader
18 (eighteen) Scania 32m30t Tipper trucks,
2 (two) Liebherr 580 Loaders and
2 (two) by Nissan Water Trucks (for purpose of road maintenance).

The purchase of Scania trucks will enable Prophecy to more efficiently schedule coal deliveries and eliminates costly contract trucking. With the combined equipment purchases, Prophecy expects to reach production rate of 1 million tonne per year exit 2011.

(Expressed in Canadian dollars)

2. BUSINESS OVERVIEW (CONTINUED)

Manpower: The current labour force can be categorised as follows:

	Expats	Mongolian	Description
Prophecy	3	3	Mine and transport managers, geologist, transaltor, driver
Leighton	2	9	Mining and camp staff and managers
Wagner	-	11	Machine operators and mechanics
Contractors	-	26	Camp staff, security, and water truck operator
Total	5	49	

Bridge Construction: The concrete bridges that will replace all existing wooden bridges along the haul road have been completed and the bridge upgrade enhances the trucking of coal from the mine site to Sukhbaatar.

Zheltura Border Opening: The Company has been informed that Russian and Mongolian governments have agreed to re-open the Zheltura border crossing on a permanent basis. Zheltura port is 10km by road from Ulaan Ovoo mine site and could present significant reduction on the transportation cost. The exact timing of the border opening is not known at this time.

Infrastructure: The workshop, office complex and mine camp with facilities for 80 people on site have been erected and the area is fenced off for security and safety purposes.

Coal Off Take/Sales Agreement: Prophecy is in active discussion with several International and Russian coal customers. The priority is to export first shipment of 10,000-30,000 tons of quality 5,000+ kcal/kg coal through the Sukhbaatar rail station into Russia. Successful execution of this trial shipment will pave the way for rail coal deliveries to the Russian Eastern Ports to fulfill potential off-takes agreements.

Wardrop Prefeasibility Study: On December 16, 2010, the Company has received an updated independent NI 43-101 technical report on the prefeasibility study on the Ulaan Ovoo. The report is authored by Brian Saul, P.Eng., and Steve Krajewski, Ed. D., P.G. of Wardrop Engineering Inc., a Tetra Tech Company, both independent Qualified Persons. The focus of this study was for the development of low ash coal reserves in the form of a starter pit. Considerable work has been completed on the starter pit design, identification of market opportunities and transportation costs since the Pre Feasibility Study was issued by Minarco in May 2009. The study is filed and available on SEDAR.

2. BUSINESS OVERVIEW (CONTINUED)

Reserve and Throughput:

The recommendation is for the coal deposit to be mined by open pit methods. Leighton, a mining contractor is to mine 250,000 tonnes (t) of product coal in 2010, 520,000t of product coal in 2011 and million tonnes per year thereafter.

The estimated reserve is shown in the table below:

Estimated Reserve Tonnages

Coal reserve statement description	Amount
Low ash product coal, (kt)	20,274
Waste, (kt)	83,854
Waste, (kBCM)	37,268
Total, (kt)	105,298
Stripping ratio, (BCM:t)	1.8
Ash Content, (%)	11.3
Calorific Value, (kcal/kg)	5,040
Moisture, (%)	21.7
Mine Life, (years)	10.7
Process rate, (kt/annum)	2,000

All coal quality values are stated on an "as received" basis. The total mineral reserve estimate is 20.7 M proven t (Mt) of product (low ash) coal. Mineral reserve estimate considers only the first phase of the project development of the Mineral resources contained in the Ulaan Ovoo project. Opportunity may exist for extension of additional low ash reserves to the south with an expanded pit and a higher throughput rate.

Costs estimates for mining and transport of coal to the Russian border expressed in US$ per tonne are as follows: $8 - mining, $12 - trucking, $35 - rail transportation, $15 - port expense.

The sustaining capital of the project is estimated at $18.5 million. Since July 2010, substantial road transport and site infrastructure development has been completed. This includes a workshop, clinic, housing for 60 staff, and road and bridge upgrade.

Chandgana Khavtgai and Tal Coal Property

The Company has received a full mining license from the Mineral Resources Authority of Mongolia for the Chandgana Tal ("Tal") Deposit in Mongolia. Tal contains 141 million tonnes of measured coal and is located 9 kms north of Prophecy's Chandgana Khavtgai project.

The Company intends to convert Chandgana Khavtgai's project (over 1 billion tonnes Measured/Indicated coal) exploration license to a mining license in 2011.

(Expressed in Canadian dollars)

2. BUSINESS OVERVIEW (CONTINUED)

An updated independent NI 43-101 technical report on the Chandgana Khavtgai property dated September 28, 2010 was completed by Christopher Kravits, LPG, CPG of Kravits Geological Services LLC. (the "Khavtgai Report"), and is filed on SEDAR herewith. The Khavtgai Report updates the previous independent technical report on the Chandgana Khavtgai property prepared by Mr. Kravits dated January 9, 2008, which was also filed on the SEDAR system. The Kravits Report included an update of resources as reported in his January 9, 2008 report.

Details of the Chandgana Coal Projects are summarized in the following table:

	Measured, mt	Indicated, mt	Heating Value, kcal/kg	Ash, %	Sulfur, %	Strip Ratio	Thickness, m	License Status
Khavtgai	509.3	545.7	4,354.00	12.66	0.72	1.9 : 1	37.7	Exploration
Tal	141.3		4,238.00	12.49	0.68	0.53 : 1	45.4	Mining
Total	650.6	545.7						

During the year ended December 31, 2010, the Company incurred a total of $52,195 and $913,798 exploration and development expenditures at Chandgana Tal and Khavtgai Properties, respectively.

On November 15, 2010, the Company reported that a Detailed Environmental Impact Assessment (DEIA) pertaining to the construction of a pit-mouth 600MW coal fired power plant by Prophecy's 1.2-billion-tonne Chandgana Coal Project has been approved by the Mongolian Ministry of Nature and the Environment.

Tal will be the starter pit and supply an estimated 2.4 million tonnes per year of coal to the Power Plant Project. Khavtgai will supplement mine production in later years. The Power Plant Project is next to a paved road and within 160 km of the Central Mongolian Railroad, which can facilitate transport of construction equipment. The Project is adjacent to a 45kv electrical distribution line and within 150km from a 2x220kv electrical transmission line.

Further to receiving mining license and environmental approval on the Power Plant Project, the Company has announced that a 170 page Mongolian Power Plant Project Feasibility Study has been completed, and will be released in May 2011 and posted on Sedar.

On April 21, 2011, the Company announced that the formal request to build the Chandgana Power Plant has been submitted to the Ministry of Natural Resources and Energy of Mongolia.

2. BUSINESS OVERVIEW (CONTINUED)

Wellgreen Nickel Property

The Wellgreen property is a platinum group metal (PGM)-rich, nickel (Ni)-copper (Cu) project located in the south-western Yukon Territory. On July 26, 2010, the Company has received a positive independent NI 43-101 technical report from Wardrop Engineering, a Tetra Tech Company, stated that the potential within the Quill Creek Ultramafic intrusion on the Wellgreen property is in the range of 77 to 254 million tonnes at 0.26 to 0.38% nickel, 0.26 to 0.36% copper, 0.32 to 0.47 g/t platinum and 0.23 to 0.38 g/t palladium based on the assumption of a specific gravity of 3.22, strike length of 4000 to 7000 metres, depth of 200 to 250 metres and a width of 30 to 35 metres. The report is authored by, Todd McCracken, P.Geo., an independent Qualified Person.

On September 27, 2010, the Company announced commencing of drilling at Wellgreen. The Company retained key operations personnel from Northern Platinum and the Wellgreen program is now being managed by Prophecy. Mr. John McGoran, P. Geo., a former Northern Platinum Director has recently been appointed Director of Prophecy Resource Corp. Subsequent to the closing the acquisition of Northern, the Company commenced 1,000 metres of step-out surface drilling on 200 metre spacing beyond known mineralization. The Corporation is in the process of assaying and reporting 2,112 metres of drill core from Northern's 2010, 6-hole drill program. That drill program focused on expanding the eastern limit of the Wellgreen property. The results from this program include 496.06 meter intercept of 0.596 g/t platinum, palladium and rhodium +Au, 0.27% nickel, 0.18% copper, 0.02% cobalt (hole 177) that collared in mineralization at surface.

Subsequent to the Corporation's report on results of two of six drill holes, Prophecy intercepted encouraging mineralization at Wellgreen and scheduled to start drilling in April 2011. Prophecy is currently completing a compilation on over 45 years of surface and underground drilling data, geophysical and geological work on the property. Dr. John Morganti, P. Geo., Adviser to Prophecy, is guiding the long-term focus of the project. Further drilling is scheduled for 2011.

During the year ended December 31, 2010, the Company incurred a total of $397,808 exploration costs.

Lynn Lake Nickel Property

From an updated resource estimate released in February 2010 by Prophecy Resource Corp, Lynn Lake has 22.9 million tons of measured and indicated resources grading 0.57% nickel or 263 million pounds of in-situ nickel as well as 8.1 million tons inferred resources grading 0.51% nickel which contains an additional 81.6 million pounds of in-situ nickel. In addition, it announced the resource contained measured and indicated resources grading 0.30% copper or 136 million pounds of in-situ copper plus inferred resources grading 0.28% copper or 45.6 million pounds of in-situ copper.

As discussed earlier and described in Note 7 (d) to the 2010 Audited Financial Statements, Lynn Lake was acquired through the amalgamation between the Company and PHI. Upon closing of the amalgamation, a total of approximately $29.4 million was capitalized as the acquisition cost of Lynn Lake. During the twelve months ended December 31, 2010, the Company incurred a total of flow through expenditures of $812,916 at Lynn Lake.

2. BUSINESS OVERVIEW (CONTINUED)

Subsequent to acquisition, the Company commenced a 3,300 metre drilling program at Lynn Lake. The drilling program was designed to test newly discovered targets from its recently completed Induced Polarization (IP) survey. Five new target areas have been delineated using a proprietary deep-seeking IP-method that penetrates to depths that were previously unexplored through VTEM.

Results from the program led to the discovery of a new mineralized zone called "Tango". Three holes in the Tango intercepted 17.3meters of 0.60% nickel and 0.30% copper (RCY10-02), four meters of 0.40 nickel and 0.20% copper (RCY 10-03), and 10 meters of 0.40% nickel and 0.20% copper (PCY 10-05). Three of the five target areas remain untested.

In February 2011, the Company has received preliminary results from its ongoing metallurgical study on the amenability of its Lynn Lake resource to the bioleach process conducted by Mintek in South Africa and overseen by Andy Carter, Manager of Metallurgical Engineering for Wardrop Engineering Inc., a Tetra Tech Company. Key findings of the results to date show that nickel recoveries in excess of 95% can be achieved using only a moderate grind and leach temperature, whereas high copper recoveries generally require finer grinding and higher temperatures. Further optimization tests are underway, and the Company expects to receive a final report in June 2011.

Okeover Property

The 60% interest of Okeover, a copper-molybdenum project in the Vancouver Mining Division of south-western British Columbia, Canada, 25 kilometres north of Powell River and 145 kilometres northwest of Vancouver, was acquired through the amalgamation between Red Hill and Prophecy Holding in April 2010. At December 31, 2010, the Ministry of Energy Mines and Petroleum Resources of British Columbia hold a $6,500 deposit on reclamation bond from the Company to guarantee reclamation of the environment on the Okeover Property. Upon completion of the amalgamation in April 2010, a total of $1,222,119 was capitalized as the acquisition costs of Okeover. Subsequent to amalgamation, a total of $80,738 flow-through expenditures were incurred at Okeover

Titan Vanadium Iron Property

The Corporation commenced an exploration program on its Titan Van804adium Iron Project ("Titan"). The program comprises 22 line kilometres of line cutting covering over 2.7 square km in 100 m intervals that will extend the current surveyed grid west and southwest of the Titan property. A ground magnetometer survey was completed during the summer of 2010, the results of which expanded the extant of the magnetic anomaly associated with Titan Deposit, successfully demonstrating exploration potential outside of the know inferred resource.

During the twelve months ended December 31, 2010, a total of $64,630 exploration expenditures incurred at Titan.

2. BUSINESS OVERVIEW (CONTINUED)

Red Lithium, ThorRee, and Banbury Properties

Under the plan of Arrangement between the Company and PHI, the Red Lithium, ThorRee, and Banbury Properties were transferred, at cost, before the closing of the Arrangement, to Elissa Resource Ltd., ("Elissa") in exchange for Elissa's common shares, which was distributed to the shareholders of the Company as dividend distribution.

(Expressed in Canadian dollars)

Summary of Mineral Properties

	Ulaan Ovoo	Chandgana Tal	Chandgana Khavtgai	Lynn Lake	Okeover, Kanichee	Titan	Wellgreen	Uranium	Red Lithium	ThorRee	Banbury	Total
Notes	7(a)	7(b)	7(c)	7(d)	7(e)	7(f)	7(g)	7(h)	7(i)	7(i)	7(i)	
Balance, December 31, 2008	$ 12,619,128	$ 1,279,337	$ 1,144,830	$ -	$ -	$ -	$ -	$ 74,844	$ -	$ -	$ 1	$ 15,118,140
Acquisition cost	-	-	-	-	-	-	-	-	290,000	155,000	-	445,000
Deferred exploration costs:												
Licenses, leases, & Power Plant Application	28,710	2,907	13,258					10,599	27,460	31,635		114,569
Geological core, engineering, & consulting	276,445		17,335						18,995	2,545		315,320
Drilling	25,153								3,152			28,305
Transportation and shipping	1,891		98									1,989
Road and bridge construction												-
Mine Development												
Personnel												
Camp and general	(1,110)		(3,179)									(4,289)
	331,089	2,907	27,512	-	-	-	-	10,599	49,607	34,180	-	455,894
Impairment charges	-	-	-	-	-	-	-	(85,443)	-	-	-	(85,443)
Balance, December 31, 2009	$ 12,950,217	$ 1,282,244	$ 1,172,342	$ -	$ -	$ -	$ -	$ -	$ 339,607	$ 189,180	$ 1	$ 15,933,591
Acquisition cost	1,570,000		-	29,805,964	1,246,890	307,274	14,172,024					47,102,152
Deferred exploration costs												-
Licenses, leases, and Power Plant Application	35,460	1,450	322,305	6,395			31,912					397,523
Geological core, engineering, and consulting	1,031,479	15,091	191,722	331,356	80,738	64,630	251,062			81,458		2,047,536
Drilling	25,129		267,080	419,402			49,876					761,487
Transportation and shipping	522,346											522,346
Road and bridge construction	2,925,587											2,925,587
Mine Development	4,671,075											4,671,075
Personnel	116,097	1,502	19,948				33,333					170,880
Camp and general	328,577	34,153	112,743	55,763			31,625					562,861
	9,655,750	52,195	913,798	812,917	80,738	64,630	397,809	-	-	81,458	-	12,059,295
Recovery	(107,614)										-	107,614
Disposal	-	-	-	-	-	-	-	-	(339,607)	(270,638)	(1)	(610,246)
Balance, December 31, 2010	**$ 24,068,353**	**$ 1,334,439**	**$ 2,086,140**	**$ 30,618,881**	**$ 1,327,628**	**$ 371,904**	**$ 14,569,833**	**$ -**	**$ -**	**$ -**	**$ -**	**$ 74,377,177**

(Expressed in Canadian dollars)

2. BUSINESS OVERVIEW (CONTINUED)

2.4 Secured Credit Facility

On September 1, 2010, the Company arranged a secured debt facility of up to $10 million (the "Loan"). Subject to certain drawdown conditions, the Loan may be drawn down in three tranches as follows:
(a) $2 million on the closing date, which occurred as at September 1, 2010; (b) $3 million, which occurred as at October 8, 2010; and (c) $5 million at such time as the Company completes an off-take agreement for the Ulaan Ovoo property. The majority of the proceeds of the Loan drawn to date have been used towards the further development of the Ulaan Ovoo Property.

The Loan was due by August 31, 2011 and bore interest at 10% per annum. A structuring fee of $50,000 and 1% of the third tranche (if drawn down) was payable in cash. In conjunction with the closing of the Loan, the Company issued 1,000,000 common shares to Waterton. In the event that the third tranche of the Loan is drawn, the Company shall issue a further 1,000,000 common shares to Waterton. The initial 1,000,000 shares issuable to Waterton were subject to a four month hold period ending on January 2, 2011.

On January 11, 2011 the Company fully repaid of the outstanding loan plus applicable fees pursuant to the Credit Agreement and has been provided with a release/discharge of securities.

3. RESULTS OF OPERATIONS

3.1 Selected Annual Information

The following table sets out highlights of the Company's financial results together with selected balance sheet information for the years ended December 31, 2010, 2009, and 2008.

	Years ended December 31, 2010	2009	2008
Current assets	$ 39,821,590	$ 142,240	$ 1,414,811
Other assets	77,770,768	16,018,368	15,203,062
Liabilities	(15,991,941)	(52,105)	(85,517)
Shareholder equities	(101,600,417)	(16,108,503)	(16,532,356)
Expenses	(4,635,612)	(1,822,332)	(1,718,329)
Other income and expenses	(1,136,229)	(80,953)	(681,589)
Loss for the year	(5,771,841)	(1,903,285)	(2,399,918)
Loss per share	(0.06)	(0.04)	(0.05)
Dividend	$ -	$ -	$ -

(Expressed in Canadian dollars)

3. RESULTS OF OPERATIONS (CONTINUED)

3.1 Summary of Quarterly Results

				Quarters ended
	31-Dec-10	30-Sep-10	30-Jun-10	31-Mar-10
Expenses	$ (482,933)	$ (2,132,058)	$ (1,646,450)	$ (397,897)
Other income and expenses	(1,072,597)	(43,302)	2,106	1,290
Loss for the period	$ (1,555,530)	$ (2,175,360)	$ (1,644,344)	$ (396,607)
Loss per share	(0.02)	(0.02)	(0.02)	(0.01)

				Quarters ended
	31-Dec-09	30-Sep-09	30-Jun-09	31-Mar-09
Expenses	$ (340,801)	$ 181,571	$ (286,783)	$ (1,376,319)
Other income and expenses	(11,215)	(60,676)	(1,595.00)	(7,467.00)
Loss for the period	$ (352,016)	$ 120,895	$ (288,378)	$ (1,383,786)
Loss per share	(0.01)	-	(0.01)	(0.02)

The expenses incurred by the Company are typical of an exploration company in the mining industry that has not yet generated significant revenue. The Company's fluctuations in expenditures from quarter to quarter are mainly related to exploration activities conducted during the respective quarter.

The fluctuation of other income and expenses from quarter to quarter is mainly attributed to interest income which fluctuates along with changes of interest rates and the balance of cash and cash equivalent, interest expense on loans payable, as well as the timing to recognize any gain or loss on the disposal of plant and equipment and written off mineral properties.

4. PERFORMANCE SUMMARY

4.1 Three months ended December 31, 2010("Q4 2010")

The Company's accounting policy is to capitalize its mineral properties at cost. Exploration and development expenditures relating to mineral properties are deferred until either the properties are brought into production, at which time they are amortized on a unit of production bases, or until the properties are sol or abandoned, at which time the deferred costs are written off.

The Company has not paid any dividends on its common shares. The Company has no present intention of paying dividends on these common shares, as it anticipates any excess funds will be invested to finance the growth of its business.

Net loss for Q4 2010 was $1,555,530 compared to net loss of $352,016 recorded in the same quarter last year. The increase of loss in Q4 2010 was mainly due to an increase of interest expense of $1,095,173 (from $nil recorded in the same quarter last year).

4. PERFORMANCE SUMMARY (CONTINUED)

In Q4 2010, the Company has reclassified consulting and admin and general expenses incurred in Red Hill Mongolia LLC and Chandgana LLC for the year 2010 to the deferred exploration costs for Ulaan Ovoo and Chandgana projects accordingly. Stock based compensation expense consists of expenses aroused from the options granted to employees, directors, consultants, and investor relations consultants.

Consulting and management fees for Q4 2010 were $250,028, an increase of $150,091, compared to the consulting and management fee of $99,937 in the same period last year. Most senior management and advisors of the Company are on a consultant basis, and the increase of consulting and management fee is mainly due to the increasing activities from those senior management and advisors after the acquisition of Northern Platinum Ltd.

Director fees for Q4 2010 were $nil compared to a recovery of $161,867 recorded in the same quarter last year. Director fees are stock based compensation expenses arising from options granted to directors. It will fluctuate from time to time depending on the fair value of options granted and the timing to amortize the fair value of options granted. No cash was paid to directors in their capacity as directors.

Professional fees for Q4 2010 were $151,851, an increase of $102,930, compared to the professional fee of $48,921 in the same quarter last year. Professional fees consist of auditing, legal, and accounting services. The increase is mainly due to the professional fees related to the acquisition of Northern Platinum Ltd.

Stock exchange and shareholder services for Q4 2010 were $48,386, an increase of $45,060, compared to $3,326 recorded in the same quarter last year. Stock exchange and shareholder services include regulatory filing fee, transfer agent service fees, and news wires services fee which fluctuate along with the volume of those services.

Advertising and promotion for Q4 2010 was $245,311, an increase of $246,670, compared to a recovery of $1,358 advertising and promotion expenses recorded in the same quarter last year, as the Company participated in more investor relations events during the year. Advertising and promotion expenses include conferences, trade shows, and media and web advertising, to improve the communication with investors.

Office and administration for Q4 2010 was $9,595, a decrease of $15,465, compared to the $25,060 office and administration expenses recorded in the same quarter last year.

Travel and accommodation for Q4 2010 was $89,993, an increase of $77,033 compared to $12,960 travel and accommodation expenses recorded in the same quarter last year and the increase was mainly due to increased travel by management and staff to participate in conferences and meetings with financial institutions as well as to supervise operating activities in Mongolia.

Foreign exchange gain for Q4 2010 was $23,726 while a loss of $38,859 was recorded in the same quarter last year. Foreign exchange gain/loss was mainly a result of the unrealized loss (gain) arising from the translation of Mongolian Tugriks and US Dollars denominated monetary items in the Company's integrated operations defined by Canadian GAAP.

Salary and benefits expense for Q4 2010 was $47,176, compared to the $46,478 salary and benefit expenses recorded in the same quarter last year. The Company has one Director on salary and four employees.

4. PERFORMANCE SUMMARY (CONTINUED)

4.1 Year ended December 31, 2010

Net loss for the year ended December 31, 2010 was $5,771,841, or $0.06 per share, compared to loss of $1,903,285, or $0.04 per share recorded in the same period last year. The increase was mainly due to the increasing management and consulting activities after the amalgamation with PHI in April 2010 and acquisition of Northern Platinum in September 2010.

Consulting and management fees for the year ended December 31, 2010 were $1,278,392, an increase of $870,432, compared to the consulting and management fee of $407,960 in the same period last year. Most senior management and advisors of the Company are on a consultant basis, and the increase of consulting and management fees is mainly due to the increasing activities from those senior management and advisors after the amalgamation with PHI in April 2010 and acquisition of Northern Platinum in September 2010.

Director fees for the year ended December 31, 2010 were $nil compared to $27,878 recorded in the same period last year. Director fees are non-cash stock based compensation expense arising from options granted to directors. It will fluctuate from time to time depending on the fair value of options granted and the timing to amortize the fair value of options granted. No cash was paid to directors in their capacity as directors.

Professional fees for the year ended December 31, 2010 were $447,512, an increase of $357,653, compared to the professional fee of $89.859 in the same period last year. Professional fees consist of auditing, legal, and accounting services. The increase is mainly due to the professional fees related to the amalgamation with PHI and acquisition of Northern Platinum Ltd

Stock exchange and shareholder services for the year ended December 31, 2010 were $254,658, an increase of $208,839, compared to $45,819 recorded in the same period last year. Stock exchange and shareholder services including regulatory filing fee, transfer agent service fees, and news wires services fee which fluctuate along with the volume of those services.

Advertising and promotion for the year ended December 31, 2010 was $693,778, an increase of $583,614, compared to $110,164 advertising and promotion expenses recorded in the same period last year. Advertising and promotion expenses mainly related to investor relation activities, such as, trade shows, media and web advertising, and investor conferences attended by the Company in North America, Asia, and Europe. The Company also sponsors a children's charity in Mongolia.

Office and administration for the year ended December 31, 2010 was $196,958, an increase of $72,757, compared to the $124,201 office and administration expenses recorded for the last year and the increase was mainly due to the increasing administration activities after the amalgamation with PHI and acquisition of Northern Platinum.

Travel and accommodation for the year ended December 31, 2010 was $367,511, an increase of $233,408, compared to $134,103 travel and accommodation expenses recorded in the same period last year and the increase was mainly due to increased travel by management and staff to participate in conferences and meetings with financial institutions. Travel expenses include flights, accommodation, and auto expenses.

4. PERFORMANCE SUMMARY (CONTINUED)

Foreign exchange gain for the year ended December 31, 2010 was $23,726 while a loss of $25,837 was recorded in the same period last year. Foreign exchange gain or loss was mainly the effect on translation of the operation results of foreign subsidiaries.

Salary and benefits for the year ended December 31, 2010 were $252,703, an increase of $21,834, compared to the $230,869 salary and benefit expenses recorded in the same period last year. The decrease was mainly due to a stock based compensation expenses arising from the options granted to employees

5. LIQUIDITY AND CAPITAL RESOURCES

At present, the Company's ability to continue as a going concern is dependent upon its ability to obtain necessary financing to complete the development of its projects, and future profitable production from, or the proceeds from dispositions of its energy resource, nickel and platinum projects. Although the Company has been successful in the past in obtaining financing, there is no assurance that it will be able to obtain adequate financing in the future or that the terms of such financing will be favourable. The timing and ability to fulfill this objective will depend on the liquidity of the financial markets as well as the willingness of investors to finance exploration companies in the mining industry. The Company will need to access additional financing to raise funds to maintain its on-going operation and to facilitate its desired expansion in the near term.

In August 2010, the Company arranged the Loan with Waterton. As of December 31, 2010, the Company has drowned down a total of $5 million from the debt facility. In January 2011, the Company fully repaid of the outstanding loan plus applicable fees pursuant to the Credit Agreement and has been provided with a release/discharge of securities.

During the year ended December 31, 2010, the Company has completed a series of non-brokered private placements and raised cash of over $42,053,750 and had cash and cash equivalents of $39,324,151 as at December 31, 2010. The Company is continuously looking at and considering financing options and believes its current capital resources are enough to fund its ongoing activities for the next twelve months, and that if additional funding is required, the Company will be able to raise additional funds through financings to meet its operating needs.

5.1 Working Capital

As at December 31, 2010, the Company had working capital of $35,811,690 (December 31, 2009 - $90,135). The significant increase in 2010 working capital is primarily due to the proceeds from private placements and short-form prospectus offering completed in December 2010, and comprised mainly of cash and cash equivalents of $39,324,151 (2009 - $139,312), receivables and deposits of $414,926 (2009 - $2,928) and prepaids of $82,513 (2009 - $nil) offset by current liabilities of $7,305,285 (2009 - $52,105).

As at the date of this report, the Company's working capital is approximately $18.7 million.

5. LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

5.1 Cash Flows Fiscal 2010 and 2009

Cash and cash equivalent as at December 31, 2010 increased by $39,184,839 to $39,324,151 from $139,312 as at December 31, 2009 as a result of: cash used in operating activities of $4,346,007, cash used in investing activities of $11,869,579, and cash provided by financing activities of $55,401,381.

Operating activities: During the year ended December 31, 2010, cash used in operating activities was $4,346,007 (2009 – was $1,201,522). The increase in cash used in operating activities was mainly due to increase of administration, management, and consulting activities after the amalgamation with PHI and acquisition of Northern Platinum.

Investing activities: During the year ended December 31, 2010, $11,869,579 cash (same period last year - $657,195) was used in investing activities, of which $12,247,891 was related to the acquisition, exploration and development expenditures incurred at the Company's mineral properties offset by the cash of $4,214,439 received upon the acquisition of PHI and Northern. $6,850 (2009 - $nil) was received on reclamation bond, $3,808,000 (2009 - $nil) was invested in the common shares of Victory Nickel Ltd., and $34,976 (2009 - $22,816) was used to purchase property and equipment.

Financing activities: During the year ended December 31, 2010, a total of $55,401,381 (same period last year - $613,800) cash was generated from financing activities, of which $3,939,445 was received from a loan (same period last year - $nil), $52,461,936 was received from share issuances, and $1,000,000 (same period last year - nil) was distributed to shareholders as part of the spin-off of assets to Elissa.

5.2 General Contractual Commitments

a) Commitment related to Lynn Lake property

On October 20, 2009, Prophecy Holding entered into an option agreement with Victory Nickel. Pursuant to the option agreement, Prophecy has the right to earn a 100% interest in Lynn Lake by paying Victory Nickel an aggregate of $4,000,000 over a four-year period, incurring an aggregate of $3,000,000 exploration expenditures at Lynn Lake over a three-year period, and issuance of 2,419,548 shares to Victory Nickel (issued). The option agreement also provided Victory Nickel with a right to participate in future financings or acquisitions on a prorated basis so that Victory Nickel may maintain its 10% interest in the number of outstanding shares of the Company.

5. LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

Pursuant to the option agreement, the schedule of cash paid or payable to Victory Nickel is as follows:

i) $300,000 within five business days after the approval from the Toronto Stock Venture Exchange (paid);
ii) $300,000 on January 9, 2010 (paid);
iii) $400,000 within 180 days of the option agreement (paid);
iv) $1,000,000 on or before March 1, 2011 (paid);
v) $1,000,000 on or before March 1, 2012; and,
vi) $1,000,000 on or before March 1, 2013.

The schedule of expenditures to be incurred at Lynn Lake is as follows:

i) $500,000 on or before November 1, 2010 (incurred);
ii) an aggregate of $1,500,000 on or before November 1, 2011; and,
iii) an aggregate of $3,000,000 on or before November 1, 2012.

b) Commitment related to Wellgreen property

Conditional upon closing of the takeover of Northern, the Company entered into a Back-In Assignment Agreement ("Assignment Agreement') with Belleterre Quebec Mines ("Belleterre"), a private company controlled by a Northern shareholder and former director. Pursuant to the Assignment Agreement, Belleterre assigns its rights, title, and interest in and to the Back-In Agreement to Prophecy for consideration of $4,200,000 payable as follows:

i) $2,100,000 in cash; and,
ii) $2,100,000 payable through issuance of 3,560,000 shares and 712,000 warrants of Prophecy. Each warrant will entitle the holder to exercise one share of Prophecy at $0.80 within a period of one year.

Pursuant to the Back-In Agreement, Belleterre was granted a back-in right to a 50% interest in Wellgreen at any time up to and including completion of a positive feasibility study at Wellgreen by paying to Northern, at the time of backing-in, 50% of the amount of expenditures incurred by Northern at Wellgreen.

In October 2010, the Company paid $2,100,000, issued the 3,560,000 shares and 712,000 warrants to Belleterre to acquire the back-in right and, as a result, the Company has acquired a 100% interest in Wellgreen.

6. RELATED PARTY TRANSACTIONS

Related party transactions not disclosed elsewhere in the financial statements are as follows:

a) During the year ended December 31, 2010, the Company paid $134,440 (year ended December 31, 2009 - $106,325), respectively, to Armada Investments Ltd, a private company controlled by a common director of the Company, for office rent, accounting, and management services provided;

During the quarter ended December 31, 2010, the Company paid $15,000 and $16,500, respectively, to Armada Investments Ltd, a private company controlled by a common director of the Company, for office rent and management services provided;

b) During the year ended December 31, 2010, the Company paid $414,109 (year ended December 31, 2009 - $22,370), respectively, to S. Paul Simpson Law Corp., a law corporation controlled by a former director of the Company, for legal services provided;

During the quarter ended December 31, 2010, the Company paid $58,545 to S. Paul Simpson Law Corp., a law corporation controlled by a former director of the Company, for legal services provided;

c) During the year ended December 31, 2010, the Company paid consulting fees of $577,363 (year ended December 31, 2009 - $82,234), respectively, to a companies controlled by a former director, a former officer of the Company, and to a private companies controlled by a director and officer of the Company, for management and financing services provided;

During the quarter ended December 31, 2010, the Company paid consulting fees of $431,242 to companies controlled by a former director, a former officer of the Company, and to a private companies controlled by a director and officer of the Company, for management and financing services provided.

Transactions with related parties are measured at the exchange amount, which is the amount of consideration established and agreed to by the parties.

7. PROPOSED TRANSACTIONS

In January, 2011, the Company has announced spinoff of Wellgreen and Lynn Lake nickel projects to Pacific Coast Nickel Corp. by issuing common shares to the Company. Pursuant to the Agreement, PCNC will acquire the Wellgreen and Lynn Lake nickel projects by issuing up to 450 million common shares of PCNC to Prophecy. Following the transaction, the Company will own approximately 90% of PCNC (85% fully diluted), PCNC will consolidate its share capital on a 10 old for 1 new basis. It is contemplated that the Transaction will be completed by way of a Plan of Arrangement. The parties have agreed to complete the Transaction by May 31, 2011 with a definitive agreement signed in April, 2011.

8. CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported on the Consolidated Financial Statements. These critical accounting estimates represent management estimates that are uncertain and any changes in these estimates could materially impact the Company's financial statements. Management continuously reviews its estimates and assumptions using the most current information available. Except the adoption of "Business Combinations and Related Sections" as per item 10.1 below and note 2(b) to the consolidated financial statements for the year ended December 31, 2010, there have not been changes to the Company's critical accounting policies and estimates since fiscal year ended December 31, 2009. Readers are encouraged to read the critical accounting policies and estimates as described in the Company's audited consolidated financial statements and Management's Discussion and Analysis for the year ended December 31, 2009.

8.1 *Adoption of Accounting Policy*

Business Combinations and related sections: In January 2009, the Canadian Institute of Chartered Accountants ("CICA") issued Section 1582, "Business Combinations" to replace Section 1581. The new standard effectively harmonized the business combinations standard under Canadian GAAP with International Financial Reporting Standards ("IFRS"). The new standard revised guidance on the determination of the carrying amounts of the assets acquired and liabilities assumed, goodwill, and accounting for non-controlling interests at the time of a business combination.
The CICA concurrently issued Section 1601, "Consolidated Financial Statements" and Section 1602 "Non-Controlling Interest", which replace Section 1600, "Consolidated Financial Statements". Section 1601 provides revised guidance on the preparation of consolidated financial statements and Section 1602 addresses accounting for non-controlling interest in consolidated financial statements subsequent to a business combination.

Effective January 1, 2010, the Company early adopted these standards and the adoption of these standards did not have any material impact on the consolidated financial statements for the year ended December 31, 2010.

8.2 *Future Accounting Changes*

a) ***Issued but not Adopted Primary Sources of GAAP***

Business Combinations, Consolidated Financial Statements and Non-Controlling Interests
The CICA issued three new accounting standards in January 2009: Section 1582, *Business Combinations,* Section 1601, *Consolidated Financial Statements*, and Section 1602, *Non-Controlling Interests*. Section 1582 replaces Section 1581 "Business Combinations" and establishes standards for the accounting for business combinations. It provides the Canadian equivalent to *International Financial Reporting Standards IFRS 3* "Business Combinations".

8. CRITICAL ACCOUNTING POLICIES AND ESTIMATES (CONTINUED)

The section applies prospectively to the business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Sections 1601 and 1602 together replace Section 1600 "Consolidated Financial Statements". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1601 applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1602 provides guidance on accounting for any non-controlling interests subsequent to a business combination. Section 1602 is to be implemented concurrently with section 1582, *Business Combinations*. It is equivalent to the corresponding provisions of *International Financial Reporting Standard IAS 27* "Consolidated and Separate Financial Statements" and applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company will consider the impact of adopting these pronouncements on its financial statements if future acquisitions are completed.

b) International Financial Reporting Standards (IFRS)

Transition to IFRS from GAAP

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly accountable enterprises will be required to adopt International Financial Reporting Standards ("IFRS") for financial periods beginning on and after January 1, 2011. The Company plans to adopt IFRS with an adoption date of January 1, 2011 and a transition date of January 1, 2010.

IFRS Conversion

The Company's IFRS conversion plan addresses matters including changes in accounting policies, IT and data systems, restatement of comparative periods, organizational and internal controls and any required changes to business processes. To facilitate this process and ensure the full impact of the conversion is understood and managed reasonably, the Company retained an IFRS conversion project manager. The accounting staff has also attended several training courses on the adoption and implementation of IFRS. Through in-depth training and detailed analysis of IFRS standards, the Company's accounting personnel has obtained a thorough understanding of IFRS and possesses sufficient financial reporting expertise to support the Company's future needs. The Company has also reviewed its internal and disclosure control processes and believes they will not need significant modification as a result of the conversion to IFRS. Further, the Company has assessed the impact on IT and data systems and has concluded there will be no significant impact to applications arising from the transition to IFRS.

IFRS 1 First-Time Adoption of International Financial Reporting Standards

Under IFRS 1 'First-time Adoption of International Financial Reporting Standards', the IFRS are applied retrospectively at the transition date with all adjustments to assets and liabilities as stated under GAAP taken to retained earnings unless certain exemptions are applied. IFRS provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters. Set forth below is the applicable IFRS 1 mandatory and optional exemption applied in the conversion from Canadian GAAP to IFRS.

8. CRITICAL ACCOUNTING POLICIES AND ESTIMATES (CONTINUED)

i. Share-based payments

IFRS 1 permits the application of IFRS 2 *Share Based Payments* only to equity instruments granted after November 7, 2002 that had not vested by the date of transition to IFRS. The Company has applied this exemption and will apply IFRS 2 for equity instruments granted after November 7, 2002 that had not vested by January 1, 2010.

ii. Estimates

In accordance with IFRS 1, an entity's estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company's IFRS estimates as of January 1, 2008 are consistent with its Canadian GAAP estimates for the same date.

iii. Assets and liabilities of subsidiaries and associates

In accordance with IFRS 1, if a parent company adopts IFRS subsequent to its subsidiary or associate adopting IFRS, the assets and the liabilities of the subsidiary or associate are to be included in the consolidated financial statements at the same carrying amounts as in the financial statements of the subsidiary or associate. The Company's Mongolian subsidiaries, adopted IFRS in 1997.

Financial Statement Impact on Transition to IFRS

IFRS employs a conceptual framework that is similar to Canadian GAAP; however significant differences exist in certain matters of recognition, measurement and disclosure. While the adoption of IFRS will not change the cash flows of the Company, the adoption will result in changes to the reported financial position and results of operations of the Company. A summary of the significant accounting policy changes on transition to IFRS and the impact of those changes on the Company's financial statements is provided below.

i. Share-based payments

The Company has modified its accounting for stock-based compensation in two significant respects to conform with the guidance in IFRS 2 *Share-Based Payments*.

Under Canadian GAAP, the fair value of stock-based awards with graded vesting are calculated as one grant and the resulting fair value is recognized on a straight-line basis over the vesting period. Forfeitures of awards are recognized as they occur.

Under IFRS, a fair value measurement is required for each vesting instalment within the option grant. Each instalment must be valued separately, based on assumptions determined from historical data, and recognized as compensation expense over each instalment's individual tranche vesting period. Forfeiture estimates are recognized in the period they are estimated, and are revised for actual forfeitures in subsequent periods.

8. CRITICAL ACCOUNTING POLICIES AND ESTIMATES (CONTINUED)

The adoption of IFRS 2 *Share-Based Payments* will result in an adjustment in the amount of stock-based compensation recognized during the year ended December 31, 2010.

ii. *Income taxes*

The treatment of the tax effect of flow-through shares differs under Canadian GAAP and IFRS.
Under Canadian GAAP, share capital is recorded at net proceeds less the deferred tax liability related to the renounced expenditures.

Under IFRS, the increase to share capital when flow-through shares are issued is measured based on the current market price of common shares. The incremental proceeds, or "premium", are recorded as a deferred charge. When expenditures are renounced, a deferred tax liability is recognized and the deferred charge is reversed. The net amount is recognized as a future (or "deferred") income tax recovery. This accounting policy change will result in an adjustment upon conversion to IFRS.

In 2010, the Company acquired Prophecy Resource Corp. ("Prophecy") and Northern Platinum Ltd. ("Northern"). Upon acquisition of Prophecy, the Company recognized a future income tax liability $6,844,063 in accordance with Canadian GAAP. Upon acquisition of Northern, the Company recognized a future income tax liability $1,702,302 in accordance with Canadian GAAP Under IAS 12 *Income Taxes*, the deferred tax liability would not be recognized, either on acquisition or subsequently. This accounting policy change will result in a write-off of the future income tax liability and a corresponding decrease in the carrying value of resource properties (known as "exploration and evaluation assets" under IFRS).

iii. *Exploration and Evaluation Accounting*

On transition to IFRS, the Company may follow the same policies established under Canadian GAAP for accounting for its resource properties (known as exploration and evaluation assets under IFRS). The Canadian GAAP policy is to capitalize all mineral property expenditures directly attributable to the exploration or evaluation of each property. The Company will continue to employ this policy under IFRS. Therefore, there will be no impact to the carrying value of resource properties as reported under Canadian GAAP as at December 31, 2010, with the exception of the adjustment arising from the adoption of IAS 12 *Income Taxes* (discussed under "Income taxes" above).

iv. *Impairment of assets*

Under Canadian GAAP, if there is an indication that an asset may be impaired, an impairment test must be performed. This is a two-step impairment test in which (1) undiscounted future cash flows are compared to the carrying value; and (2) if those undiscounted cash flows are less than the carrying value, the asset is written down to the fair value.

8. CRITICAL ACCOUNTING POLICIES AND ESTIMATES (CONTINUED)

Under IFRS, an entity is required to assess, at the end of each reporting period, whether there is any indication that an asset may be impaired. If such an indication exists, the entity shall estimate the recoverable amount of the asset by performing a one-step impairment test, which requires a comparison of the carrying value of the asset to the higher of value in use and fair value less costs to sell. Value in use is defined as the present value of future cash flows expected to be derived from the asset in its current state.

Additionally, another difference exists as IAS 36, *Impairment of Assets* allows for the reversal of any previous impairment losses where circumstances have changed such that the impairments have been reduced. Canadian GAAP prohibits reversal of impairment losses.

The Company has concluded that the adoption of these standards will not result in a change to the carrying value of its assets on transition to IFRS.

c) Multiple Deliverable Revenue Arrangements

In December 2009, the Emerging Issue Committee ("EIC") issued EIC Abstract 175, "Multiple Deliverable Revenue Arrangements." This Abstract addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how such a multiple deliverable revenue arrangement consideration should be measured and allocated to the separate units of accounting. This Abstract should be applied prospectively and should be applied to revenue arrangements with multiple deliverable entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011 with early adoption permitted. The Company did not early adopt this Abstract and expects there will be no material impact on the consolidated financial statements upon adoption of this Abstract.

9. FINANCIAL INSTRUMENTS AND RELATED RISKS

The Company manages its exposure to financial risks, including liquidity risk, foreign exchange rate risk, interest rate risk, and credit risk in accordance with its risk management framework. The Company's Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and reviews the Company's policies on an ongoing basis.

Fair Value

Fair value is the amount of the consideration that would be agreed upon an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

The fair value hierarchy established by amended CICA Handbook Section 3862 – Financial Instruments – Disclosures establishes three levels to classify the inputs to valuation techniques used to measure fair value:

9. FINANCIAL INSTRUMENTS AND RELATED RISKS (CONTINUED)

- Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2 – Quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liabilities.
- Level 3 – Prices or valuation techniques that require inputs that are both significant to fair value measurement and unobservable (supported by little or no market activity)

The following table sets forth the Company's financial assets and liabilities that are measured at fair value on a recurring basis by level within the fair value hierarchy. As at December 31, 2010, those financial assets and liabilities are classified in their entirety based on the level of input that is significant to the fair value measurement.

Financial instruments

	Level 1	Level 2	Level 3	Total
Financial assets				
Receivables and deposits	-	20,000	-	20,000
Long-term investments	3,295,385	-	-	3,295,385
	$ 3,295,385	**$ 20,000**	**$ -**	**$ 3,315,385**
Financial liabilities				
Loans payable	-	5,000,000	-	5,000,000
	$ -	**$ 5,000,000**	**$ -**	**$ 5,000,000**

10. RISKS AND UNCERTAINTIES

The Company is exposed to many risks in conducting its business, including but not limited to: a) product price risk as any fluctuations in the prices of the products that the Company purchases and the prices of the products that the Company sells have a significant effect on the Company's business, results of operations, financial conditions and cash flows; b) credit risk in the normal course of dealing with other companies and financial institutions; c) foreign exchange risk as the Company reports its financial statements in Canadian dollars while the Company has significant operations and assets in Mongolia; d) interest rate risk as the Company raises funds through debt financing and has a total of $5,000,000 in loans payable outstanding as at December 31, 2010; and e) other risk factors, including inherent risk of the mineral exploration, political risks, and environmental risk. These and other risks are described in the Company's audited consolidated financial statements, management's discussion and analysis for the year ended December 31, 2009 and note 10 of the consolidated financial statements for period ended December 31 2010. Readers are encouraged to refer to these documents for a more detailed description of some of the risks and uncertainties inherent in the Company's business.

10. RISKS AND UNCERTAINTIES (CONTINUED)

Management and the Board of Directors continuously assess risks that the Company is exposed to, and attempt to mitigate these risks where practical through a range of risk management strategies.

10.1 *Political and Country Risk*

The Company conducts its operations mainly in Mongolia and is potentially subject to a number of political and economic risks. The Company is not able to determine the impact of these risks on its future financial position or results of operations. The Company's exploration, development and production activities may be substantially affected by factors outside of the Company's control. These potential factors include, but are not limited to: levies and tax increases or claims by governmental bodies, expropriation or nationalization, foreign exchange controls, cancellation or renegotiation of contracts, and environmental and permitting regulations. The Company currently has no political risk insurance coverage against these risks.

10.2 *Environmental Risks*

The Company's activities are subject to extensive laws and regulations governing environmental protection and employee health and safety. Environmental laws and regulations are complex and have tended to become more stringent over time. Although the Company makes provisions for reclamation costs, it cannot be assured that these provisions will be adequate to discharge its future obligations for these costs. Failure to comply with applicable environmental health and safety laws may result in injunctions, damages, suspension or revocation of permits and imposition of penalties. There can be no assurance that the Company has been or will be at all times in complete compliance with current and future environmental and health and safety laws and permits and such failure may materially adversely affect the Company's business, results of operations or financial condition.

10.3 *Risk Factors*

The Company is subject to other risks that are outlined in the Short Form Prospectus, and the NI 43-101 technical reports, which are available on SEDAR at www.sedar.com.

11. INTERNAL CONTROL OVER FINANCIAL REPORTING PROCEDURES

The management of the Company is responsible for establishing and maintaining appropriate information systems, procedures and controls to ensure that information used internally and disclosed externally is complete, reliable and timely. Management is also responsible for establishing adequate internal controls over financial reporting to provide sufficient knowledge to support the representations made in this MD&A and the consolidated financial statements for the three and twelve months ended December 31, 2010.

The management of the Company has filed the Venture Issuer Basic Certificate with the Interim Filings on SEDAR at www.sedar.com.

In contrast to the certificate required under Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings ("MI 52-109"), the venture issuer certificate does not include representations relating to the establishment and maintenance of disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR"), as defined in MI52-109. In particular, the certifying officers filing certificates for venture issuers are not making any representations relating to the establishment and maintenance of:

- controls and other procedures designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation, and

- a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's generally accepted accounting principles.

The issuer's certifying officers are responsible for ensuring that processes are in place to provide them with sufficient knowledge to support the representations they are making in their certificate(s).

Investors should be aware that inherent limitations on the ability of certifying officers of a venture issuer to design and implement on a cost effective basis DC&P and ICFR as defined in MI 52-109 may result in additional risks to the quality, reliability, transparency, and timeliness of interim and annual filings and other reports provided under securities legislation.

12. ADDITIONAL DISCLOSURE FOR VENTURE ISSUERS WITHOUT SIGNIFICANT REVENUE

Directors and Officers

As at the date of this report, the Company's Directors and Officers are as follows:

Directors	Officers
John Lee, Director and Chairman	John Lee, CEO
Michael J Deats, Director	Paul Venter,VP Energy Operations
John McGoran, Director	Christiaan Van Eeden, VP Mining Operations
Paul Venter, Director	Irina Plavutska, Interim CFO
Greg Hall, Director	Enkbaatar Ochirbal, VP Mongolia Country Manager
Paul McKenzie, Director	Scott Parsons, VP of Corporate Development
Chuluunbaatar, Director	Joseph Li, General Manager & Corporate Secretary
Jivko Savov, Director	

Audit Committee

Greg Hall
Paul Venter
Paul McKenzie

Qualified Person

Mr. Danniel Oosterman, PGeo, a qualified person for the purposes of NI 43-101.

Investor Relations

John Lee, CEO, and Scott Parson, Investor Relations, coordinate investor relations' activities for the Company.

13. OFF-BALANCE SHEET ARRANGEMENT

The Company does not have any off-balance sheet arrangements.

(Expressed in Canadian dollars)

14. DISCLOSURE OF OUTSTANDING SHARE DATA

As at the date of this MD&A, the following securities are outstanding:

14.1 *Share Capital*

Authorized – unlimited number of common shares without par value.

Issued and outstanding – common shares outstanding 184,981,199 with recorded value of $125,458,376.

Summary of securities issued during the period

Shares Issued on Acquisition of Prophecy Holdings	36,178,285
Share reduction upon acquisition	(5,265,840)
Shares Issued on Acquisition of Northern Platinum	14,370,815
Shares issued for mineral properties:	5,560,000
Shares Issued Through Private Placement	23,470,168
Shares Issued on Prospectus	49,475,000
Shares Issued as Financing Fees	1,000,000
Shares issued on Exercise of Options	2,610,000
Shares Issued on Exercise of Warrants	3,722,896
Total	131,121,324

14.2 *Options*

Summary of options granted during the year:

	Number of options	Exercise price	Expire date
May 10, 2010	2,430,000	$0.67	May 10, 2015
September 21, 2010	1,000,000	$0.54	September 21, 2015
September 23, 2010	100,000	$0.80	September 21, 2015
October 1, 2010	250,000	$0.54	October 1, 2015
October 15, 2010	175,000	$0.67	October 15, 2015
December 10, 2010	9,000,000	$0.77	December 10, 2015
December 24, 2010	2,050,000	$0.77	December 24, 2015
December 24, 2010	2,950,000	$0.93	December 24, 2015
	17,955,000		

* The Company granted 3,692,505 stock options that were in excess of their stock option plan during the year, and will be subject to receipt of shareholder approval at the Company's next annual general meeting.

(Expressed in Canadian dollars)

14. DISCLOSURE OF OUTSTANDING SHARE DATA (CONTINUED)

As the date of this report, the outstanding options are comprised of the following:

Exercise price	Options outstanding	Expiry date
$0.25	50,000	February 14, 2012
$0.25	1,225,000	October 29, 2014
$0.38	200,000	November 30, 2014
$0.40	1,383,000	January 23, 2014
$0.40	381,250	January 29, 2015
$0.54	1,000,000	September 21, 2015
$0.54	-	October 1, 2015
$0.55	350,000	March 15, 2015
$0.60	550,000	July 17, 2014
$0.60	65,000	September 21, 2014
$0.67	1,967,500	May 10, 2015
$0.67	175,000	October 15, 2015
$0.77	9,000,000	December 10, 2015
$0.77	2,050,000	December 24, 2015
$0.80	475,000	April 30, 2014
$0.80	100,000	September 21, 2015
$0.80	120,000	January 4, 2016
$0.93	50,000	January 6, 2016
$0.93	2,950,000	December 24, 2015
$0.98	130,000	February 14, 2016
$1.03	150,000	March 24, 2015
$0.25 to $1.03	**22,371,750**	

Subsequent to December 31, 2010, a total of 120,000 options exercisable at $0.80, 50,000 options exercisable at $0.93, and 130,000 options exercisable at $0.98 with a life of five years were granted to an employee and consultants.

(Expressed in Canadian dollars)

14. DISCLOSURE OF OUTSTANDING SHARE DATA (CONTINUED)

Summary of options exercised subsequent to December 31, 2010:

Exercise Price	Number of Options Exercised	Expiry Date	Weighted Average Exercise Price
$0.60	50,000	September 21, 2014	$0.04
$0.40	268,600	January 23, 2014	$0.15
$0.40	18,000	January 23, 2014	$0.01
$0.40	50,000	January 23, 2014	$0.03
$0.25	12,500	October 29, 2014	$0.00
$0.25	50,000	October 29, 2014	$0.02
$0.40	218,750	January 29, 2015	$0.12
$0.80	25,000	April 30, 2015	$0.03
$0.67	12,500	May 10, 2015	$0.01
$0.54	31,250	October 1, 2015	$0.02
	736,600		$0.42

14.3 *Warrants*

The following tables summarize the number of warrants outstanding as of the date of this MD&A:

		April 26, 2011
	Number of warratns	**Average exercise price**
Balance outstanding, beginning of the year	**29,501,121**	**$1.25**
Granted	**-**	
Exercised	**(4,205,215)**	**$0.50**
Cancelled/forfeited	**(144,167)**	**$0.68**
Balance, April 27, 2011	**25,151,739**	**$2.43**

(Expressed in Canadian dollars)

14. DISCLOSURE OF OUTSTANDING SHARE DATA (CONTINUED)

Exercise price	Number of warrants outstanding	Expiry date
$0.10	3,250,000	December 31, 2011
$0.40	-	December 31, 2011
$0.40	-	January 25, 2012
$0.40	90,000	June 5, 2011
$0.40	17,500	December 31, 2011
$0.46	72,500	September 4, 2011
$0.49	1,859,321	February 17, 2012
$0.50	-	December 31, 2011
$0.60	670,000	June 5, 2011
$0.60	187,500	August 18, 2011
$0.60	133,750	December 31, 2011
$0.60	143,750	December 21, 2011
$0.60	-	December 22, 2011
$0.65	414,000	September 1, 2011
$0.66	3,831,511	October 28, 2012
$0.70	536,250	September 4, 2011
$0.77	5,377,932	March 31, 2012
$0.80	2,964,731	March 31, 2012
$0.80	337,750	April 21, 2012
$0.80	2,753,244	March 23, 2012
$0.80	712,000	October 8, 2011
$0.85	1,800,000	December 24, 2011
$0.10 to $0.85	**25,151,739**	

15. OUTLOOK FOR FISCAL 2011

The Company's objectives for 2011 include the following:

- Conclude long term Ulaan Ovoo coal off take agreements with regional Russian power plants;
- Conclude long term Ulaan Ovoo coal off take agreements with international buyer for coal deliveries via the Russian Eastern Sea Ports.
- Commence shipments of Ulaan Ovoo coal to Asian customers via Russia's eastern coal ports;
- Increase production for the year to 520,000 tonnes of coal at Ulaan Ovoo;
- Increase profit margins at Ulaan Ovoo with owner equipment and utilising Zeltura port in addition/alternative to Naushki;
- Secure Chandgana power purchase off take MOUs with Mongolian entities;
- Obtain Government cooperation and full licensing on our Chandgana Power Plant;
- Secure equity and debt financing for Chandgana Power Plant construction;
- Spin-off of Lynn Lake and Wellgreen assets through the Pacific Coast Nickel Corp agreement; and
- Seek additional stock exchange listings.